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Real Estate 2024

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John Sullivan and Matt Alshouse
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Global Practice Guides

Real Estate

Contributing Editors

John Sullivan and Matt Alshouse

DLA Piper LLP

2024

Chambers Global Practice Guides

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INTRODUCTION

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DLA Piper LLP has more than 995 lawyers in the real estate sector operating in more than 40 countries, including strongly established teams in the Americas, Europe, the Middle East, Africa and Asia Pacific. The firm is widely recognised as a market leader in the commercial real estate sector. It represents many of the world's leading investors, owners, developers, lenders, asset managers, fund sponsors and investment advisers, and offers the full range of real estate services, including single asset and portfolio acquisitions and dispositions, single asset and multi-property/programmatic joint ventures, fund formation, operating company investments, cross-border investments, REITs, financing, construction and design, leasing, zoning/land use, public-private partnerships, environmental law, real estate litigation and tax.

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John Sullivan is chair of DLA Piper's US real estate practice and co-chair of the global real estate practice. He has a broad-ranging practice that encompasses all aspects of commercial real estate, with a particular emphasis on representing public and private pension plans, opportunity funds, investment advisers and non-US investors in equity, debt, hybrid and joint venture transactions throughout North America. John has been lead counsel for many of the largest US real estate transactions. He is on the board of the Boston Chapter of the Urban Land Institute and is a member of the Pension Real Estate Association and the American College of Real Estate Lawyers. John is a guest lecturer at the MIT Real Estate Center and Columbia Business School, and is on the firm's executive committee and policy committee.



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INTRODUCTION

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Overview: Despite Recent Turbulence, Real Estate's Place as a Global Asset Class is Secure

Despite recent challenges, real estate remains an important asset class for global investment. With a global value estimated by real estate company Savills to be USD326.5 trillion, real estate is the world's largest store of wealth, more valuable than all global equities and debt securities combined, and almost four times the size of global GDP. By comparison, the value of all gold ever mined is USD12.1 trillion, just 4% of the value of global property, and less than half of just the agricultural portion of the real estate market. Despite recent market turbulence, the private real estate publication PERE recently reported that private equity fund allocations to real estate were on the upswing in the second half of 2023, and a January, 2024 survey of European fund managers and investment analysts by TIME Investments indicated that just over three quarters of investors planned to increase real estate allocations in the foreseeable future. A 2023 Investment Intentions Survey by the Pension Real Estate Association shows that institutional investor portfolios have an average 10.2% allocation to real estate. The asset class clearly remains an important investment target for global investors.

2023 global trends and results

Over the last several years, central bankers have raised interest rates aggressively in order to combat post-pandemic inflation. In the United States, the Federal Reserve raised interest rates 11 times between March 2022 and July 2023, with rates hitting a 23-year high in July of last year. At its March 2024 meeting, the Bank of England decided to maintain the Bank Rate at 5.25%, its highest level since 2008, as policymakers awaited clearer signals indicating that the country's persistent inflationary pressures had subsided. And during its April 2024 meeting, the European Central Bank maintained interest rates at record-high levels for a fifth consecutive time. Because commercial real estate investors typically employ debt when acquiring real estate, this large increase in the cost of debt means that investors need lower prices in order to achieve their desired returns. Many owners,

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however, are not willing to sell at these lower values. The result has been a dramatic drop in transaction activity. MSCI Real Capital Analytics estimated that real estate sales decreased by 51% from 2022 to 2023, and the Urban Land Institute reported that global transaction activity within commercial real estate was lower in 2023 than in any year since 2012. Anyone working in this space (presumably anyone who may be reading this global guide) has seen more recent examples than they would care to of buyers and sellers starting down the road to transact but ultimately finding themselves unable to bridge the bid-ask gulf.

The results, at a macro level:

- Very few deals occurred. It qualifies as relatively good news that Asia-Pacific volume, after an uptick in the final quarter of the year, was down only 17%, with some markets such as Hong Kong and Australia actually expanding volume, according to real estate advisers JLL. On the other hand, property agents Colliers reported that direct investment in major European markets in commercial real estate was down 50% from 2022 – a ten-year low. In the US, according to Altus Group, only about USD190 billion was invested in traditional property classes for the year, down by almost half from 2022, with overall transaction volume down 55% from 2021, making 2023 the slowest year since 2013.
- Sticking close to home: the activity that was seen in 2023 was largely focused on investing domestically. A Real Capital Analytics study showed that global cross-border real estate activity in 2023 was down 40% from its five-year average. This was most pronounced in EMEA (down 59%) and the US (off 56%), in large part due to Asian funds staying home or at least in-region. Global funds transactions among Asian investors were down 64% year-on-year in the third quarter of 2023, according to professional services network PwC.
- Banks and owners spent more time fixing their debt portfolios, and for good reason: according to a recent
- *Wall Street Journal* article, close to USD550 billion in loans linked to commercial properties matured last year. Ratings agency Fitch anticipates that almost 5% of loans in commercial mortgage-backed security pools will be delinquent at the end of the year, with potentially 10% of those tied to office properties in default by some point in 2025. A significant number of owners will lose out before seeing a reset in debt costs, but in the meantime, there is sufficient appetite in both the investor and lender worlds to continue extending and restructuring loans. New loan issuances, by contrast, were down 43%, according to the Mortgage Bankers Association.
- Investors, seeing better returns in safer places, could not be bothered. As but one example, according to JLL, among US closed-end funds, fundraising was down nearly a third in 2023 from the year prior, to just USD142 billion. Investment data company Preqin reported that less than half as many funds closed in the first three quarters of 2023 as in the year before. Private funds in Asia-Pacific play a smaller role, but even there, new fund closings were off by more than 50% from 2022. Some of this unavailability of new funds is offset by the lack of transactions closing, although global commercial real estate company CBRE's European Market Outlook for 2024 indicated that funds on the continent were sitting on USD66 billion in dry powder for European deployment alone.

Value reductions in 2023 were much smaller in Asia, which may indicate an earlier bottoming

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out and start of the recovery cycle in Western markets, while investors in APAC wait out repricing exercises. That said, PwC reported that commercial volume was down 25% in the first three quarters of 2023 in China, with many funds and other players stepping out of the market indefinitely. The collapse of Evergrande and Country Garden, in part due to changes in central government policy, may hamper inbound as well as domestic investment in the market for the foreseeable future. Australia may also be an outlier, as its upward interest rate swing was steeper than in other markets in the region.

Not all was grim, however. There was investment activity in certain asset classes, including data centres, housing, cold storage, medical office and life science assets.

The data centre space was the best performing asset class in 2023. The rise of artificial intelligence, along with cryptocurrencies, streaming services and other heavy computing power usages, are combining to fuel the need for ever more data centre space. According to CBRE, North American deliveries increased 26% from 2022 to 2023, and current construction projects were up almost 50% from the previous year. A Cushman & Wakefield study predicts a 2.5 times increase in data centre capacity in the Americas, a two times increase in EMEA and a 2.2 times increase in APAC. Research firm Renub predicts that, within four years, the Asia-Pacific data centre market alone will be worth USD54 billion. US investment management firm PIMCO recently announced the launch of its first European data centre fund, targeting a EUR750 million fundraise. Although the demand is strong and predicted to grow, one challenge faced by this sector is the availability/sufficiency of power and, in some markets, the availability of land.

Longer term, analysts are nearly unanimous in seeing increased activity in the housing markets. Ageing populations, especially in East Asia and Europe, lack of affordable housing in Western urban centres, and the demand for education are starting to strain current inventory, so construction growth in senior, student and affordable multi-family housing, in particular, is anticipated.

2024 Outlook: Have We Reached the Bottom of the Market?

There are some signs of light at the end of the tunnel. In a recent consensus forecast from the Pension Real Estate Association (PREA), investors predict a gradual improvement in 2024 and beyond, and a recent CBRE survey reveals higher purchasing and selling expectations for 2024 compared with 2023, amid growing optimism that the real estate investment market will return to normalised levels of activity in the short to medium term. A number of the largest commercial real estate investors have indicated that they believe that the market is close to, or already at, the point where significant investment opportunities will arise. For example, with Blackstone recently announcing its USD10 billion acquisition of AIR Communities and its USD3.5 billion agreement to take single-family landlord Tricon private, President Jonathan Gray told investors that the firm believes that real estate values are bottoming and he expects deal activity to pick up. More generally, US transaction volume started to rebound in the last quarter of 2023, rising by more than a third from the prior quarter's doldrums, according to Altus Group. European investment volumes started to pick up slightly in the fourth quarter, too, according to CBRE, with large upticks in the Nordic markets, Spain and Italy.

A year ago, one of the topics of the day was distressed debt, and how resolving the difficul-

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ties in lending books was the biggest hurdle to the resumption of business as usual. How much property would banks be taking back? How much debt could be restructured? How long would it take to redeploy?

As the year wore on, the markets started to address this issue. While many owners entered 2023 in "wait and see" mode, hoping that interest rates would come down and drive cap rates down with them, or attempted to restructure their debt and hang on a bit longer, eventually time ran out for some as lenders started to move on collateral. According to real estate data source ATTOM, commercial foreclosures began climbing in the US market in the second quarter of 2023, and by January of this year reached 635 new filings, the highest level since 2015.

For many who avoided turning their properties over to their lender, 2023 saw more owners coming to grips with writing down the value of their investments. JLL reported second quarter year-to-year value drops in 2023 of 19% in the US and 21% in Europe (29% and 31%, respectively, in the office sector).

Given the higher cost of debt, in most cases, prices will have to come down in order for transaction volume to increase. In this regard, the so-called "wall of maturities" is a double-edged sword. In the US alone, there is an estimated USD1 trillion of commercial real estate debt coming due before the end of 2025, according to data and analytics provider Trepp. The combination of declining values and higher interest rates will mean that many owners will not be able to – or will elect not to – refinance their existing debt. Although this is bad news for owners who cannot refinance their loans, many lenders prefer not to own these assets, and so they will price them to sell, which should result in buying opportunities and increased transaction volume.

The dynamic of markets establishing new pricing in order to move forward can be seen in some recent transactions featuring prominent properties in Western markets. Just a few examples:

- Two towers at Detroit's Renaissance Center, totalling close to 700,000 square feet of office space, traded earlier this year for a measly USD15 million. That is a per-square-foot price closer to the average yearly rental rate in the Detroit market.
- The Aon Center in downtown Los Angeles was sold at the end of 2023 for a little over half what it previously traded for, in 2014.
- 5 Churchill Place in London's Canary Wharf moved into receivership last year and has now sold at a 60% discount.

There are other signs of life emerging, as well. Along with uncertainty in the debt markets, the long-term effects of the COVID-inspired "work from home" movement have been hampering rental markets, as corporate tenants struggle to determine how much space they really need going forward. Some normalisation has started to occur, however: return-to-office mandates have taken hold at an 85% clip in Asia and 75% in Europe, according to JLL's 2024 Global Real Estate Outlook. The US is lagging here, with just 55% of employers having taken affirmative steps to bring people back to the office, but this is widely expected to increase throughout 2024.

The result is some hopeful signs starting to appear in the office leasing submarket. In the final quarter of 2023, global office leasing volume was up 13%, as strong as it had been in almost two years. Logistics leasing was another bright spot towards the end of 2023. US volume,

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after a year-and-a-half of consistent falloff, was up 17%. Meanwhile, the Asia-Pacific logistics market had a record-setting year in uptake.

With more and more people returning to daily routines that include spending time in central business districts, knock-on effects in retail, hospitality and tourism could begin to appear in the medium term.

Inflation and interest rates

As noted above, the efforts of central bankers to combat inflation by raising interest rates took a significant toll on the real estate sector. With inflation starting to get closer to central bank targets, there has been a growing expectation for interest rate cuts in 2024. However, the US Bureau of Labor Statistics (BLS) March report indicated that the US economy added 303,000 jobs in March, an acceleration in the pace of hiring, and other important labour market indicators in the BLS report, including a 3.8% unemployment rate and a 0.3% month-on-month rise in average hourly earnings, were also strong. In the UK, although the annual inflation rate fell in March for the second consecutive month, the fall was less than expected. These reports have generated some uncertainty about the timing and amount of rate cuts in the US and the UK. Rate cuts may come sooner in the European Union. The EU ended 2023 with a 3.2% inflation rate across its markets, and the rate has since gone down to around 2.6%. As a result, the European Central Bank has signalled that it could start cutting rates as soon as June.

While Asian markets tended to see far less drastic rises in their inflation rates – with China moving from around 5% before the pandemic all the way into a deflationary environment throughout 2023 – those markets have settled, as well. CBRE's 2024 outlook for Asia anticipates entering an "interest rate cut cycle" by midyear.

Conclusion

The global commercial real estate market has been on a roller coaster ride in recent years, with 2021–2022 representing the climb to the top, and 2023 reflecting the swift (and sometimes scary) descent. However, certain asset classes, such as data centres, continue to attract significant investor interest. More broadly, there are indications that the market may be at or near the bottom and poised for a recovery. The amount and timing of interest rate reductions will be a major factor in the market's performance over the next 12 months, with a reduction in rates being a welcome tailwind, but any increase (or even the absence of a decrease) in rates being a significant headwind. In addition, the huge amount of low-interest-rate debt coming due over the next few years should force a repricing of many assets and thus spur investment activity.

ANDORRA



Law and Practice

Contributed by:
Elena Redondo, Albert Hinojosa and Marc Ambrós
Cases & Lacambra

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CASES & LACAMBRA

1. General

1.1 Main Sources of Law

No information has been provided in this jurisdiction.

1.2 Main Market Trends and Deals

As a preliminary consideration, Andorra has neither a civil code nor any regulation based on civil law, to the extent that there was no codification process as in other neighbouring civil law countries that are members of the European Union. Consequently, generic provisions in real estate are based on the applicable Roman Law or Digest, as are guarantee rights.

Notwithstanding this, the pace of change in the Andorran society has led to the need to develop specific regulations governing land and urban planning (*Llei General d'Ordenació del Territori i Urbanisme*), real estate building, condominiums, urban leasing and emphyteutic census.

Additionally, the following normative provisions are relevant in the housing sector: planning instruments, guidelines and specific regulations on urban planning and real estate building, as well as projects of national interest and sectorial plans (*Projectes d'interès nacionals i plans sectorials*) and the Plan and the Master Plan of Urban Planning and Development (*Pla d'Ordenació i Urbanisme Parroquial* – POUP) issued by the respective town halls (*Comuns*).

Over the last few months, the real estate market in Andorra has been very active, although focused on smaller operations than those observed in previous years.

On July 2022, the town hall (*Comú*) of Ordino definitively passed the amendment of the Ordinations on subsidiary regulations and building rehabilitation of the Plan and the Master Plan of Urban Planning and Development by means of the Decree of 22 July 2022. The amendments were introduced in order to reduce the occupation of the plots and the maximum size of buildings.

Likewise, Act 32/2022, 14 September, for the promotion of the sustainability of urban development and tourism, and of amendment of the General Act on Land Planning and Urban Planning, of 29 December 2000, and Act 16/2017, 13 July, of Touristic Lodgings has been passed to ensure the sustainable growth of urban development. By virtue of this Act, on the one hand, the Andorran government was mandated to amend the Regulations containing the planning guidelines and, once these amendments came into force, the town halls must draw up maximum load capacity studies within a maximum period of one year and adapt the Master Plan of Urban Planning and Development to the content of these studies. Thus, during this period, the Act introduces a new requirement for obtaining the approval of any building permit for new construction, partial plan or urban development project, consisting of obtaining a favourable report issued by the competent ministries in matters of urban planning and the environment, whereby it will be evaluated whether the infrastructures and facilities of each town hall (*Comú*) can adequately cover the needs resulting from the urban development at stake.

On the other hand, this Act also introduced the express suspension of the granting of new authorisations for tourist lodgings in flats and studios for a period of two years as from the entry into force of the Act. However, the Act also provides for an exception to this suspension, in so far as it allows the processing and granting of authorisations that affect lodgings for which it is

accredited that they fulfil the requirements to be classified in the five-star category.

Act 42/2022, 1 December, of the digital economy, entrepreneurship and innovation has also been passed and it establishes, among others, the legal framework for co-living and co-working spaces in Andorra.

The real estate market in Andorra has recovered from the COVID-19 pandemic and is no longer impacted by it.

Notwithstanding the above, the real estate market in Andorra has been impacted by the rising inflation and increases in interest rates, through the increase of the construction costs which caused some works to be temporarily suspended, and the increase of the financing costs which caused some projects to reduce the amount financed by third parties and increase financing by equity partners.

1.3 Proposals for Reform

The Andorran government is working on a law proposal to modify the current regulations regarding urban planning and development to substitute the current Act and adapt it to the actual circumstances of the country and the sector. The actual regulation is from the early 2000s.

2. Sale and Purchase

2.1 Categories of Property Rights

The right of property can be understood as a full right or a limited right. In Andorra, the right of property understood as a full right could be:

- an absolute freehold, permanent and absolute tenure of land or property, with the freedom to dispose of it at will;
- a co-ownership, which is the right owned by more than one person over real estate; or
- in a condominium (*propietat horitzontal*), the ownership of common premises is shared by the plurality of owners of each unit that makes up the apartments.

On the other hand, the property right could be understood as a limited right. Therefore, in Andorran law, the following rights are recognised as limited property rights:

- leasehold, which is the temporary right that includes the ability to build on the ground or in the subsoil, and the right to overhang, with the right to appropriate what has been built for a specific period;
- beneficial interest, which is the right by which a person can use the property of another and enjoy its benefits, with the obligation to preserve and take care of it; and
- emphyteutic lease, which is the right by which the useful domain of a real estate property is given for a period by the payment of an annual pension, whereby the assignment is made as recognition of the useful domain of the property.

2.2 Laws Applicable to Transfer of Title

Titles are transmitted by the theory of the title and mode. This theory is a system of transmission of ownership that requires the conclusion of an agreement, the subsequent delivery of the real estate to be transmitted, and proof before a public notary, without any aspect being enough separately.

Depending on the activity to be carried out with the real estate, attention should be paid to administrative regulations. Depending on the economic sector (residential, industrial, offices, retail and hotels), different types of real estate

would have specific regulations, but the theory of the title and mode would apply to any sector.

2.3 Effecting Lawful and Proper Transfer of Title

The lawful and proper transfer of title to real estate occurs when the conclusion of an agreement and the subsequent delivery of the real estate has been made before a public notary. There is no land registry in Andorra, but each town hall has its own real estate registry for tax purposes. The transfer of title is recorded in the Andorran chamber of notaries. The public notaries record all the public deeds granted in reference to a real estate, including the encumbrances, modifications and other duly recorded vicissitudes of the real estate. Title insurance is not used in Andorra.

2.4 Real Estate Due Diligence

Buyers usually carry out due diligence on a real estate property, undertaking an exhaustive investigation of the ownership and main characteristics of the real estate. The red flag aspects to analyse are the following:

- titles and encumbrances;
- the rights of third parties over the real estate, eg, if there are lease rights, if they are subject to a specific licence, if the real estate is subject to any tax, or if there is some kind of foreclosure on the real estate;
- whether there is any debt involved in the case of condominiums; and
- whether there are any litigious procedures concerning the real estate.

2.5 Typical Representations and Warranties

The parties negotiate the representation and warranties within a commercial real estate transaction. The typical representations and warranties in Andorra are as follows:

- the buyer must obtain authorisation for any foreign investment from the Andorran government before the completion of the transaction;
- at the time of granting the public deed of sale, the property must comply with the conditions for building on the land, being free of charges, encumbrances, tenants and occupants;
- the property must be transmitted with all the rights, facilities, elements and equipment that are inherent and accessory to it;
- the seller shall carry out all the necessary or agreed acts to avoid the occupation of the property by third parties so that it is free; and
- although, from a legal standpoint, an environmental contingency certificate is not requested, it is highly recommended.

The buyer's remedies against the seller for misrepresentation include the resolution of the agreement, with the return of any reciprocal benefits, the compensation of damages to the buyer, or the specific performance of the terms and conditions of the agreement.

Depending on the relevance of the transaction, it is customary for the seller's representations and warranties to expire after a certain amount of time. The typical range of that survival period is usually between two to four years.

On the other hand, there is usually a cap on the seller's liability for a breach of its representations and warranties, the typical range of that cap being from a limited percentage of the price to the full price.

2.6 Important Areas of Law for Investors

The most important areas of law for an investor to consider when purchasing real estate could be:

- civil law, to have the base knowledge of property rights and the different charges and encumbrances that the real estate could have;
- administrative law, in order to know the regulations pertaining to planning and zoning; and
- tax law, to use the most beneficial tax structure to acquire the real estate.

2.7 Soil Pollution or Environmental Contamination

In accordance with Andorran legislation regarding civil liability, the liability for others' actions must be considered. In this sense, the buyer of the real estate shall be liable for any soil pollution or environmental contamination of real estate, even if it is not attributable to said buyer.

The liability for others' actions allows the buyer of the real estate to claim the necessary expenses to compensate for the damages against the seller since they had responded previously when it did not belong to them.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can ascertain the permitted uses of a parcel of real estate under the applicable zoning and planning law by consulting the Andorran official gazette (*Butlletí Oficial del Principat d'Andorra* – BOPA), where the permitted uses for a plot or zones are published.

It is possible to enter into a specific development agreement with relevant public authorities to facilitate a project relating to, eg, the execution of a project of national interest or local sectorial plans, a project concerning the construction of roads and communications infrastructure, or the execution of the hydraulic and energy policy.

2.9 Condemnation, Expropriation or Compulsory Purchase

In Andorra, there is a law of compulsory expropriation. The procedure first requires the prior declaration of the public utility of the construction project and necessitates the occupation of the property or the acquisition of the affected economic rights. In order to carry out the expropriation, the expropriator must develop a file, which is public information and be published in the Andorran official gazette. Later, the government transmits the entire file to the Andorran Parliament (*Consell General*), with all the observations and objections received, attaching a report suggesting the approval or denial of the declaration of public utility and the necessity of occupation. The Andorran Parliament makes the final decision, which has to be published in the Andorran official gazette and is directly enforceable.

2.10 Taxes Applicable to a Transaction

Asset Deal

The purchase of a property would be subject to a Transfer Tax at a rate of 4% (*Impost sobre transmissions patrimonials*) or to IGI (*Impost General Indirecte*), which is the Andorran VAT, at a rate of 4.5%, depending on the condition of the seller. If the seller is a company or professional acting in a professional capacity, IGI will be applicable; otherwise, Transfer Tax will be applicable.

Share Deal

The purchaser would be subject to Transfer Tax only if at least 50% of the company's assets are real estate located in Andorra, and that as a result of the transaction they will hold more than 20% of the company's shares.

In both cases – Asset Deal or Share Deal – capital gains on the sale of a property would be subject to Corporate Income Tax (*Impost sobre societats*) if the seller is a company, at a nominal rate

of 10% to 15%, depending on the time elapsed since the date of acquisition. On the other hand, if the seller is an individual, Personal Income Tax (*Impost sobre la renda de les persones físiques*) would apply. In this case the nominal rate would be between 0% and 15%, also depending on the time elapsed since the date of acquisition.

2.11 Legal Restrictions on Foreign Investors

A restriction on foreign investment in real estate establishes that a foreign natural person has to obtain a prior foreign investment authorisation from the Andorran government to acquire real estate located in Andorra. Furthermore, foreign legal persons cannot directly acquire a property located in Andorra, so they must use an Andorran special purpose vehicle or SPV. The acquisition or constitution of the SPV is also subject to obtaining the relevant prior foreign investment authorisation from the Andorran government if the foreign entity owns more than 10% of the SPV's share capital or controls more than 10% of its voting rights. Finally, the Andorran government has a veto right, which enables it to deny the authorisation of foreign investment when the investment may harm, even occasionally, the exercise of public power, sovereignty and national security, public and economic order, the environment, public health or the general interest of the Principality of Andorra and any direct foreign investment related to sensitive goods.

Law 3/2024, published in the Andorran official state gazette on 28 February 2024, has introduced the Foreign Investment in Real Estate Tax (FIT) in the Principality of Andorra. The newly established FIT is levied on foreign investments in real estate in Andorra, as defined in the Foreign Investment Law. This includes acquisitions of real estate or other rights in rem, concessions, participation in companies or other legal entities holding rights over such real estate, or for urban or real estate development purposes. The FIT is levied on both natural and legal persons.

The tax base is calculated on the basis of the actual value of the realised foreign investment, upon which a progressive tax rate (3%, 5%, 8% or 10%) is applied, depending on the number of real estate units involved in the investment. Furthermore, the FIT Law introduces a 90% rebate on the tax liability if the foreign investment is directed towards the acquisition of construction of real estate intended for the rental housing market, meant for habitual and permanent residence for a minimum period of ten years.

The settlement and payment system for the FIT entails an advance payment before the issuance of the favourable foreign investment resolution, in which the appropriate tax rate will be applied. Tax payment must be completed before the execution of the public deed for the foreign real estate investment and must be verified before the notary public attesting to such execution.

In any case, the FIT Law delineates several exemptions, which include, among others, acquisitions mortis causa by natural or legal persons who are not resident for tax purposes in the Principality of Andorra and acquisitions intended for conducting business, professional, commercial, or industrial activities (provided that specific conditions are met) if such acquisitions are made by a non-resident or resident individuals with less than three years of residence, or by non-resident legal entities.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate located within Andorra are generally financed with recourse to debt by means of one-off or revolving loans or credits granted by local banking entities.

The financing structure and disposal conditions may vary widely, depending on the specific characteristics of the acquisition and the borrower. However, it is common for the guarantee scheme of such financing operations to encompass a mortgage granted over the real estate asset and one or several pledges granted over any credit rights deriving from agreements entered into by the borrower (eg, insurance contracts) or other instruments (eg, borrower's bank account(s)).

There are no special financing options for acquisitions of large real estate portfolios.

3.2 Typical Security Created by Commercial Investors

The standard security package for a commercial real estate transaction would normally encompass the following.

- A first-ranking mortgage over the target real estate asset.
- A pledge over the shares of the company holding the target real estate asset (usually an SPV).
- A pledge on the company's bank accounts (over the bank account balance and the bank account itself), usually complemented by periodical cash-sweeps, limits for maximum-free disposal amounts or minimum-unavailable amounts and disposals subject to the consent of the financing entity.
- A pledge granted over credit rights deriving from any income-producing agreement entered into by the borrower and related to the specific real estate asset. In a non-exhaustive manner, a pledge may be created over insurance policies, lease agreements or hedging agreements. The key point is that such agreements generate liquid, due and payable credit rights in favour of the borrower. The creditor shall notify the counterpart of each pledged agreement in an enforcement scenario to receive any payments due or positive-balanced set-off rights deriving from the pledged credit rights.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Lending is subject to the reservation of activity within Andorra, and it can only be carried out by local banks authorised to operate as such by the Andorran Financial Authority (*Autoritat Financera Andorrana* – AFA). Therefore, direct lending granted by foreign lenders to finance an acquisition of commercial real estate assets located within Andorra is not allowed, as it would result in a breach of the reservation of activity regime. However, indirect lending (ie, granting financing to a foreign entity that will acquire the real estate asset located in Andorra) would be allowed.

The recently enacted FIRRMA has expanded the scope of transactions subject to the Committee's review by granting CFIUS the authority to examine the national security implications of a foreign acquirer's non-controlling investments in US businesses that deal with critical infrastructure, critical technology, or the sensitive personal data of US citizens. Therefore, FIRRMA grants the Committee the authority to limit the transactions that are subject to its review by providing that it "shall specify criteria to limit the application of such clauses to the investments of

certain categories of foreign persons" and that such criteria shall take into consideration "how a foreign person is connected to a foreign country or foreign government".

FIRRMA does not single out any specific country. CFIUS's authorities may be applied to address the national security risks posed by foreign investment in the US, regardless of where the investments originate. Therefore, FIRRMA will also apply to investments made from Andorra to the US.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Notary fees are generated concerning the granting and enforcement of security over real estate (usually a mortgage or a pledge) to benefit from a priority over other creditors in an insolvency scenario.

No documentary taxes or registration fees are generated in connection with the granting and enforcement of security over real estate assets.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Other than the limits on financial assistance outlined in **3.1 Financing Acquisitions of Commercial Real Estate**, no legal rules or requirements must be complied with for an entity to give valid security over its real estate assets. However, such a decision authorising the creation of valid security over specific asset(s) must be adopted according to the generic legal and statutory requirements that apply to the company.

3.6 Formalities When a Borrower Is in Default

No specific formalities or obstacles need to be overcome to enforce a security over real estate against a defaulting borrower, although the granting of security over real estate by public deed before a notary is mandatory in the case of creating a mortgage and advisable regarding the granting of pledges.

Priority of the lender's security interest is determined by strict order of creation (*prior tempore potior iure*). In a scenario of borrower default, legal action must be taken by the lender by means of the following.

- A declarative procedure to ascertain the existence and quantification of the debt.
- Filing a payment demand before the competent courts after such declarative procedure. A notarial enforcement proceeding is also available if the parties have previously agreed to this proceeding and its terms and conditions.

According to Andorran case law, the enforcement procedure cannot be started unless the defaulted amount corresponds to at least three defaulted instalments.

The typical range of time needed to successfully enforce and realise on real property security, if such is security is a mortgage, is from six to 12 months.

3.7 Subordinating Existing Debt to Newly Created Debt

As there is no land registry in Andorra, secured debt priority is ranked by means of recording in the Andorran Notary Chamber (*Cambra de Notaris del Principat d'Andorra*).

The subordination of a secured mortgage to a newly created one requires express agreement between creditors and the raising of such consent into the status of a public deed before a public notary.

The subordination of a pledge to a newly created one requires express agreement by the parties; its documentation through a notarial deed is highly recommended.

3.8 Lenders' Liability Under Environmental Laws

Overall, Andorran environmental regulations follow the "polluter pays principle" and are configured as a strict liability system.

Therefore, in an enforcement scenario, the new owner of the land corresponding to a real estate asset may be liable for any environmental damage caused to that specific plot of land or deriving from it, even if that new owner did not cause any pollution of the real estate, irrespective of the new owner (lender) demanding liability from the prior owner (borrower) on the grounds of latent defects.

3.9 Effects of a Borrower Becoming Insolvent

From a general perspective, security interests created by a borrower in favour of a lender are not made void upon the borrower's declaration of insolvency, as the protection granted to the lender in rem guarantees and its faculties against the guaranteed asset are not affected by the declaration of insolvency or the development of the insolvency procedure, due to their ranking as privileged claims.

Nevertheless, the claw-back regime provided for under the Insolvency Decree of 4 October 1969 (*Decret de suspensió de pagaments i fallida*) states that the insolvency judge can declare any mortgage or pledge granted over the debtor assets after the cessation-of-payments day in merits of outstanding debts prior to the cessation of payments as unenforceable against the insolvent estate. The insolvency judge can also declare it unenforceable if the granting of such mortgage or pledge occurred six months prior to the cessation-of-payments day as a gratuitous act. Lastly, the insolvency judge can set the declaration of the cessation-of-payments date up to 18 months prior to such an effective declaration.

3.10 Taxes on Loans

There are no rules requiring lenders or borrowers to pay registration or similar taxes in connection with real estate mortgage loans.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Legislative and governmental controls applicable to strategic planning and zoning principally correspond to regional authorities (town halls) of each administrative unit (parish – *Parròquia*), even though the Andorran government set out the general boundaries in respect of its development.

In this vein, the regional authorities are the competent authorities to do the following:

- draft, pass and publish the general master plans (*plans d'ordenació i urbanisme parroquials*) and special plans (*plans especials*), the regulatory state ordinances (*ordenances reguladores de la normativa subsidiària*), reform ordinances (*ordenances de rehabilitació*) and protection, sanitation and internal reform programmes (*programes de reforma interior, de protecció i de sanejament*);
- advise owners and collaborate with them in drafting and passing town plans (*plans parcials*); and
- issue building licences (*llicències d'obra*).

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The key control concerning the design, appearance and construction methods of new buildings or refurbishment is obtaining working licences (*llicències d'obra*) and the approval of construction projects (*projectes d'edificació*) by the town halls, in accordance with the applicable generic and sectorial planning and building regulations.

The Construction Act was amended in May 2020 to allow the public authorities to suspend construction works if they are not compliant with the Construction or Urban Act. The amended Construction Act also adapts the authorisation procedures under the Urban Act.

4.3 Regulatory Authorities

Town halls are responsible for drafting and passing the general master plans (*plans d'ordenació i urbanisme parroquials*) which determine the total buildability for each of the parishes (*Parròquies*) and a priority use for every parcel in accordance with specific technical and administrative restrictions, by establishing the soil classification and the action units (*unitats d'actuació*) and fixing the public service estimations.

In this connection, the Technical Committee of Urban Development (*Comissió Tècnica d'Urbanisme*) is configured as the advisory and executive board for regulating the development and designated use of individual parcels of real estate and which legislation applies, including functions such as:

- to decide on all appeals lodged against the resolutions issued by the town halls in respect of urban development;
- to verify and report on the special plan or town plan draft; or
- to order the working licences' (*llicències d'obra*) suspension.

4.4 Obtaining Entitlements to Develop a New Project

As stated in **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction**, working licences (*llicències d'obra*) and the approval of construction projects (*projectes d'edificació*) by the town halls must be obtained to develop a new project or complete a major refurbishment.

Overall, the general process for the granting of working licences from the town halls involves the following.

- Submission of the request by the person concerned (stating personal information, the specific information concerning the plot of land or the building, the sort of urban licence requested, and the place, date and signing of the applicant jointly with documentation of the project).
- Upon reception of the documentation legally required and the licence request by the administration, the pertinent internal and external, legal and optional reports required by the specific town hall must be delivered to such administration.
- A resolution on this procedure must be issued within two months of submitting the application. Third parties do not have the right to participate and object to the procedure until a resolution is issued.

4.5 Right of Appeal Against an Authority's Decision

Concerned persons may appeal a decision within the framework of the administration route and, subsequently, with recourse to contentious administrative proceedings.

4.6 Agreements With Local or Governmental Authorities

Entering into agreements with local or governmental authorities, agencies or utility suppliers to facilitate a development project relies on the urban planning and construction legislation and may vary on a case-by-case basis, depending on the specific town hall.

4.7 Enforcement of Restrictions on Development and Designated Use

In synthesis, restrictions on development are designed on an ex ante or ex post basis. Overall, the ex ante mechanisms are controlled by means of the granting of licences through a regulated procedure, as stated in **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction** and **4.4 Obtaining Entitlements to Develop a New Project**, and by the exercise of the urban supervisory power. Ex post mechanisms are the exercise of the sanctioning power by the administration and the imposition of additional measures with the aim of stopping the administrative offence (including the cessation of construction work (*cessació de l'obra*), the demolition of construction work (*demolició*) or the suspension of construction work (*aturada*)).

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Entities available to investors are:

- corporate vehicles, which may take the form of a limited liability company (*societat limitada*) or a public limited company (*societat anònima*); or
- regulated investment vehicles, which may take the form of an open-ended collective investment scheme (*Societat d'Inversió de Capital Variable* – SICAV) or a real estate fund.

In respect of corporate vehicles, the incorporation of an SPV is a common instrument for investing in real estate assets.

The use of regulated collective investment vehicles is more restricted due to the costs associated with their incorporation and prior registration requirements required before the AFA. However, the tax treatment of collective investment schemes is highly efficient.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The main features of each type of entity used to invest in real estate are as follows.

- Limited liability company (*societat limitada*) – a company whose share capital is divided into company shares (*participacions*). Partners in the company benefit from the limitation on personal liability from the company's debts. Overall, limited liability companies have a closed structure that restricts the transmission of company shares outside the company, and the representation and faculties of shareholders in general meetings are limited.
- Public limited company (*societat anònima*) – a company whose share capital is divided into shares (*accions*). Partners in the company benefit from the limitation on personal liability from the company's debts. Overall, public limited companies have an open structure that allows the transmission and traffic of shares as negotiable securities and a broader intervention scope for shareholders in general meetings.
- SICAV – an open-ended collective investment scheme whose share capital is divided

into shares (*accions*) and whose general legal regime is determined by corporate regulations applicable to public limited (*societat anònima*), with specific regulatory requirements. Its government and management may be performed by a management company (*societat gestora*) if provided for by the SICAV's articles of association.
- Real estate fund – a collective investment scheme whose assets are governed and managed by a management company (*societat gestora*) and held in custody by a custodian (*societat dipositària*). Their relationship is governed under a written agreement the legal content of which is legally determined.

SICAVs and real estate funds are subject to Corporate Income Tax at a nominal rate of 0%. Although, it should be noted that the CFC rules may apply if the taxpayer, whether by itself or jointly with certain related persons or entities, holds 50% or more of the share capital, equity, voting rights or results of the Andorran collective investment scheme.

5.3 REITs

No details have been provided for this jurisdiction.

5.4 Minimum Capital Requirement

The minimum capital required to set up each type of entity used to invest in real estate in Andorra is as follows:

- Andorran limited liability company (*societat limitada*) – EUR3,000 fully paid upon incorporation;
- Andorran public limited company (*societat anònima*) – EUR60,000 fully paid upon incorporation;
- Andorran self-managed SICAV – EUR300,000, with a minimum of 10% of such estate disbursed upon incorporation;
- Andorran SICAV managed by an Andorran management company – EUR1.25 million with a minimum of 10% of such estate disbursed upon incorporation; and
- Andorran real estate fund – EUR6 million, and a minimum of 10% of such estate must be disbursed on the date of incorporation.

5.5 Applicable Governance Requirements

Governance requirements for a limited liability company (*societat limitada*) and a public limited company (*societat anònima*) are quite flexible and allow their setting up and organisation mainly on a shareholder's consensus basis (through the articles of association) and, residually, on an imperative basis determined by provisions of Act 20/2007, 18 October, on limited liability companies and public limited companies. Shareholders must determine the structure and the scope of the board of directors' representation powers in the articles of association prior to the incorporation by means of granting a public deed before a notary public. In synthesis, the governing body may take the form of:

- a sole director;
- two or more directors acting jointly;
- two or more directors acting jointly and severally; or
- a board of directors.

Governance requirements for SICAVs and real estate funds differ from mercantile companies due to their condition as regulated entities. Governance requirements applicable to collective investment schemes are provided for in:

- Act 7/2013, 9 May, on the regime for operating entities in the Andorran financial system and other provisions that govern the financial activities in the Principality of Andorra;
- Act 8/2013, 9 May, which covers the organisational requirements and operating conditions of the operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements; and
- Act 10/2008, 12 June, governing the collective investment undertakings of Andorra.

In synthesis:

- the governing body shall adopt the form of a board of directors, composed of at least three directors;
- members of the board of directors shall be persons of recognised commercial and professional honourability and must possess adequate knowledge and professional experience to exercise their duties;
- the elected chairman cannot hold the position of general manager;
- the board of directors shall draft and approve a set of internal operating rules to comply with legal obligations and promote responsibility among all members; and
- both the management company (*societat gestora*) and custodian entity (*entitat dipositària*) must comply with local rules on the conduct of business.

5.6 Annual Entity Maintenance and Accounting Compliance

Costs associated with maintenance and accounting compliance may vary notably depending on the particulars of each entity, business decisions adopted by the governing body, and whether or not it is a regulated entity. In a non-exhaustive manner, costs may be determined as follows.

- Limited liability companies (*societat limitada*) and public limited companies (*societat anònima*) are legally obliged to draw up financial statements yearly, submit them to external audit (in certain cases, depending on the business volume and/or number of employees) and deposit financial statements to the Companies Register (*Registre de Societats*). Moreover, the yearly maintenance fee for registering limited liability companies (*societat limitada*) and public limited companies (*societat anònima*) with the Companies Register amounts to EUR851 and EUR935.50, respectively.
- SICAV and real estate funds: due to their condition as regulated entities, the costs associated with maintenance and accounting are generally higher. Specifically, Andorran management companies (*societats gestores*) of collective investment schemes are subject to a yearly fee of EUR3,000 in the concept of supervision payable to the AFA. This fee increases by EUR2,000 if the specific management company carries out the discretional and individualised management of investment portfolios. The collective investment scheme is subject to the same fee, ranging from EUR1,800 to EUR3,300, depending on the type of vehicle. Collective investment schemes must comply with accounting requirements stated in Act 10/2008, 12 June, governing the Andorran collective investment undertakings (*Llei de regulació dels organismes d'inversió col·lectiva de dret andorrà*), which essentially are:
  (a) confidential financial statements (to be issued quarterly);
  (b) public financial statements (yearly as a minimum and subject to audit); and
  (c) external audit process (permanent; it cannot be the same auditor for a period exceeding five years; such audit entity

must be the same as the management's company auditor).

Moreover, distribution, management, subscription and reimbursement fees (for the management company) and depositary fees must also be considered and costs arising from the publication of the collective investment scheme prospectus (simplified and complete form).

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The Andorran regulatory provisions recognise a lease agreement as commercial as long as it allows any natural or legal person to occupy and use a real estate for a limited period without the tenant having an obligation to purchase it.

6.2 Types of Commercial Leases

The Andorran regulatory provisions do not establish any differentiation between commercial leases. In this vein, commercial leases have the purpose of conducting a commercial, industrial, professional, logistics or teaching activity, as well as other purposes.

6.3 Regulation of Rents or Lease Terms

Unless a law stipulates otherwise, the principle of freedom of contract between/among the parties governs in commercial leases. Without prejudice to the principle of freedom of contract and pursuant to the Andorran provisions, the maximum length for a commercial lease agreement is four years.

Rent is freely agreed upon between the landlord and the tenant. A rent adjustment, if agreed between the parties, cannot be carried out more than once per contractual year. Furthermore, it is the use of variation experienced by the general Consumer Price Index during the previous calendar year based on the income paid when the right to adjust came into being.

However, a fixed minimum income can be established and increased according to turnover or operating income. In this scenario, the period during which the tenant must provide the landlord with business accounts must be agreed. If the tenant does not provide the landlord with the business accounts, the landlord is entitled to terminate the contract and claim the corresponding compensation for damages suffered. Any other adjustment system agreed upon between the parties is void.

6.4 Typical Terms of a Lease

The length of a lease term is agreed upon by the parties, but it cannot be less than four years. If a term is not agreed by the parties, or if a term lower than the legal minimum is agreed, the lease shall be deemed to be for a four-year term. Once the minimum term has expired, the agreement is tacitly extended for periods of one year unless a party notifies the other of its willingness to resolve the agreement, with a minimum notice of three months before the end of the principal term or any of its extensions.

The landlord is obliged to carry out the necessary repairs so that the tenant can continue carrying out the activity for which the real estate was leased. The tenant is obliged to carry out the repairs that are the result of wear and tear due to normal or abnormal use of the real estate or its facilities or services.

The rent is paid in the manner agreed by the parties in the agreement. In the absence of such

agreement, the rent shall be paid monthly, within the first five days of each month.

6.5 Rent Variation

The rent is freely agreed upon between the landlord and the tenant. During the contractual term, and if the parties have agreed on no price adjustment system, the landlord and the tenant may adjust the rent at the end of each contractual year in accordance with the percentage variation experienced by the general Consumer Price Index or the other price adjustment mentioned in **6.3 Regulation of Rents or Lease Terms**.

6.6 Determination of New Rent

Any increase in the rent is determined in accordance with the general Consumer Price Index or according to variables such as turnover or operating income. See **6.3 Regulation of Rents or Lease Terms** and **6.5 Rent Variation**.

6.7 Payment of VAT

Commercial leases are subject to local VAT, called Indirect General Tax (*Impost General Indirecte* – IGI), at 4.5%.

Residential leases are subject to IGI at a 0% rate.

6.8 Costs Payable by a Tenant at the Start of a Lease

The tenant has an obligation to arrange an insurance policy that covers at least the risk of fire, explosion, water leaks and civil liability for damages, to sign up for the national electricity company through an electricity journal, to pay taxes related to the economic activity that will take place, and sign up in the trade register.

6.9 Payment of Maintenance and Repair

The tenant is obliged to pay the expenses that arise from the services and utilities supplied to the real estate that they can use. This consideration is derived from the use of common elements of the property, parking lots, gardens, porter's lodge services, and the supply of water, electricity, heating, telephone and other analogues.

6.10 Payment of Utilities and Telecommunications

In order to collect payment for the supply of utilities and telecommunications services, the landlord must justify the amount to the tenant. If the real estate is enjoyed by more than one tenant, the total cost is distributed among them, according to the surface of each floor, unless the participation fees are set for each floor or premises. This does not apply if there are individual meter boxes, in which case the tenant will pay according to what the individual meter box indicates. The agreement of a previously fixed amount for all services is valid.

6.11 Insurance Issues

The landlord is obliged to sign and maintain an insurance policy that sufficiently covers the damages that could be caused to the tenant and third parties.

The tenant is obliged to arrange an insurance policy that covers the risks of fire, explosion, water leaks and civil liability for damages, to sign up for the national electricity company through an electricity journal, to pay taxes related to the economic activity that is going to take place, and to sign up to the trade register.

6.12 Restrictions on the Use of Real Estate

The landlord is entitled to terminate the lease agreement if the tenant:

- changes unilaterally the destination of the leased real estate asset and persists in this

action for more than six months during the year;
- subleases or transfers totally or partially the leased asset without prior consent from the landlord;
- causes harm to the leased asset due to wilful misconduct or gross negligence, or carries out construction works that alter the structural configuration of the leased asset or its common elements;
- breaches the essential conditions of the lease agreement (or breaches the conditions specifically determined as being essential in the lease agreement); or
- carries out notoriously immoral, dangerous, annoying or insalubrious activities within the leased asset or when such activities affect the leased asset's common elements.

Furthermore, any activity other than residential use shall require correspondent authorisation from the competent authority (*Comú*).

6.13 Tenant's Ability to Alter and Improve Real Estate

Within limits provided for in **6.12 Restrictions on the Use of Real Estate**, the tenant may alter or improve the leased asset by carrying out repairs needed due to deterioration through normal or abnormal use.

The Urban Rents Law of 30 June 1999 (*Llei d'arrendaments de finques urbanes*) does not thoroughly regulate the introduction of improvements to the leased asset by the tenant. Thus, there is no obstacle to the tenant introducing improvements to the leased asset, usually subject to the landlord's consent.

Upon the termination of the lease agreement, the tenant is entitled to revert the improvement works introduced to the leased asset if it can do so without causing harm to the asset.

The minimum legal term for commercial leases is four years. However, if the tenant carries out improvement works that result in a cost exceeding the equivalent of three years' rent, they have the right to require an extended lease term of up to seven years. In this situation, the landlord is obliged to accept this extension.

6.14 Specific Regulations

There are no specific regulations and/or laws that apply to leases of particular categories of real estate, such as residential, industrial, offices, retail or hotels, other than the Urban Rents Law, which provides the common regime for residential and commercial leases.

6.15 Effect of the Tenant's Insolvency

The Urban Rents Law does not expressly provide for insolvency as a termination cause for lease agreements but states that a default in rent payment by the tenant constitutes a termination cause in favour of the landlord.

However, a declaration of insolvency is not sufficient in itself as a termination cause for the specific lease agreement in case the insolvency situation of the tenant is rapidly reversed. Generally, Andorran courts may refuse to uphold the termination of a contract based on a breach of obligations, undertakings or covenants, or on a change in circumstances that is merely accessory or complementary to the main undertakings, or based on an unreasonable, inequitable or bad faith interpretation of one of the events of default or changes in circumstance.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The Urban Rents Law states that, prior to taking possession of the leased asset, the tenant must deliver to the landlord a guaranteed deposit equivalent to a maximum of two months' rent; depending on the case, this security may be replaced by a bank guarantee. Such deposit is held by the landlord to be returned to the tenant upon termination of the lease agreement against delivery of the leased asset's keys (return of possession over the leased asset).

The tenant and the landlord may also agree on additional guarantees to cover payment defaults by the tenant (eg, bank guarantees, specific default insurances or even upfront payment).

6.17 Right to Occupy After Termination or Expiry of a Lease

Overall, the tenant does not have the right to continue to occupy the leased asset after the expiration or termination of a commercial lease. Nevertheless, the Urban Rents Law provides for a tacit renewal (*tàcita reconducció*), which takes place if the tenant stays in the leased asset more than 15 days after the termination of the lease agreement without express opposition from the landlord, whereby the lease agreement shall be automatically extended each month without any action by the landlord (or in the same term foreseen for payment of the rent).

The lease agreement may also be subject to tacit extension (*pròrroga tàcita*) for one year upon termination unless the landlord or the tenant gives prior notice to the other party three months before the termination or any extended period expiry date.

To ensure that a tenant leaves on the date originally agreed, landlords will usually conduct an ocular inspection (or similar inspection mechanisms as inventories) before the tenant leaves the real estate asset.

6.18 Right to Assign a Leasehold Interest

A tenant who has concluded a lease contract for a definite period has the right under Andorran regulatory provisions to lease or sublease all or a portion of the leased premises in so far as there is written approval from the landlord.

Likewise, there is a prohibition against subletting by the subleased.

6.19 Right to Terminate a Lease

In addition to the events described in **6.12 Restrictions on Use of Real Estate**, breach by the tenant of the following obligations stated in the lease agreement entitles the landlord to terminate the lease agreement:

- expiry of the lease agreement term;
- loss or destruction of the real estate asset;
- transfer or disposal after the expiry of the legal lease agreement term (four years);
- mortgage foreclosure (when the leased agreement has been formalised after the creation of the mortgage without the mortgagor's knowledge);
- usufruct extinction (if the beneficial owner had granted the lease agreement and the tenant was aware of such circumstance);
- when the real estate is declared to be in a state of ruin; and
- compulsory expropriation.

The tenant is entitled to terminate the lease agreement without prior notice to the landlord upon verification of the following circumstances:

- breach by the landlord of contractual conditions expressly identified as being of essential character in the lease agreement;
- any de facto or legal interference by the landlord in the use of the leased asset;
- the landlord fails to carry out the necessary repairs to preserve the property in suitable condition for its normal use;
- the landlord failing to render the services stated in the lease agreement; or
- the occupant or tenant of other commercial or residential units located in the same building unit carrying out immoral, dangerous, annoying or insalubrious activities affecting the landlord in any manner.

Furthermore, the Urban Rents Law states that the tenant's death will not constitute a termination cause until the expiry of the term of the agreement if the spouse, ascendants or descendants who have lived together with the deceased tenant choose to continue with the lease for its agreed term. Lastly, the buyer entitled to a repurchase right (*pacte de retro*) may not evict the tenant until the expiry of the term of such repurchase right.

6.20 Registration Requirements

There are no land records in Andorra, nor are there registration requirements regarding commercial leases.

6.21 Forced Eviction

The landlord may force the tenant to leave if there is an early termination of the lease agreement. The duration of eviction procedures may vary significantly, depending on the specific circumstances.

6.22 Termination by a Third Party

The termination of a lease agreement could normally take place based on either an eviction proceeding, an administrative concession termination, or a ruling by the insolvency administrator as long as it is considered detrimental to the insolvency proceeding.

6.23 Remedies/Damages for Breach

No information has been provided in this jurisdiction.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The price of construction projects may be subject to different criteria:

- a fixed price (where the contractor executes and releases the entire work, while the total price is satisfied at the time of receipt of the construction project);
- construction project by units or measures (consists of the partial realisation of the work with the reception of partial payments); and
- the construction project by administration (in which the contractor receives a percentage, or units, of the project executed as payment in kind).

7.2 Assigning Responsibility for the Design and Construction of a Project

In general, in the absence of a contractual agreement, and in the event that different parties intervene, the parties agree that the liability of the contractors and the different parties will be jointly and severally liable.

The period of prescription to carry out claims against the different parties is 15 years. On the contrary, once the work has been carried out and the price has been paid, without any type of complaint by the buyer, the risk becomes part

of it, leaving the contractor or the other parties involved to be responsible.

7.3 Management of Construction Risk

The risk of destruction, loss or deterioration of construction lies with the contractor, and the immediate consequence of such destruction, loss or deterioration is that the contractor cannot charge the price agreed by the parties. Therefore, it is necessary to differentiate between two scenarios:

- when the contractor provides the work but not the materials because the client provides them (in these cases, the contractor must bear the risk of losing or deteriorating, as long as it is not attributable to the contractor or in default due to the contracting party not having received the work when it was agreed); and
- when the contractor provides the work and the materials (the contractor will be responsible for these damages as long as there is no default on the part of the contracting party).

7.4 Management of Schedule-Related Risk

The reception of the construction project must be carried out within the term agreed by the parties. In the absence of any agreement, it will be understood that the term of termination of the work will be the usual for completion of the construction project, as agreed by the parties.

Often, a conventional penalty is established as a guarantee of the contractor's obligation to deliver the construction project within the agreed term, usually based on the days of delay in delivery. Such conventional penalty shall be enforceable when the delay in delivery is attributable to the contractor, provided that it acts with guilt or fraud, and the determination of the amount corresponds to the parties but may be moderated by the judicial authority if it is excessive.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Other guarantees may be agreed upon to guarantee the execution of a construction project, as long as both parties have accepted them.

Comfort letters, parent guarantees and letters of credit are commonly used.

7.6 Liens or Encumbrances in the Event of Non-payment

The contractor has a legal guarantee that substantiates their right to receive the price of the construction project carried out. The guarantee consists of the retention of the property until the price agreed by both parties is paid.

The contractor's right to claim in relation to the contracting party to obtain the agreed price lasts 30 years. In cases where the client does not pay the agreed price to the contractor, and the contractor is a debtor of the subcontractor in the construction project, the latter may exercise direct claims against the contracting party, with the maximum limit of the amount owed to the contractor.

7.7 Requirements Before Use or Inhabitation

The management plans, the zoning plans of the village and the regulatory ordinances will establish the conditions of habitability of the residential buildings and those destined for other uses. These conditions must respect the minimum requirements of the law.

In general, the law requires obtaining a certificate issued by the Andorran government to demonstrate that the residential building complies with the conditions of habitability. This cer-

tificate must be requested by the promoter of the construction project.

8. Tax

8.1 VAT and Sales Tax

According to Andorra Law, IGI applies to real estate transactions at 4.5%. The seller has an obligation to pass on IGI to the buyer if the seller is considered by law to be a legal person or individual carrying out habitual business activities. Otherwise, Transfer Tax (*Impost sobre Transmissions Patrimonials Immobiliàries*) should be paid by the purchaser at a rate of 4% over the total amount of the transaction.

8.2 Mitigation of Tax Liability

There is no exemption for indirect tax, even for collective investment vehicles. The only special regime that includes real estate transactions without being subject to indirect tax is that of corporate reorganisation operations (mergers, divisions, transfers of assets and exchanges of shares).

8.3 Municipal Taxes

Municipal tax rules apply to commercial or business premises. However, there are exemptions, depending on the business sector of the company and the activity carried out in the relevant business premises.

There are also local taxes related to the ownership of property depending on the size of the plot over which that property it distributed. In addition, there are also local taxes levied on income from the rental of real estate.

8.4 Income Tax Withholding for Foreign Investors

Real estate capital gains of non-residents are taxed by the Non-Residents Income Tax (Llei 94/2010, *de l'impost sobre la renda dels no-residents fiscals* – IRNR), for the positive difference between the real value of the transferred assets and their acquisition value. At the time of transfer, the buyer must apply a withholding tax of 5% of the sale price and advance this payment to the Andorran government if the seller is a non-resident. Then, if the withholding is less than the effective taxation with respect to the law, the seller could request the Andorran government to undo the difference, and the Andorran tax authorities would then refund this amount within six months from the requested date.

A withholding tax of 10% is also levied on rental income obtained by foreign investors from property located in Andorran territory. To determine the taxable base of rental income, the IRNR law allows a deduction of 20% of gross income. Consequently, the withholding tax will be applicable to 80% of the gross income.

8.5 Tax Benefits

Regarding corporate income tax (*impost sobre societats*), the company can deduct the amortisation of the construction according to the amortisation plan adopted by the company and regulated by law.

Also, in relation to corporate income tax, there is the possibility of reducing the positive taxable income by up to 15% through the contribution of housing to the National Housing Institute, to promote public policies for access to housing.

Finally, there is also the possibility of reducing the corporate income tax base by an amount equal to 5% of the income from the rental of housing located in the Principality of Andorra, when the income obtained is less than EUR8 per square metre.

ANGUILLA



Law and Practice

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Webster Legal

1. General

1.1 Main Sources of Law

The main sources of real estate law are the Registered Land Act and the Stamp Duty Act.

1.2 Main Market Trends and Deals

In an attempt to stimulate the market, since 2017 the government has implemented a reduction of stamp duties on real estate sales.

Over the past 12 months, motivated sellers, coupled with the stamp duty incentive, which was extended to 31 December 2024, resulted in increased sales of properties between locals and also of investment properties for foreign direct investment.

Recent significant deals include:

- the sale of several villas and condominium units (priced between USD500,000 and USD5 million) in the resort managed and operated by Four Seasons Anguilla;
- the acquisition of Cuisinart Resort (now known as Aurora Anguilla Resort & Golf Club) and the transport of the resort's passengers and others by Aurora Airlines; and
- the sale of several properties with values ranging between USD300,000 and USD3 million.

1.3 Proposals for Reform

There are currently no proposals for reform that would significantly impact real estate investment or development.

In relation to ownership, there is a proposal to digitise the Land Registry, which would allow persons to conduct online searches to confirm ownership of land.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights are divided into four categories:

- absolute title;
- concurrent (or co-ownership), whether as joint tenants or tenants in common;
- leasehold interest; and
- a lender is able to register a charge to secure the payment of money or its value or to secure the fulfilment of a condition – this does not give a proprietary right over the property.

2.2 Laws Applicable to Transfer of Title

The applicable legislation is the Registered Land Act RSA c R30, which applies to all types of real estate.

2.3 Effecting Lawful and Proper Transfer of Title

A lawful transfer is effected on execution of an instrument (Form RL 1 – Transfer of Land) by the proprietor/transferor to a transferee, on payment of the relevant stamp duties and registration fees and submission of the instrument for recording to the government.

Anguilla maintains a registered system of title registration.

Title insurance is common in transactions involving substantial overseas (usually US) loans to acquire and/or develop a property.

2.4 Real Estate Due Diligence

Due diligence is carried out by requesting Land Registry searches to establish the legal proprietor and that the land is free from encumbrances that would affect the interest intended to be transferred. A Court Registry search is usually conducted as well to establish if there are any

judgments that act as a charge over the property.

2.5 Typical Representations and Warranties

Typical warranties are:

- transferor's warrant that it has the right to sell and that as at the date of the agreement nothing has been done to encumber the property;
- clear title will be delivered on completion of the transaction; and
- there is no dispute or controversy or claim against the property or its appurtenances that are known and there is a registered right or way (access) to the property.

There are no warranties as to the state of the building. Properties are customarily sold as is. The issue of asbestos is not one that customarily affects properties in the Caribbean.

The buyer's remedies usually include specific performance of contracts and a claim for damages against a party to a transaction.

Representation and warranty insurance is not customarily used in this jurisdiction.

2.6 Important Areas of Law for Investors

The Anguilla Registered Land Act is the most important piece of legislation for an investor to consider when purchasing real estate.

The intention of the investor will dictate whether or not other statutes are required to be considered, such as:

- the Condominium Act (if condominium units are intended to be constructed);
- the Stamp Act (with respect to duties payable); and
- the Aliens Land Holding Regulation Act (if the investor is a foreigner – not an Anguillian).

Other acts such as the Customs Act will be considered if an investor intends to negotiate with the government and enter into a Memorandum of Understanding for concessions and/or waiver/reduction of custom duties and taxes that will affect a project.

Other permits, licences and approvals are necessary for the project:

- Planning Permits (under the Land Development (Control) Act);
- Building Permits (under the Building Act);
- Trade Licence (required under the Trades, Businesses, Occupations and Professions Licensing Act if the investor is managing and developing the property); and
- Work Permits (issued under the Control of Employment Act) for the management and operation of the project (if the investor makes satisfactory representations to the government that the skills and experience required cannot be identified locally).

2.7 Soil Pollution or Environmental Contamination

The Public Health Act deals with storage, discharge and disposal of contaminants and hazardous materials. Environmental Health Officers are authorised to enter upon any premises with or without the consent of the owner to conduct inspections as necessary under the act.

A buyer should conduct due diligence prior to entering into any contract as environmental protection legislation does not run with the land. If the buyer fails to conduct the required due

diligence prior to the completion of the transaction and purchases the real estate as is, where contamination is present and the buyer discovers this and fails to include terms in the contract, then the responsibility for remedial work will fall to the buyer.

An Environmental Impact Assessment may be required depending on the scale and type of development.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

There is no zoning legislation save for the Special Economic Zones Act, which affects certain land, areas or locations in Anguilla declared as such by regulation by the Executive Council of the government.

The Land Development (Control) Act, governs the development (building or rebuilding engineering or mining operations; making of material change in the use of building or land; subdivision or alteration of the nature or the character of any land).

The Planning Committee is, however, guided by the Proposed Anguilla National Land Use Plan, which was prepared in consultation with the United Nations Development Programme.

Notwithstanding that there is no zoning legislation, areas are identified by various designations such as:

- institutional/commercial use;
- resort; and
- resort/residential.

Refer to **2.6 Important Areas of Law for Investors** with respect to the specific development agreements with relevant public authorities.

2.9 Condemnation, Expropriation or Compulsory Purchase

The government may compulsorily acquire land under the Land Acquisition Act in instances where the land is required for a public purpose. Once the decision is taken by the government in council, a declaration (which shall include the description of the land, the public purpose for which it is required, etc) is published in two issues of the gazette, which is required to be posted on a building (if any) on the property or exhibited at suitable places in the area where the land is located. The land is automatically vested in the Crown upon the second publication of the declaration in the gazette.

If the premises are occupied during the process, the occupier must be given seven days' written notice if it is intended to enter upon the land for any reason. As soon as the declaration is made, persons with an interest in the land should contact the government and there should be negotiations for compensation upon reasonable terms and conditions.

Compensation, if any, required to be paid based on the use of the land, shall be assessed and paid based on any actual damage suffered as a result of the acquisition. Such assessment is usually undertaken by a Board of Assessment.

2.10 Taxes Applicable to a Transaction

A 5% stamp duty on transfer of land (or undivided share in land) and registration fees are customarily payable by a purchaser, who can negotiate with a motivated seller on any sale.

If the purchaser is not an Anguillian, an Aliens Land Holding Licence (which attracts stamp duty of 12.5%) will be required from the government to legally acquire the property. If the land purchased by a non-Anguillian is undeveloped,

a 10% refundable deposit is payable by the purchaser pending completion of construction within a specified time noted on the Aliens Land Holding Licence.

If shares in a company that owns property are transferred, the same principle applies – ie, 5% of the value of the assessed value of land being transferred in the transaction; and USD5 for every USD500 or part thereof on the share or stock in the company, which is payable at the Companies' Registry.

So long as an interest in property is being transferred, stamp duty on the transfer will apply.

Reduction of Stamp Duties to Stimulate the Real Estate Market (Which Expires on 31 December 2024)

- Aliens Land Holding Licence (developed property) – 5% (down from 12.5%).
- Aliens Land Holding Licence (undeveloped property) – 6.25% (down from 12.5%).

There are circumstances (negotiated with the government) in which:

- the stamp duty payable on an Aliens Land Holding Licence can be reduced or negotiated down to 0%; and
- custom duties can be waived.

2.11 Legal Restrictions on Foreign Investors

An Aliens Land Holding Licence is required before a foreign person can legally acquire an interest in real estate.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

This is negotiated between/among the parties concerned. Typical financing options include personal savings or loans.

3.2 Typical Security Created by Commercial Investors

The following securities are typically created or entered into by commercial real estate investors:

- a charge over the real estate by the lender;
- a caution preventing dealing with the security without the lender's (chargee's) consent;
- life insurance on the principal or directors;
- guarantee;
- debenture over fixed and floating assets; and
- any other security required by the particular lender.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

An Aliens Land Holding Licence is required by a foreign lender as this affects an interest in land. There are no restrictions on repayments being made to a foreign lender; the repayment terms are a matter of contract.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Stamp duty on the charge to be registered against the property is 1% of the charge (loan) amount. Stamp duty on the loan document is USD20.

Registration fees on each document are USD37.20. There are no documentary taxes in Anguilla. Notary public fees will vary.

The enforcement of security is dependent on the requirements and steps taken to recover any outstanding amount. This may involve court costs and fees, legal fees and costs resulting in the transfer by the chargee (lender) and the attendant stamp duties and registration fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The Articles of Incorporation/by-laws and other underlying documents, if any, of the entity would dictate the legal requirements with respect to the provision of valid security.

3.6 Formalities When a Borrower Is in Default

So long as the lender holds a first legal charge over the security or at the onset, the lender ensures that the charge ranks pari passu with any existing charge, then the lender, along with the prior charge (lender) will rank in priority to the interests of other creditors.

The Registered Land Act will dictate the steps required to be taken in a foreclosure. After three months of default the lender may exercise its powers of sale and take steps to sell the land at public auction. A defaulting borrower/proprietor, in good faith, may seek to vary the repayment terms of an outstanding loan.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt in any circumstances, whether by agreement or otherwise, with the consent of the first chargee (lender). The balance due on the existing loan and the value of the security will dictate whether or not a lender will take the security.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over real estate cannot be liable under environmental laws if it did not cause any pollution of the real estate, as the interest is not proprietary in nature.

3.9 Effects of a Borrower Becoming Insolvent

There is no law that makes security interests void if a borrower becomes insolvent. The lender can pursue its rights under the bankruptcy laws.

3.10 Taxes on Loans

The issue of interest is one that is subject to negotiation among parties.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The applicable legislation is the Land Development (Control) Act and related protocols – see **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Proposed Anguilla National Land Use Plan sets out the guidelines relied upon by the Planning Committee while the Anguilla Building Code is a guideline that applies to the design and construction of new buildings (alteration, demolition, relocation, reconstruction, etc), and provides recommendations with respect to waste disposal facilities and the minimum provision of water supply, etc.

4.3 Regulatory Authorities

The Planning Committee of the Department of Physical Planning guided by the National Land Use Plan is responsible for regulating the development and designated use of individual parcels of real estate. The submission to the Planning Committee is required to include details such as placement of the intended building and confirmation that no boundary covenants will be breached.

Once planning permission with respect to the use of the land is obtained, an application is made to the Building Board under the Building Act. The decision in relation to design, layout, construction, sanitation and drainage of the intended construction is made at this level.

4.4 Obtaining Entitlements to Develop a New Project

Development of a new project will require the necessary licences/permissions as outlined. So long as the refurbishment does not include an addition to an existing structure that amounts to more than 25% of the square footage of the existing structure, no additional building permission may be required. It is, however, recommended that the department be consulted to ensure that the structural integrity of the building is not compromised by the refurbishment.

So long as there is no encroachment on the property of a third party, there should be no reason for an objection. However, if any citizen believes that the project may harm the environment or cause long or short-term devaluation of their property, they have the right to be heard.

4.5 Right of Appeal Against an Authority's Decision

There is a right of appeal against a relevant authority's decision respecting an application for permission for development or the carrying on of a designated use. An aggrieved party has the right to appeal a decision.

4.6 Agreements With Local or Governmental Authorities

A Memorandum of Understanding or similar document is usually entered into with the government. Such agreement usually includes a clause stating that the government will use its best endeavours to facilitate expeditious approvals under its control.

Agreements with utility suppliers would involve separate contracts between the developer/contractor and the utility supplier.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and designated use are enforced through building inspections and notices by the Building Board under the umbrella of the Department of Physical Planning.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

As at 19 April 2022, the Anguilla Companies Act (ABC) and the International Business Company Act (IBC) were repealed. Therefore, the only type of company that is now legally able to hold an interest in property is one governed by the Business Companies Act (BCA).

A foreign Limited Liability Company (LLC) such as a Delaware LLC can also hold title subject to government approval in relation to alien shareholders, if any, and registration as a foreign company under the BCA.

A foundation is considered by some investors to be a preferred vehicle.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

There is no specific feature that the by-laws of a company formed to invest in real estate would contain. As is usual in companies, there will be mechanisms for approval of contracts and agreements, voting rights of investors, and so on.

5.3 REITs

REITs are not currently available as an investment vehicle in this jurisdiction.

5.4 Minimum Capital Requirement

The minimum capital required to set up each type of entity used to invest in real estate would be the value of one share.

5.5 Applicable Governance Requirements

The governance requirements will be set out in the legislation under which the entity is formed.

5.6 Annual Entity Maintenance and Accounting Compliance

A company that holds an interest in property is required to ensure that all the statutory requirements are met. This includes the filing of an Annual Return and Economic Substance Return and complying with normal accounting principles. The costs associated with these requirements can vary, but they start at a minimum of USD800. Accounting compliance costs will vary based on the organisation that is performing this function.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Rental and lease agreements can be entered into, to occupy and use real estate for a limited period of time without buying it outright. Persons/entities rarely enter into licensing agreements.

6.2 Types of Commercial Leases

Commercial lease agreements are dependent on the intended use of the properties and the terms agreed between the parties.

6.3 Regulation of Rents or Lease Terms

Rental and lease agreements are not regulated, save that if the lease term exceeds a period of two years the lease is required to be recorded in the Land Registry.

6.4 Typical Terms of a Lease

The following terms are typically included in a lease agreement for business premises, whether contractual or regulated:

- length of lease term;
- maintenance and repair of the real estate actually occupied by the tenant;
- frequency of rent payments;
- COVID-19 pandemic issues;
- the full description of the leased property;
- the purpose of the lease;
- insurance, determination, breach, nuisance and remedial and notice clause(s);
- permissions with respect to subleasing (if allowed); and
- the jurisdiction of the lease.

6.5 Rent Variation
The rent payable will not necessarily remain the same as long as the lease lasts. There is usually a clause with respect to incremental/periodical/annual rental increase based on the duration of the lease (calculated using the CPI or by percentage/other).

6.6 Determination of New Rent
The matter of rent increase is determined between the parties. However, if there is a disagreement regarding the amount of rent increase beyond any prior agreements, a party may refer to the limitations established in the Rent Restriction Act (Revised Statutes of Anguilla, Chapter R50). This act does not apply to furnished accommodations, building leases, or renewals or continuances of such leases for terms of 25 years or more.

6.7 Payment of VAT
Since 1 July 2022, Goods and Services Tax (GST) is payable on rental or Accommodation services provided for a period of 182 days or less.

Long-term rental (183 days or more) is exempt from GST.

6.8 Costs Payable by a Tenant at the Start of a Lease
If the lease is for a term exceeding two years, it is required to be recorded. In this event, stamp duties and registration fees will apply.

6.9 Payment of Maintenance and Repair
Declaration of Covenants Easements and Restrictions under which the register is created, as well as the Condominium/Home Owners Association and Unit Management Agreements, usually outline the obligations of owners in relation to the common areas of developments.

6.10 Payment of Utilities and Telecommunications
In a property occupied by multiple tenants, utilities and telecommunications costs are typically covered through Unit Management Agreements, and are prorated based on each unit's square footage and the proportion of shared common areas. This method is used when individual units are not separately metered.

6.11 Insurance Issues
Usually the tenant is required to obtain insurance as one of the terms of a lease, with a requirement that a copy of such insurance be provided to the landlord. Recoveries are subject to the terms of the policy. The author is unaware of any instances of recoveries as a result of the COVID-19 pandemic.

6.12 Restrictions on the Use of Real Estate
Restrictions can be imposed by the landlord on how a tenant uses the real estate and the use of the property is usually a condition of the lease. There is no zoning statute in Anguilla.

6.13 Tenant's Ability to Alter and Improve Real Estate
The tenant is permitted to alter or improve the real estate. Typically, the lease agreement includes a clause stating that no structural alterations or modifications can be made without the prior consent of the landlord, and that such consent should not be unreasonably withheld.

6.14 Specific Regulations
Leases are governed by the Registered Land Act.

6.15 Effect of the Tenant's Insolvency

The landlord reserves the right to forfeit the lease where the tenant, as a company, goes into liquidation or, as an individual, becomes bankrupt.

Enforcement actions can be taken in the court.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A landlord usually ascertains that a prospective tenant is employed and requests a security payment equivalent to one or two months' rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

The agreement usually includes a termination clause. The landlord has the right of forfeiture whether expressed or implied in the lease, after giving notice to the tenant. Eviction proceedings can be commenced.

6.18 Right to Assign a Leasehold Interest

Such permission would first be required to be included in the initial lease agreement. Some agreements indicate that the tenant does not have the right to assign for a period (say ten years from the date of the initial lease); while others may include a clause where the tenant agrees not to assign or part with possession of the premises or any portion thereof without prior written consent and for which an adjustment of the rental rate will have to be agreed.

6.19 Right to Terminate a Lease

Landlords have the right to terminate a lease in the following circumstances:

- without cause within a stated period;
- for non-payment of rental after say 30 days after written demand; and
- for tenant's failure to remedy breach after notice.

Either party may terminate after a specified period, such as 12 months, by giving, for example, no less than six months prior notice in writing, during which time the tenant should pay rent, and the landlord and tenant should perform and observe the covenants in the lease.

Tenants have the right to terminate a lease in the following circumstances:

- failure of the landlord to grant the tenant peaceful enjoyment of premises without any interruption or disturbance from the landlord or any person claiming through, under or in trust for the landlord;
- failure of landlord to maintain access to premises; and
- failure to carry out repairs, at all, or in accordance with terms of the lease.

The Registered Land Act includes other implied terms that apply to lease agreements, whether or not they are expressly included in any agreement executed between the parties.

6.20 Registration Requirements

Leases for a term of more than two years must be recorded. To effectuate the recording, the responsible party (usually the lessee) must execute and submit an instrument (Form RL 8 – Lease/Sublease) and an agreement, pay the relevant stamp duties and registration fees, and submit the instrument to the government for recording.

The stamp duty payable is calculated based on 0.05% of the value of the leased property for each year or part of a year of the lease term, up

to a maximum of 5% of the value of the leased property. The registration fee is USD37.20.

6.21 Forced Eviction

A tenant can be evicted in the event of a default prior to the date originally agreed. A notice to quit giving 30 days from the date of service of the notice is usually issued. If the tenant does not leave the property after that time has passed, then an application can be made to the Magistrates' Court. The process could take several months. There are no known eviction moratoriums.

6.22 Termination by a Third Party

While it is unprecedented for a lease agreement to be terminated by a third party, it is possible in certain circumstances, such as when the government claims the property for public purposes.

6.23 Remedies/Damages for Breach

While there are no statutory limitations on damages that a landlord may claim, there is a limitation period of six years. Typically, landlords will request a cash security deposit equivalent to one or two months' rent.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structure used to price construction projects is the cost of the work (generally measured per square foot).

7.2 Assigning Responsibility for the Design and Construction of a Project

Usually a request for tender is made. Once the selection is made, the assignment of responsibility is a matter of contract.

7.3 Management of Construction Risk

An indemnification clause indicating that indemnification shall not be limited in any way by any limitation on the amount or type of damages, compensation or benefits payable by or for the contractor, and subcontractor, or sub-subcontractor, is usually included in the agreement.

Warranties are also included in the agreement.

A Contractor's All Risk Insurance Policy and Workmen's Compensation Policy are also required.

The devices are only limited by the terms of the agreement, so long as there is no contravention of the applicable statute, or policy.

7.4 Management of Schedule-Related Risk

In the schedule, tasks are assigned by creating a work/task schedule and creating a chart to measure progress.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Large investment projects would require performance bonds.

As most construction projects are conducted on a task-related staged payment basis with the funds being provided by the owner, whether directly or by loan, additional performance security is not required.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and/or designers are not permitted to lien or otherwise encumber a property in the event of non-payment; a claim is required to be filed.

7.7 Requirements Before Use or Inhabitation

Once the contractor issues a Certificate of Practical Completion, or a similar document, arrangements will be made for the Building Inspector to inspect the property to confirm that it is completed and fit for habitation or use for its intended purpose. An Occupancy Certificate is issued after inspection.

8. Tax

8.1 VAT and Sales Tax

Gains from disposition of real property are not taxed.

8.2 Mitigation of Tax Liability

There are no methods commonly used to mitigate transfer, recordation, stamp or other similar tax liability on acquisitions of large real estate portfolios.

8.3 Municipal Taxes

Property taxes are payable by the proprietor of developed property whether or not it is occupied. There are no business rates and no exemptions.

Property taxes are not charged on undeveloped property (bare land).

8.4 Income Tax Withholding for Foreign Investors

There is no specific income tax withholding in Anguilla. However, under the Goods and Services Tax Act 2022, where a taxable person is providing goods or services to the government and is required to charge GST on those goods or services, the government may withhold such taxes that would be charged by the taxable person.

Effective 1 July 2022, goods and services tax becomes payable on short-term accommodation (rental) for a period not exceeding 182 days at a rate of 13%. This tax is collected by the proprietor from the occupier for payment to the Inland Revenue Department. Gains from disposition of real property are not taxed.

Exemption applies, upon the implementation of GST, to:

- a supply of:
  - (a) a lease, licence, hire rental or other form of supply of accommodation, to the extent that it is a supply of the right to occupy or be accommodated in premises for 183 days or more; or
  - (b) leasehold land by way of lease (not being a grant or sale of the lease of that land) to the extent that the subject land is used or is to be used for the principal purpose of accommodation in a residential dwelling erected or to be erected on that land, where the lease is for 183 days or more;
- a supply of the following immovable property:
  - (a) vacant land; and
  - (b) a residential dwelling that is:
    - (i) resold by the initial purchaser including all subsequent sales of such property; and
    - (ii) sold by the first-time owner after two years of continuous occupancy of such premises by the owner or his immediate family;
- a lease, licence, hire rental of land to the extent that it is to be used for agricultural purposes; and
- a lease, licence, hire rental of land except for in vacant land, where the lease is for 183 days or more.

8.5 Tax Benefits

There are no tax benefits from owning real estate in Anguilla.

Trends and Developments

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Webster Legal stands as a leading law firm in Anguilla and Nevis, distinguished by its global reach through esteemed associations worldwide and an unwavering commitment to delivering the highest standards of advice and service. The firm specialises in a comprehensive array of legal domains, including international commercial litigation, corporate and commercial law, real estate, estate planning, governmental and constitutional affairs, intellectual property, offshore finance and provides registered office facilities through its affiliate Registered Agent. Webster LP provides cross-border advice to Anguillian, Nevisian and international clients. Its approach to problem-solving and strategic planning is marked by creativity, ensuring that its services are crafted to meet the unique needs of each client, regardless of the nature of their matter or transaction. Webster LP is uniquely qualified to assess the political and constitutional forces that may impact its clients' commercial activities in Anguilla. The firm is dedicated to safeguarding clients' interests and providing unparalleled legal expertise.

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An Insight Into the Anguillian Real Estate Market in 2024

Introduction

Anguilla's reputation as a premier destination in the Caribbean and on the global stage continues to fuel significant growth in its luxury real estate market. Boasting pristine beaches, a laid-back tropical lifestyle, stunning seafront properties, and appealing tax advantages, Anguilla attracts both tourists and investors alike.

Moreover, the evolving dynamics of remote work and lifestyle preferences, spurred on by the COVID-19 pandemic, have intensified interest in Anguilla's property market. As individuals increasingly seek a lifestyle liberated from the confines of a single location, Anguilla emerges as a captivating option.

Additionally, Anguilla remains an attractive investment prospect due to its status as a zero-tax jurisdiction. Void of direct taxation, including income tax, capital gains tax, inheritance tax, and corporate tax, Anguilla offers an appealing fiscal environment.

Trends in the Anguillian real estate market

Over the past year, Anguilla's property market has witnessed remarkable expansion, largely driven by the flourishing tourism sector. The government's steadfast commitment to preserving Anguilla's exclusivity and natural beauty, coupled with strategic investments in essential infrastructure upgrades, has played a pivotal role. Notably, recent improvements in transportation infrastructure, such as a modern ferry terminal and ongoing airport expansion plans, have instilled confidence among investors and facilitated increased tourist accessibility.

The soaring demand for Anguilla's premium tourism offerings prompted American Airlines to introduce daily flights directly from Miami since December 2021. This significant enhancement in air connectivity has resulted in a surge in tourist arrivals, subsequently driving demand for real estate, particularly in the villa rental market. A noteworthy trend emerging in Anguilla is the growing preference among visitors for unique travel experiences through vacation rentals on platforms like Airbnb and VRBO, as opposed to traditional hotel stays. This shift has created lucrative opportunities for property investors, further enriching the market's diversity.

Anguillian residency and luxurious living – the Residency by Investment Programmes

Anguilla's recently launched Residency by Investment Programmes to present enticing options for high-net-worth individuals seeking tax-efficient residency or permanent residency in a tropical haven. These initiatives have gained heightened interest among foreign buyers eager to establish deeper ties with Anguilla.

The Residency by Investment Programme not only serves as a pathway to permanent residency but also offers a route to British nationality, enhancing its appeal to global citizens.

Similarly, the Residency for Tax Purposes Programme caters to successful entrepreneurs and investors seeking strategic tax planning solutions. These programmes, combined with Anguilla's robust regulatory framework and flexible financial planning options, position the island as an ideal destination for wealth management and asset protection.

Asset protection opportunities

Anguilla is widely recognised as a promising destination for those seeking avenues for wealth management and asset protection. Among the various financial strategies available, offshore

trusts emerge as a robust solution, repeatedly demonstrating their efficacy in asset protection, estate planning, confidentiality, and tax optimisation.

In particular, an asset protection trust is a separate legal vehicle offering a multitude of benefits. Designed to safeguard assets from potential risks and liabilities, these trusts serve as a shield against unforeseen events. Their versatility allows them to hold a diverse range of assets, including real estate, bank accounts and other valuable holdings.

It is best suited for assets that already are or can be moved offshore and for this reason real estate is quite commonly chosen as a trust asset. Its tangible nature and potential for appreciation make it an attractive choice for investors. By placing real estate assets within the protective confines of a trust, individuals can mitigate risks associated with property ownership while capitalising on the benefits of offshore structures.

Anguilla presents itself as a premier destination for those seeking secure and reliable wealth management solutions and some of the key benefits include the following.

- Regulated by the English Common Law System – the Anguilla government is stable and it is a British overseas territory, so it is well governed and secure.
- Asset protection – upon creating a trust, the offshore trustee receives title to the settlor's assets which protects them from risk of attachment by creditors of the settlor.
- Confidentiality and discretion – Anguilla offers a level of discretion which is rarely found elsewhere. There is also no requirement to register your trust.
- Tax benefits – there are considerable tax planning opportunities by creating a trust in a tax-free jurisdiction such as Anguilla. Provided the trustees are resident for tax purposes in Anguilla, the trust's income and gains are not subject to tax and there will be no inheritance tax payable on the trust assets upon the death of the settlor.
- No probate – trusts are not subject to probate because the wealth and assets held in trust no longer belong to the settlor. Instead, the trust owns them until such time as they are passed along to the beneficiaries. Avoiding probate can save a lot of time and effort and reduce costs.

Developments contributing to the Anguillian real estate market

The developments contributing to the Anguilla real estate market are multifaceted and dynamic, reflecting both the island's inherent allure and strategic governmental initiatives.

Since the lifting of all COVID-19 travel restrictions in September 2022, Anguilla has enjoyed a resurgence in tourism, setting the stage for a vibrant real estate landscape. The island's appeal as a prestigious tourist destination, coupled with its status as a tax haven, has attracted investors seeking not only financial returns but also a slice of paradise to call their own.

Central to the growth of the Anguillian real estate market is its reputation as a premier tourism hotspot. While official housing-price statistics may not be readily available, the palpable surge in visitor arrivals in 2023 reported by the government of Anguilla speaks volumes about the island's growing popularity. To capitalise on this momentum, the government has implemented strategic measures, such as the temporary reduction of

stamp duties for foreign purchasers, aimed at incentivising real estate investment.

Luxury properties have emerged as a particularly sought after segment within the Anguillian real estate market. International buyers, drawn to the island's pristine beaches and exclusive lifestyle offerings, are driving demand for upscale residences. Recent transactions underscore this trend, with several high-profile sales, including a notable deal fetching USD16 million for a lavish nine-bedroom villa. Such transactions not only showcase the desirability of Anguillian real estate but also demonstrate the willingness of investors to invest substantially in the island's flourishing hospitality sector.

Looking ahead, the trajectory of the Anguilla real estate market appears promising, maintained by a confluence of factors including sustained tourism growth, favourable government policies, and an increasing appetite for luxury living in an unparalleled tropical setting. As the island continues to captivate investors and tourists alike, its real estate sector stands poised for further expansion and prosperity in the years to come.

Reduction of stamp duties on property transfers for foreign investors

In an effort to further stimulate the real estate market, the government of Anguilla has reduced the stamp duties payable by foreign purchasers until 31 December 2024. Currently all foreign purchasers are subject to the following stamp duty rates:

- 5% (reduced from 12.5%) on the value of developed property for all Alien Land Holding Licensees; or
- 6.25% (reduced from 12.5%) on the value of undeveloped property for all Alien Land Holding Licensees.

In addition, there is a 5% stamp duty payable on all property transfers.

Recent initiatives aimed at stimulating real estate investment, such as the reduction of stamp duties for foreign purchasers until December 2024, underscore the government's commitment to fostering economic growth. Anguilla's participation in the UK's Ocean Conservation Blue Belt Programme further demonstrates its dedication to sustainable development and environmental stewardship.

By managing its coastal and marine resources responsibly, Anguilla aims to ensure the long-term viability of its economy and environment. These initiatives, combined with the island's inherent charm and appeal, bode well for continued growth and prosperity in Anguilla's real estate market.

Conclusion

In conclusion, Anguilla's allure as a premier real estate destination remains unmatched, driven by its pristine natural beauty, favourable tax environment, and commitment to sustainable development. The recent trends and developments within the Anguillian real estate market point towards a promising future, attracting investors seeking both financial returns and a slice of paradise. As Anguilla continues to evolve and thrive, opportunities abound for those looking to invest in luxury living amidst tranquility and natural splendor.

BELGIUM



Law and Practice

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Linklaters is a leading global law firm, supporting clients in achieving their strategies wherever they do business. The firm uses its expertise and resources to help clients pursue opportunities and manage risk across emerging and developed markets around the world. In Belgium, Linklaters has a presence dating from 1969 and offices in both Brussels and Antwerp. The construction practice is part of the real estate practice, which has been organised in a unique way, offering an integrated one-stop approach combining all areas of relevance for real estate development and transactions. The team includes specialists in real estate M&A, real estate investment, real estate finance, projects and project finance, public law, construction, environment, planning/zoning, tax, real estate funds, capital markets derivatives and structured finance, construction and real estate disputes, and energy. This enables the real estate practice to perform market-leading international projects and deal from origination to financing and on to securitisation/capital markets.

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1. General

1.1 Main Sources of Law

In general, the primary sources of law in Belgium are legislation, case law, doctrine, and customs. However, it should be highlighted that for real estate specifically, the below considerations are to be taken into account.

Belgian real estate law operates under a dual framework: it is governed at the federal level by the Civil Code, which is currently undergoing recodification, and at the regional level, where legislative powers can enact laws.

In the area of civil law, the Civil Code governs, notably, property rights (Book 3), contractual obligations (Book 5), and general tenancy agreements. Retail leases are mainly regulated by the Retail Lease Act of 30 April 1951 and regional decrees. Finally, residential leases are also regulated at the regional level.

Public real estate law, encompassing zoning, planning, and environmental legislation, is essentially governed by regional and local authorities.

Taxation powers in real estate law are shared between the federal state (matters with respect to the Income Tax Code and VAT Code) and the regions (notably transfer tax matters).

Other legal sources impact real estate legal practice and transactions such as:

- the Code of Companies and Associations;
- the law of 12 May 2014, on Belgian Real Estate Investment Trusts (B-REITs);
- the Code of Companies and Association;
- the law of 19 April 2014 on alternative investment funds and their managers, and the related decree of 9 November 2016 on the Belgian SREIF (Specialised Real Estate Investment Fund); and
- the Code of Economic Law.

1.2 Main Market Trends and Deals

In 2023, the Belgian real estate market faced challenges from ongoing macro-economic issues and geopolitical tensions, including the Ukraine conflict, high inflation, and volatile construction materials costs. These factors, combined with higher interest rates, contributed to reduce investment activity and a notable decline in real estate (M&A) transactions and stimulate a conservative climate as borrowing costs rose and financing entities exercised increased caution in lending and the structuring of securities associated with the financing of real estate operations.

The following economic factors are also to note.

- Signs of recovery – despite the slowdown, there are early signs of recovery as evidenced by stabilised, higher-level rents and a reduced vacancy rate in the Belgian office and retail real estate sectors in Q4 2023.
- Fundraising trends – real estate-related fundraising has declined, reaching a ten-year low in 2023, but a modest recovery is expected, likely driven by large investment funds.

The real estate market is currently facing a challenging economic environment. The sector's inherent resilience, coupled with strategic adaptation by investors (with an increased focus on ESG and sustainability needs), may lead to significant recovery and growth in the forthcoming periods.

With respect to major deals, some remarkable transactions occurred in 2023, such as:

- the acquisition by IRET of the Grand Bazar shopping center;
- the acquisition by BNP Paribas REIM of five companies holding five healthcare properties from Baltisse Real Estate;
- the sale of the Blue Towers in Ghent to Reactr;
- several transactions in the hotel real estate investment market, involving among others Extendam, Limestone, FICO and Van der Valk;
- the transfer of the office part of the AXS mixed-use development project by Baltisse to AGRE and Baloise; and
- the sale by Cofinimmo of Park Hill to License to Construct.

1.3 Proposals for Reform

In the context of the Civil Code reform (see **1.1 Main Sources of Law**), several of the Civil Code Books affecting the real estate practice are already in force: Book 3 (Property Law) since 1 September 2021, and Books 1 (General Provisions) and 5 (Obligations) since 1 January 2023. On 1 February 2024, the Belgian Chamber of Representatives approved Book 6, which will include a reform of the Extracontractual Liability regime in Belgian law. Its provisions are set to enter into force six months after their publication in the Belgian gazette. Proposals for Book 9 and Book 7, which encompass securities and special contracts (including sales and leases), were filed in February and April 2024 respectively.

2. Sale and Purchase

2.1 Categories of Property Rights

The different types of Belgian property rights are exhaustive in nature, as only the legislator can establish new property rights. The current legal property rights are:

- Ownership – provides the owner with use, enjoyment, and disposal rights regarding their property (subject to legal limits). It is a perpetual right.
- Co-ownership – shared property rights among multiple (natural or legal) persons over the same asset or set of assets, without exclusive right over such asset(s) or parts of them.
- Easements – property right of use involving the imposition of a charge on a property benefitting another.
- Usufruct – temporary entitlement to prudent and reasonable use and enjoyment of someone else's property, in accordance with the property's purpose, with the obligation to return the property upon expiration or the right (upon death of the holder or, for legal persons, their bankruptcy or dissolution).
- Long-term lease right – extensive use and enjoyment of another's property for a minimum of 15 years up to 99 years (or perpetual, subject to conditions).
- Right to build – ownership of volumes (constructed or not) on another person's property, for the purpose of erecting buildings or plantings, lasting up to 99 years (or perpetual, subject to conditions).

Real securities, including special privileges, mortgages, pledges, and retention rights, also fall within this closed system.

2.2 Laws Applicable to Transfer of Title

In asset deal transactions, the general principle is that the transfer of ownership occurs when parties agree on essential elements (mainly the object and price). Exceptions may apply, such as court-ordered transfers in the context of ownership disputes.

Regarding share deal transactions, the transfer of special purpose vehicle's shares also generally occurs through the consent of the parties on the essential terms of the transaction. Court decisions may also be a source of transfer of shares (eg, in the context of a dispute between shareholders).

Prior to the transfer of share ownership, formalities such as pre-emption rights or approval by existing shareholders may be required, often stipulated in articles of association/shareholders' agreements whereas various operations causing the issuance of shares require formalities such as publishing a (de)merger draft in the annexes to the Belgian Gazette at least six weeks prior to the relevant general meeting resolution and/or preparing reports by the management body of the company and a chartered/statutory accountant (for example, in case of a contribution in kind).

Additionally, the recording of the transaction in the company's share register post-transfer or issuance is mandatory.

2.3 Effecting Lawful and Proper Transfer of Title

In addition to the principle of consensual agreement described in **2.2 Laws Applicable to Transfer of Title**, the completion of the transfer or granting of real rights in Belgium requires specific formal actions, such as transcription and registration, which will cause the transfer or granting of real rights to be enforceable against third parties.

Usually, the transfer of title/granting of real rights must be recorded in a notarial deed and then transcribed in the Belgian mortgage register. Are also transcribed in this register (amongst others) deeds granting a right of pre-emption to a property and leases longer than nine years.

2.4 Real Estate Due Diligence

Sellers of real estate assets have an obligation to provide information on the condition of the asset (including known hidden defects) and therefore typically constitute a data room populated with relevant information needed for a buyer to make an informed decision.

Buyers usually conduct a legal due diligence on real estate assets based on the data room and public registers information, covering areas such as:

- ownership title and encumbrances;
- occupancy agreements;
- construction agreements;
- business, repair and maintenance agreements;
- insurance coverage;
- existing or potential legal disputes; and
- property's tax obligations and financial information.

These legal analyses also often cover environmental and planning aspects such as:

- planning status;
- permits;
- soil condition;
- asbestos presence; and
- energy efficiency compliance.

When purchasing shares of a company that holds real estate assets, due diligence also includes examining the company's financing agreements, corporate structure, employment agreements (if any) and accounting and tax obligations.

Beyond the legal framework, purchasers generally perform a technical evaluation of the properties involved in the scope of the transaction to assess their physical condition and maintenance.

2.5 Typical Representations and Warranties

Seller's representations and warranties (R&W) in real estate transactions generally relate to:

- the seller (eg, its rights to enter into the transaction);
- property ownership;
- agreements with respect to the property;
- absence of litigation; and
- permits/environment.

In a share deal structure, the seller's R&W are usually broader and may also include corporate law, employment, accountancy, and tax matters.

In the event of warranty breaches, the purchaser can seek compensation for damages suffered or the annulment/termination of the transaction in court (in case of material breach or defect in consent). Alternative remedies or limitation to the purchaser's remedies may be agreed upon by the buyer and seller.

Time limitations on liability for breaches of warranties by the sellers vary depending on the type of warranties. Fundamental warranties (typically concerning the ownership of the asset /shares of the target entity) usually remain in force for a period up to 30 years. Tax warranties typically endure until the expiration of the prescription period for claims by tax authorities. For other warranties, parties commonly agree to time limitations ranging from 12 to 36 months.

A materiality threshold is often agreed upon for claims for damages by the purchaser due to breaches of warranties as well as a maximum limitation of liability for breaches is often stipulated, which is usually a percentage of the purchase price (eg, 10%).

The implementation of a warranty & indemnity (W&I) insurance covering damage resulting from breaches of warranties given by the seller is not unusual.

2.6 Important Areas of Law for Investors

When preparing for a real estate transaction, investors should review:

- conditions impacting titles on properties such as pre-emption rights, specific stipulations (such as easements), applicable environmental aspects, and obligations, including potential remediation requirements (see **2.7 Soil Pollution or Environmental Contamination**);
- lease agreements legislation; and
- for development investments – local zoning regulations affecting project acceptability.

Investors also need to consider tax, urban planning, and permitting aspects. Most development/construction projects require prior approvals from public authorities, such as building and environmental permits, in addition to specific authorisations based on the business type/size (eg, hotels, restaurants and cafes).

2.7 Soil Pollution or Environmental Contamination

To determine if a real estate purchaser (or real right grantee/transferee) is responsible for soil pollution or environmental contamination on a property, it is necessary to differentiate between the regulatory framework (eg, conducting soil surveys and remediation) and civil liability (which

addresses the financially responsible party for pollution-related costs and damages).

Regulatory Framework

Each region has enacted soil legislation defining the party responsible for soil surveys and remediation.

- Flemish region – first on the operator of a listed activity, then the user (through personal or real rights), and finally the landowner.
- Brussels region – the responsibility varies with the contamination nature and may fall on the current operator, the polluter, or the holder of real rights (including the owner).
- Walloon region – the responsibility falls upon the volunteer to perform the obligation, then to the polluter the operator, real rights holders, and, lastly, the landowner.

Legal obligations under the soil legislation (eg, providing a soil certificate and performing soil surveys or remediation), are triggered by events such as real rights transfers, corporate restructuring, permit requests, etc.

Civil Liability

In all regions, the person carrying out soil surveys and remediation – whether voluntarily or following a legal obligation – can seek damages from the polluter under general civil liability law. Additionally, specific strict liability rules for polluters under the soil legislations may apply in certain scenarios.

Whether a buyer, upon acquiring a real estate asset, will be legally obliged to perform soil surveys and soil remediation works depends on the structure of the deal.

Asset Deal Structure

Asset deals are a triggering event in all regions. The seller must perform at least a soil survey prior to closing if specific listed activities likely to cause soil contamination are or have been carried out on the asset. If further surveys or soil remediation works are necessary, the closing will, in principle, need to be postponed and may also require an undertaking to remediate the soil, backed by a financial guarantee, typically provided by the seller but potentially assumable by the buyer.

Share Deal Structure

Share deals do not constitute a triggering event and soil surveys or soil remediation works are, in principle, not required by law prior to closing. This may create information asymmetry as the buyer may not have (full) knowledge of contamination at the time of closing but the company it will acquire will keep its existing environmental liabilities.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Information on the authorised use/destination of land plots is available on the websites of public authorities and through urban planning information from municipalities. Generally, urban planning information must be provided to the buyer before closing an asset deal. Regional legislation incorporates public-private co-operation aspects for development projects, with the Flemish region using an integrated permitting and planning process for complex projects, and the Brussels Capital and Walloon regions providing urban planning certificates outlining conditions for building permit approval.

2.9 Condemnation, Expropriation or Compulsory Purchase

Public entities have the right to expropriate for the public interest and against indemnification, subject to limitations which are notably enshrined in the constitution.

Certain properties are encumbered with a legal pre-emption right enabling public authorities to fulfil their duties of public interest (regarding nature conservation, spatial planning, housing policy, water management, etc). Pre-emption and repurchase rights can also be contractually stipulated, which often occurs in the sale of industrial real estate by public authorities.

2.10 Taxes Applicable to a Transaction

In share deals as well as in other restructuring operations (such as (de)mergers) neither transfer tax nor VAT typically applies. Other taxes, such as capital gains tax on the share transfer (see **8.2 Mitigation of Tax Liability**), may potentially be levied.

Additionally, Belgian law includes anti-abuse regulations that may make certain legal acts unenforceable against tax authorities.

If the tax administration considers that a transaction was specifically designed to transfer a real estate asset via a share deal (or a restructuring operation) instead of an asset deal and is abusive (for instance, on the basis that the transaction structure would be set up with the sole or essential objective to avoid a disadvantageous tax regime), it could claim the payment of the taxes that would have been due in an asset deal structure as well as applicable penalties.

Regarding asset deals, the transfer tax could either be the applicable VAT rate or registration duties, depending on whether the transaction falls under the VAT regime (see **8.1 VAT and Sales Tax**). When VAT is applied to a real estate sale, registration duties are correspondingly exempted.

If a real estate transfer of ownership is not subject to VAT, registration duties apply. Registration duties rates vary by region:

- 12.5% in Brussels and Wallonia; and
- 12% in Flanders.

For long-term leases and rights-to-build, duties' rate are usually 5%.

2.11 Legal Restrictions on Foreign Investors

Investors must be mindful of the existing legal frameworks aimed at the prevention of money laundering and the financing of terrorism, as well as the consequences of international sanctions on their activities in Belgium. It is now common to encounter clauses in real estate agreements (including leases) which allow for contract termination if international sanctions are imposed on a party, or clauses that prevent the transfer of contractual rights to a person subject to international sanctions.

Furthermore, as of 1 July 2023, a foreign direct investment screening mechanism entered into force in Belgium pursuant to which non-EU investor (including natural persons or entities with their principal residence or registered office outside the EU and EU-based entities with one of their ultimate beneficial owner having its principal residence outside the EU) must submit a notification to a screening commission for any direct or indirect acquisition by non-EU investors of:

- 25% or more of voting rights in a Belgian company with activities relating to, among others, (physical or virtual) critical infrastructure (including energy and other sectors), critical technologies and energy storage, critical inputs, access to sensitive information, private security, freedom of media or biotech; or
- 10% or more of voting rights in a Belgian company (i) active in certain sensitive strategic sectors in Belgium (including energy, defence, cybersecurity), and (ii) which realised a global turnover exceeding EUR100 million in the financial year preceding the investment.

The commission's prior authorisation is required for the completion of the investment. Non-compliance with the notification requirement can lead to administrative penalties amounting to up to 30% of the total investment value.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The financing of commercial real estate acquisitions usually involves a combination of equity, potentially including intra-group debt, and debt in the form of a loan or occasionally bonds. In case of share deals, the existing debts of the entity holding real estate may be refinanced.

Financial leasing, in which the lessor/financier acquires full ownership or real rights of a real estate asset and leases the property to the lessee/debtor, with an option to acquire the (residual) ownership rights upon expiry of the agreement is also common for financing commercial real estate.

3.2 Typical Security Created by Commercial Investors

Usual securities for real estate financing are:

- a mortgage on the real estate asset;
- in case of share deals, a pledge over the shares of the special purpose vehicle;
- security on the income generated by the real estate asset (eg, pledge on rent receivables, bank accounts, and insurance receivables); and
- potentially also parent guarantees.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

In principle, security over real estate can be granted to foreign lenders without restrictions, and payments can be made to them under security arrangements or loan agreements, as long as they do not provide regulated banking or investment services in Belgium without a licence or authorisation.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The granting of a mortgage on a real estate asset is subject to registration duties at a rate of 1% and a mortgage duty at a rate of 0.3%, calculated on the secured amount. In addition, mortgage register and notary fees will be due.

Mortgages are usually granted on a limited percentage of the secured amount in combination with a mortgage mandate (where costs are lower than those associated with mortgages) convertible into a mortgage in case of default on the remaining part of the secured amount.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Belgian companies are prohibited from advancing funds, granting loans, or providing security

with a view to the acquisition or subscription of their own shares by a third party (unless certain conditions are met) and transactions entered into by a Belgian grantor must fall within its corporate purpose and serve its corporate benefit.

3.6 Formalities When a Borrower Is in Default

In the event of a debtor's default, a lender can enforce its (validly established) mortgage. Enforcement of mortgages may only take place by sale of mortgaged assets at public auction or direct sale of pledged assets pursuant to procedures decided by the court. Lenders with valid security interests over the real estate asset will have priority, depending on their ranking, over unsecured lenders regarding the proceeds of the sale.

The timing for the enforcement of a mortgage varies, depending on the duration of court proceedings required for the verification of the claim and the formalities related to selling the asset but may easily take up to one year from the claim before the courts. Generally, the execution of the notarial deed of sale takes several months.

Enforcement of a security interest is not dependent on the debtor's insolvency.

Bankruptcy proceedings can delay the enforcement of security. Although the lenders in principle retain the right, in the case of bankruptcy of the debtor, to initiate or continue proceedings, any enforcement procedure is automatically suspended for a maximum period of 60 days while creditors' claims are checked. Enforcement procedures by the lenders may be suspended by the court, at the request of the receiver, for a period of up to one year from the declaration of insolvency to allow the receiver to proceed with the sale by court order.

In judicial reorganisation proceedings (a corporate rescue procedure), all enforcement measures will be suspended during the moratorium declared by the court (for a period of up to four months, which may be extended, under certain circumstances, up to a maximum of 12 months).

3.7 Subordinating Existing Debt to Newly Created Debt

A creditor can agree to contractually subordinate existing secured debt to newly created debt through a subordination or intercreditor agreement.

Furthermore, should the debtor enter into insolvency proceedings, the pre-existing secured debt may become subordinate to claims of certain privileged creditors (in particular bankruptcy proceeding debts (debt of the estate) – eg, the costs of managing the estate).

3.8 Lenders' Liability Under Environmental Laws

As a principle, lenders do not bear liability for environmental damages or infringements of environmental legislation incurred by the borrower (see **2.7 Soil Pollution or Environmental Contamination**).

3.9 Effects of a Borrower Becoming Insolvent

In principle, a validly granted and perfected security interest cannot be declared void in the event of the insolvency of the borrower.

However, new security granted in respect of pre-existing debt may be declared ineffective against third parties if concluded or performed during a so-called "hardening period" before a bankruptcy judgment.

The cessation of payments (a condition for filing for bankruptcy) is deemed to have occurred as of the date of the bankruptcy order. However, the court issuing the bankruptcy order may determine that the cessation of payments occurred at an earlier date (but not earlier than six months before the date of the bankruptcy order). The period from the date of cessation of payments up to the declaration of bankruptcy is referred to as the "hardening period".

The rules regarding the hardening period do not apply in case of judicial reorganisation.

In case of the opening of a judicial reorganisation procedure, during the moratorium, no enforcement measures with respect to pre-existing claims in the moratorium may be continued or initiated against any of the debtor's assets. The debtor cannot be declared bankrupt, nor can its business be wound up by court order.

3.10 Taxes on Loans

See **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security** for the (registration) fees relating to the granting of mortgages. No taxes or fees (other than a stamp duty of EUR0.15 per original of certain finance documents drafted and/or signed in Belgium) are payable by the lender or borrower in connection with the entry into of loans.

No withholding tax is payable on interest on loans paid to a financial institution by a borrower.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Zoning plans (at the regional, provincial and local levels) have been adopted by the authorities. These plans specify the authorised use or destination of a plot of land and include specific zoning prescriptions.

Each region has adopted its own instruments, under different names and with varying degrees of binding authority.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The construction of new buildings, as well as modifications to the exterior appearance or structural elements of existing buildings and, in some cases, change in destination require a building permit. The proposed construction and modifications are assessed by the permitting authority during the application procedure based on compliance with the applicable legislation (including zoning plans) (ie, legality check) and the integration/impact on the neighbourhood and the environment (ie, proper special planning check).

4.3 Regulatory Authorities

Local municipalities where plots of land are located have the authority to issue development/renovation permits. For certain projects (eg, projects located on multiple municipalities, projects of public authorities/public importance), this responsibility is transferred to either the provincial or regional level (in the Flemish region) or the delegated officer (in the Brussels Capital region and the Walloon region). They examine compliance with the applicable zoning plans, consult

various advisory bodies, assess the impact of the proposed project on its surroundings and may impose the permit holder conditions and/or charges (amount to be paid to the local authority, works to the benefit of the community) to compensate the negative impact a project may have on its surroundings.

4.4 Obtaining Entitlements to Develop a New Project

The developer must submit a permit application to the relevant authority which, depending on the type and/or size of the project, will include an environmental impact assessment.

Once the application is declared admissible and complete, the authority must examine the request within a binding timeframe, seek advice from various authorities and, if required due to the type and/or size of the project, conduct a public inquiry to allow interested third parties to submit their objections. The duration of the procedure varies, spanning from two to three months up to half a year, depending on the complexity and nature of the permit request.

4.5 Right of Appeal Against an Authority's Decision

The permit applicant, the relevant authorities and interested third parties have the right to appeal a decision related to the granting of a permit. Depending on the region and the appealing party, such appeals must be initiated through administrative procedures with governmental bodies or through jurisdiction procedures with the Council of State (Brussels Capital and Walloon region) or the Council for Permit Disputes (Flemish region).

4.6 Agreements With Local or Governmental Authorities

The permit applicant may negotiate agreements with local or governmental authorities provided that public procurement rules and general rules on transparency and equality are followed. Transfers of real rights and/or the obtaining of an occupation right on neighbouring plots of land are often negotiated with the local authority and/or utility suppliers to allow the execution of projects.

4.7 Enforcement of Restrictions on Development and Designated Use

If permit conditions are breached or construction works lack authorisation, sanctions may include administrative actions like stop or modification orders, site restoration, and administrative fines. Severe breaches can lead to criminal proceedings. Interested third parties can also seek damages through civil claims for unauthorised works, potentially resulting in premises restoration or financial compensation.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The preferred corporate vehicles for holding real estate are:

- the public limited liability company (SA/NV); and
- the private limited liability company (SRL/BV).

Additionally, the use of limited partnerships (Scomm/CommV) is also common for holding real estate. Limited partnerships are structured with two categories of partners:

- the general partner(s), which bear(s) unlimited liability for the entity's obligations; and
- the limited partner(s), whose involvement is restricted to their contributions and which may not participate to the management of the company.

Belgian law also encompasses a variety of investment fund regimes. Since the establishment of its dedicated regime in 2016, the "*Fonds d'Investissement Immobilier Spécialisé (FIIS)*"/"*Gespecialiseerd Vastgoedbeleggingsfonds* (GVBS)", a specialised real estate investment fund (SREIF), has become a prominent structure for real estate investments. It should, however, be noted that SREIFs' investments are limited by a list of allowed investments defined by law (including, amongst others real rights on properties located in Belgium and abroad and shares of companies and investment vehicles active in real estate investments, subject to conditions).

The shares of a SREIF can only be offered to investors eligible by law (such as institutional or professional investors, including investors registered with the Belgian financial services and markets authority).

SREIFs must be incorporated subject to a set duration of ten years, although their articles of association may allow the shareholders to vote on extensions in increments of up to five years each.

SREIFs are distinguished by certain features specific to their legal framework, including (but not limited to):

- mandatory registration with the Ministry of Finances' list of SREIFs;
- IFRS-compliant preparation of annual financial statements;
- a requisite distribution of 80% of net results, which generally triggers withholding tax for the shareholders, although relevant double taxation treaty provisions may apply;
- SREIFs may, in principle not act as real estate developers (except if such activity is carried-out on an occasional basis);
- specific mandatory reporting obligations (such as a specific annual financial report and information document for the shareholders);
- mandatory annual valuation of the net asset value of the SREIF's shares; and
- SREIF's real estate portfolio must reach a minimum valuation of EUR10 million by the close of the second financial year subsequent to their registration.

A specific tax regime, detailed in **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**, applies to SREIFs.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The incorporation of Belgian corporate entities essentially requires a notarial deed. This requirement applies to both public limited liability companies and private limited liability companies whereas limited partnerships can be incorporated by a private agreement among founding partners (without notarial deed). For the incorporation of both limited and public limited liability companies, founders must also communicate a financial plan over a two-year horizon to the notary (amongst other information and KYC documents).

In terms of real estate ownership, there are no specific tax incentives. Excluding specific tax regimes, such as the one applicable to SREIFs (which is detailed in the paragraphs below), Bel-

gian companies are in principle subject to a corporate tax rate of 25%. A reduced rate of 20% on the first EUR100,000 of taxable income may be available to small and medium-sized enterprises, subject to conditions.

SREIFs benefit from a derogatory tax regime. SREIFs taxable base is essentially limited to "abnormal and benevolent" advantages and various disallowed expenses. Rental income and capital gains are in principle not subject to taxation.

A specific "exit tax" (at a rate of 15%) is applicable and triggered upon the subscription of an existing company to SREIFs' official list (such as via conversion of an existing company, merger, demerger or contribution) on unrealised capital gains (and, potentially, untaxed reserves). This tax is also due if a SREIF acquires properties through corporate restructuring (eg, a merger with a public limited liability company).

SREIFs are also subject to an annual "subscription" tax levied on collective investment entities at a rate of 0.01% on the total net assets placed in Belgium.

5.3 REITs

An alternative investment structure to SREIFs is the "*société immobilière réglementée*"/"*gereglementeerde vastgoedvennootschappen" (commonly referred to as the* "Belgian REIT", or B-REIT).

These entities, designed for long-term investment and risk diversification fall into three distinct categories.

- The "public" B-REIT, financed by the public (notwithstanding other financing methods), with their shares mandatorily listed on a regulated market.
- The "institutional" B-REIT, which can only be financed by eligible investors or individuals (on the condition that their subscription or purchase price is at least EUR100,000) – more than 25% of the share capital of an institutional B-REIT must be held, directly or indirectly by a public B-REIT.
- The "social" B-REIT, whose operations must be dedicated to real estate necessary for the social sector and housing for individuals, amongst other conditions.

B-REITs are incorporated for an unlimited duration, must adhere to a minimum capital requirement of EUR1.2 million and are subject to an approval from the Belgian financial services and markets authority. Their main activity must be the purchase of real estate assets (directly or indirectly) or construction and renovations of real estate assets in view of the occupation by users or the direct or indirect holding of shares in entities with a similar activity. B-REITs are also allowed to participate in various categories public-private partnerships and to participate in energy, fuel, water and waste sectors projects. B-REITs are also notably forbidden to act as real estate developers and B-REITs' investments are limited by a list of allowed investments defined by law.

The tax and accounting framework for B-REITs has similarities with the one applicable to SREIFs: B-REITs must prepare their annual accounts in accordance with IFRS standards, and their taxable income essentially comprises "abnormal and benevolent" advantages received and various disallowed expenses. B-REITs are also subject to a distribution obligation, requiring them to annually distribute 80% of a portion of their income, as defined by a particular formula.

Due to their specific regime, B-REITs are also subject to specific governance and information obligations (including periodical valuation of public B-REITs' assets and publication of specific annual and biannual financial reports), as well as various consequences if the debt ratio, as defined by law, of a public B-REITs reaches thresholds provided in the law.

From a tax perspective, B-REITs are also subject to an "exit tax" as well as an annual subscription tax on their Belgian net assets (at a rate of 0.0925% for public B-REITs) (see **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**).

The remainder of this publication will focus on SREIFs' regime, with the understanding that numerous legal principles governing SREIFs are also applicable to B-REITs.

5.4 Minimum Capital Requirement

Public limited liability companies must maintain a minimum share capital of at least EUR61,500. This obligation does not extend to private limited liability companies and limited partnerships.

5.5 Applicable Governance Requirements

The governing body of public limited liability companies may be structured in one of the following ways:

- a single director, who can be made jointly liable for the company's commitments;
- a board of directors, composed of at least three members (or two if the company has fewer than three shareholders); and
- a dual-board system featuring a management board overseen by a supervisory board.

Private limited liability companies are characterised by greater flexibility in their management structure, which can include:

- a lone director;
- multiple directors with either individual or collective full decision-making authority; or
- a board of directors.

The Belgian Code of Companies and Associations does not prescribe detailed rules for managing limited partnerships, but limited partners may not be involved in the management of the limited partnership.

The directors are generally entrusted with most of the decision-making responsibilities, except for certain powers reserved by law for the shareholders' meeting (eg, ratifying the annual accounts and making decisions regarding share capital and corporate restructuring activities). Directors can usually be either individuals or legal entities (with a natural person permanent representative).

The day-to-day management can be delegated by the directors to either a director (a "delegated director") or a third party. Listed companies are subject to additional governance obligations.

Finally, investment entities such as SREIFs that meet the criteria specified by law might be required to appoint a licensed manager (with the necessary approvals from the financial services and market regulator) tasked with fulfilling the obligations laid out in the legislation governing alternative investment funds.

5.6 Annual Entity Maintenance and Accounting Compliance

The expenses associated with accounting compliance can vary significantly, depending on sev-

eral factors, including the specific legal structure chosen for holding property, the volume of assets held by such entity and the nature and quantity of agreements in force with respect to these assets (for example, leases, maintenance contracts, etc). Accounting obligations entail, among others, the filing of yearly financial statements (which must be approved by the general meeting of the shareholders).

Additionally, if the entity meets the criteria for having to appoint a statutory auditor (or decides to opt-in for the appointment of such auditor), a specific annual report on the annual accounts will be prepared by them annually. The fees for these accounting services, including those for external accountants and company auditors, are generally in the range of EUR20,000 to EUR40,000.

With respect to SREIFs, an annual financial report must be drafted by the SREIF and communicated to its shareholders, which must include the statutory accounts, a table detailing the cash-flow flux, the statutory auditor's reports as well as various mandatory analysis with respect to the accounts and operations. Such requirements, including the appointment of a licensed manager if the SREIF meets the relevant legal requirements, can increase the accounting and compliance costs of the SREIF, which can be above EUR75,000.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

There are two types of limited-duration real estate use rights:

- property rights (eg, long-term leases/rights to build); and
- personal rights (eg, lease agreements).

6.2 Types of Commercial Leases

Business premises can be leased via a retail lease (in case of direct contact with clients), regulated by the 30 April 1951 law and regional decrees (essentially composed of imperative provisions), or a common law lease for other uses such as offices, covered by the Civil Code (with generally suppletive provisions).

6.3 Regulation of Rents or Lease Terms

Lease terms, including rental arrangements, are usually negotiable (but will depend on the business activities carried-out in the premises). Common law leases (eg, office leases) often include clauses to prohibit retail activities in the premises in order to avoid the application of the mandatory retail lease law.

Fixed rent, typically indexed annually, is common in Belgium, but variable rent (with a guaranteed minimum) based on turnover is often used for hotels, shopping centres, and some food and retail businesses. Temporary contractual rent reductions or exemptions can also be arranged between the parties.

6.4 Typical Terms of a Lease

Length of Lease Term

Retail leases have a minimum nine-year term with triennial termination rights granted to tenants (and, sometimes, to the landlord) as well as up to three renewal options. Special "pop-up" retail leases (regulated at the regional level) offer shorter terms. Common law leases require no specific duration but cannot be perpetual. For third-party enforceability, all leases must be registered and leases over nine years also require execution in the form of a notarial deed.

Maintenance and Repairs

With respect to both retail and common law leases, the Civil Code essentially limits tenants responsibility to minor rental maintenance and repairs but leases often transfer more maintenance and repairs responsibilities to tenants, making landlords responsible only for major repairs (eg, structure, roof, etc). Belgian leases commonly adopt usufruct rules, making tenants liable for most maintenance and repairs, subject to normal wear and tear and dilapidation, while landlords are mainly responsible for major repairs on the structure of the property and its inherent components.

Inventory of Fixtures

An inventory of fixtures is usually drawn up before the commencement date of the lease to establish the original condition of the premises, which is used to assess any damages to the premises and the tenant's liability and repairs/payment obligations in that respect at the end of the lease. In the absence of such inventory, proving damages caused by the tenant is challenging for the landlord, as the tenant will then be presumed to have received the premises in the end-of-lease condition.

Guarantee

Parties commonly agree on a guarantee provided by the tenant as security for its payment and other obligations, such as a first demand bank guarantee, parent company guarantee, or cash deposit, often set at six months' rent.

Force Majeure and Hardship

During the COVID-19 crisis, tenants used force majeure as an argument to seek rent reductions or exemptions with mixed success, arguing that government restrictions suspend landlords' obligations to provide premises, causing the tenant to be relieved of its obligation to pay the rent.

The hardship principle, now enshrined in the civil code (under suppletive provisions), allows for contract renegotiation or court intervention (leading to adaptation or termination of the agreement) when unforeseen circumstances cause the performance of an agreement to become excessively onerous for a party.

Post-COVID-19, real estate contracts frequently include specific force majeure and hardship clauses, deviating from standard civil code provisions.

Rising Use of Green Clauses

Landlords are increasingly incorporating "green clauses" into their standard leases, requiring tenants to use energy-efficient materials in their fit-out works, disclose energy usage, and adhere to other environmentally sustainable practices.

6.5 Rent Variation

Leases often include an indexation clause allowing annual rent adjustments based on an index and formula determined by (imperative) law. However, as a commercial gesture, the landlord may waive indexation, for a specific period of time or for the entire duration of the lease. See **6.6 Determination of New Rent** for retail rent specifics.

6.6 Determination of New Rent

Indexation

See **6.5 Rent Variation**.

Renewal of Commercial Lease

Under the retail lease law, tenants can request rent reductions or other lease modifications in the context of the renewal process. In the absence of agreements, a judicial proceeding is provided by law, pursuant to which the Judge of the Peace will decide on the adapted lease

conditions (including rent), usually guided by the parties' arguments and independent valuations.

Additionally, at the end of every three-year period, either party can seek before the courts a rent review if the property's rental value has shifted by at least 15% from the current rent due to new circumstances.

6.7 Payment of VAT

Payment of VAT

The leasing of immovable property is usually a VAT-exempt activity, unless the VAT option provided in the VAT Code is applied, which is subject to the following conditions (amongst others):

- the building must be used for the economic activity of the tenant;
- the leased premises are (parts of) a new/substantially renovated building (ie, buildings for which VAT on construction or refurbishment cost became due for the first time on 1 October 2018 at the earliest); and
- the option will apply for the entire duration of the lease.

However, leases for specific properties such as parking spaces and storage units generally incur VAT, but exemptions may apply. Additionally, VAT also applies to short-term leases under six months (with exceptions, eg, residential leases) and to other arrangements such as hotel accommodation or "service/business centre" which include services (cleaning, maintenance, furniture, printers, meeting rooms, etc) in addition to premises made available (such as offices).

6.8 Costs Payable by a Tenant at the Start of a Lease

Inventory of fixture – if both parties decide to appoint a professional, such as a land surveyor, to draft an inventory of fixtures, the costs thereof are usually split equally. Alternatively, each party may hire their own expert to collaborate on the inventory of fixture.

Insurance – tenants are usually required to have insurance to cover risks such as fire and water damage as well as their fit-out works. Landlords sometimes also require additional risk coverage from the tenant (such as operational losses).

Registration duties – at the start of the lease, the tenant is usually required to pay the registration duties of the lease.

Entry fee – in the context of retail leases, an entry fee is sometimes contractually agreed between the tenant and the landlord (or between the transferee and transferor of a lease).

Guarantee – see **6.4 Typical Terms of a Lease**.

6.9 Payment of Maintenance and Repair

Retail and common law leases usually assign maintenance and repair costs to the tenant, except for major repairs. In multi-tenants properties, the landlord usually enters into maintenance and repair agreements for the common areas, which are re-invoiced to the tenants in proportion to their occupied space.

6.10 Payment of Utilities and Telecommunications

Tenants are usually responsible for arranging their own connections to utilities and communication services.

6.11 Insurance Issues

Even if there is, in general, no statutory obligation to take out insurance, two types of insurance are usually required in lease agreements.

- Building insurance – landlord insurance typically covers property damage from events such as water damage, vandalism, or fire. The insurance premiums are often re-invoiced to the tenants as part of the service charges.
- Tenant's insurance – such insurance covers the tenant's business operations and civil liability, as well as any personal fixtures and furnishings. It has been observed that insurance policies covering business interruption have standard exclusions for events such as the COVID-19 pandemic, which could prevent the tenant to claim compensation for interruptions caused by such exclusions.

Should the tenant plan to carry-out fit-out works on the premises, the landlord may require the tenant to take out all-risk construction insurance.

It is also common that the parties agree that the insurance agreements include waiver of recourses provisions.

6.12 Restrictions on the Use of Real Estate

The premises' use by the tenant is agreed upon by the parties. The importance of the specified use of the premises extends beyond the lease, as it may affect a range of matters regarding the property and the landlord, such as taxation considerations and compliance with environmental law and zoning regulations.

6.13 Tenant's Ability to Alter and Improve Real Estate

Common Law Lease

Parties usually agree that tenants can carry-out reversible alterations works to the leased premises, with stipulations often allowing landlords to keep or require removal of changes post-lease, sometimes compensating the tenant or not, depending on the agreement's terms and ensuring that, if irreversible alterations are made without the landlord's consent, the landlord is entitled to request their removal at the tenant's costs or to retain them without compensation to the tenant.

Retail Lease

Under the retail lease law, tenants have the right to alter and improve the premises to suit their operational needs, provided that:

- they notify the landlord of the project (who can only object on valid grounds);
- the total costs do not exceed three years' rent;
- the structure of the property is not permanently altered; and
- the works do not affect the safety, the aesthetic value or the health aspects of the property.

6.14 Specific Regulations

In conjunction with the retail lease law and regional ordinances, parties to a lease agreement must comply with the broader legal framework governing leases (such as Civil Code provisions). With respect to residential leases, regional regulations govern the use of properties for natural persons' occupation, including their primary residence.

6.15 Effect of the Tenant's Insolvency

Lease agreements often include clauses mandating prompt notification from one party to the other upon the initiation of insolvency proceedings and granting the other party the right to terminate the lease under these circumstances. The enforceability of such termination clause depends on various factors, including the type of insolvency procedure – for instance, clauses that allow termination solely because the tenant has sought judicial restructuring are expressly pro-

hibited, whereas such restriction does not apply in the case of bankruptcy proceedings (subject to limitations, as express resolutive clauses are forbidden in lease agreements).

Usually, tenant's bankruptcy does not cause the lease to end automatically and landlords have to file a statement of their claims. In the absence of specific contractual provisions, the receiver usually decides on lease termination, but may also decide to continue its performance (eg, if he seeks a buyer for the tenant's business). In case of judicial reorganisation proceedings initiated by the tenant, the latter may request a moratorium, during which it is no longer possible for creditors to use means of execution. In such context, matured debts (including outstanding rents prior to the reorganisation proceedings) are frozen during the moratorium. New debts, including rents accrued following the opening of the judicial reorganisation proceedings are in principle not affected by the moratorium.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is a common practice for landlords to obtain a rental guarantee from tenants, as mentioned in **6.4 Typical Terms of a Lease**.

Furthermore, landlords are given a statutory privilege against other creditors over the tenant's movable assets located within the leased premises, providing the landlord with additional security in the event of a default by the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

When a common law lease expires, it is automatically terminated, and the tenant is not entitled to remain in the premises, unless otherwise agreed.

For retail leases, if a tenant without renewal rights remain in occupancy of the leased premises at the lease expiry, a new lease tacitly enters into force for an indefinite duration, which may be terminated by the landlord with at least 18-months' notice, without affecting the tenant's right to request renewal.

6.18 Right to Assign a Leasehold Interest

In common law and retail leases, tenants can sublease or assign their rights under their lease to third parties, unless restricted by agreement. To prevent adverse effects for the landlord, leases often state that the landlord's prior consent to the sublease or assignment is required.

In retail leases, clauses restricting the transfer of the lease are unenforceable if the assignment or sublease occurs in conjunction with a business transfer, unless the landlord or their immediate family members reside in (a part of) the building. Formal procedures must be followed for such transfers.

6.19 Right to Terminate a Lease

Leases may be terminated prior to their natural expiry either by the landlord or the tenant under conditions agreed between parties (subject to exceptions provided in the law) or by mutual consent.

Common law leases often allow early termination in case of a change of control of a party, transfer of the property/leased premises and force majeure events. Partial destruction of the premises usually lead to rent reduction or lease termination.

Retail leases can be early-terminated at the end of each triennial period:

- by landlords (provided that such right is stipulated in the lease), with at least one-year notice, and under condition that the landlord or close family members will operate (potentially through a company) a business in the property; and
- by tenants upon expiry of each three-year period, subject to a six-months' notice.

In case of early termination of a retail lease by the landlord, the landlord will not have to indemnify the tenant, unless they conduct the same business in the premises. If so, the landlord must pay two years' rent as compensation (and three years' rent in the absence of disclosure of this information).

6.20 Registration Requirements

In retail or common law leases, lease registration may be the landlord's or tenant's responsibility, but the registration duties (ie, 0.2% of total rent and charges to be paid for the duration of the lease) are usually borne by the tenant. Leases over nine years or with a discharge of three years of rent require a notarial deed and mortgage registration.

Failure to comply with these formalities may cause the lease to be unenforceable against third parties who, in good faith, claim an ownership interest in the leased premises.

6.21 Forced Eviction

landlords seeking to evict their tenant on the basis of a contractual breach must initiate a claim before the justice of the peace. The process may last several months, especially if tenants claims the landlord's request is unjustified, for instance, if they remedied the breach before the hearing, potentially leading to debates.

6.22 Termination by a Third Party

There is no such thing as a termination of a lease by a third party in Belgium, except in case of expropriation (by a public entity), which may lead to a claim for indemnity by the tenant.

6.23 Remedies/Damages for Breach

Remedies for lease breaches often involve financial compensation, enforcing lease obligations, retention of rental guarantee, or lease termination. In case of termination, leases (and court decisions confirming the termination) usually define principles on property reinstatement, occupation indemnity, and other potential financial compensations.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Architects and main contractors usually enter into agreements with a fixed price model, based on specific assumptions such as the projected surface area of the project. To account for unexpected changes and ensure costs reflect actual expenses, adjustments to the fixed price are usually contractually defined to protect involved parties (such as the contractor or the architect), covering hypothesis such as additional research or project alterations due to permit requirements, including termination rights. Alternatively, parties sometimes agree on a price model with set minimum and maximum limits.

Payment schedules are usually milestone-based, aligning with significant project stages such as design approval or delivery phases, or can be structured around regular monthly or quarterly invoicing that reflects actual costs incurred.

Payments schedules are typically structured in instalments based on project phases (milestones) such as the final design, provisional delivery and final delivery. Alternatively, invoicing may occur on a monthly or quarterly basis, reflecting the actual expenses incurred during said period.

7.2 Assigning Responsibility for the Design and Construction of a Project

Architects are usually responsible for the project's design, assisting in obtaining building permits, required for construction and (in some instances) demolition of significant structures, and also tasked to oversee the project's implementation. An engineering consultant might contribute to studies and design. The main contractor handles project execution, often hiring subcontractors with no direct contractual relationship with the employer. A safety co-ordinator is sometimes appointed, and in certain cases, legally required, to mitigate the risks of workplace accidents.

7.3 Management of Construction Risk

The parties may agree on a two-stage work delivery: provisional and final acceptance. Provisional acceptance occurs when works are free of (visible) defects, aside from minor issues ("punch items") not hindering the property's use. The employer arranges acceptance visits with the main contractor, possibly with the architect and technical advisors present, to inspect and ensure the works meet the agreed contractual standards.

If no or only minor defects are identified, parties will approve the provisional acceptance, listing any issues for the contractor to remedy, and draft provisional acceptance minutes. This milestone causes the handover and acceptance of the property in its visible condition, with unreported visible defects considered accepted and not claimable later, unless specific warranty provisions state otherwise. After provisional delivery, the contractor remains liable for defects remediation during the (contractually agreed) defects liability or warranty period(s), as well as for structural defects under the statutory ten-year liability (see below). Defects in relation to technical equipment (HVAC, lifts and other) are often subject to a two-years warranty period (and one year for other defects).

Following remediation of minor defects from provisional acceptance and defects identified within the contractually agreed warranty period, the parties will proceed to the final acceptance of the works. Typically, one year, or two years for special techniques, will expire after provisional acceptance to enable the employer to uncover any (hidden) defects and verify the remediation of minor defects/issues before granting final acceptance.

The contractor is also liable for hidden defects discovered after final acceptance, subject to a ten-year statute of limitation post-final acceptance. Claims in that respect must be reported within a "reasonable period" upon discovery, which will be assessed by the courts on a case-by-case basis. This liability can be adjusted (usually limited) by contract.

Furthermore, following final acceptance, the employer also remains protected by a specific mandatory ten-year liability provided for in the Civil Code and pursuant to which the architect and stability engineer (and potentially other technical study contractors) are liable for hidden or apparent defects affecting the structural soundness of the building. This liability starts from the construction's acceptance, typically final

acceptance, but agreements often stipulate that it will start from provisional acceptance.

This safeguard also applies to future owners since the ten-year liability is linked to the property itself, rather than to the individual buyer or employer.

The aforementioned division between provisional and final acceptance is mandatory if the Breyne Act applies, ie, for agreements concerning residential buildings to be built or under construction. In that case, the warranty period should entail at least one year.

Constructions involving technical installations, such as solar panels or a cogeneration installation, will usually also benefit from contractually stipulated performance guarantees ensuring, for example, a minimum output or functionality during an agreed period of time.

7.4 Management of Schedule-Related Risk

Contractual agreements generally address the consequences of delays attributable to the architect/contractor, including late delivery penalties, time extensions, contractor/architect substitution or termination. Contracts often exempt the architect/contractor from liability for third-party caused delays and address force majeure events by excluding or granting employer indemnification only if the delay extends past a certain timeframe.

For residential properties, the Breyne Act provides that the compensation must be at least equivalent with the property's standard rental value upon completion.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Construction agreements often stipulate that contractors must provide a bank-guaranteed performance bond to ensure work completion. The conditions for releasing or reducing the bond are negotiable, but typically involve reaching milestones (eg, a half release at provisional acceptance, and the rest at final acceptance). Alternative guarantees like parent company guarantees, letters of credit, performance guarantees, and insurance policies may also be negotiated. In cases where the Breyne Act apply (for residential properties), securities must be provided by contractor, the scope of which varying between accredited or non-accredited contractors.

7.6 Liens or Encumbrances in the Event of Non-payment

Construction and architect agreements usually include a default interest clause for late payments. Architects and contractors can also withhold performance their services in case of default of payment. They have also privileged creditor status on the increase in value of the employer's property resulting from their services.

Furthermore, contractors may also retain ownership of certain installations or materials, despite incorporation into the works, through retention of title registered in the national pledge register.

7.7 Requirements Before Use or Inhabitation

Depending on the specific use of the real estate asset and the region in which the real estate asset is located, several authorisations or certificates might be required, including with respect to the operation of certain classified activities or installations (eg, operation of parking, heating and cooling installations), the operation of

socio-economic activities (eg, retail activities), the energy performance certificates and asbestos inventories.

8. Tax

8.1 VAT and Sales Tax

VAT (at a standard rate of 21%) may be applicable to sales of real estate assets classified as "new" for VAT purposes (ie, until 31 December of the second year after its initial use or occupation). This classification applies to newly constructed buildings as well as those that have been substantially renovated. With respect to renovations, the VAT regime is largely determined by administrative practices.

Tax authorities have clarified in their commentary of the VAT Code that significant renovations that fundamentally alter the key components of a building, namely its nature, structure or intended use will qualify it as "new" for VAT purposes. A property can also be qualified as "new" if renovation costs, excluding VAT, amount to at least 60% of the building's market value, excluding land, upon completion of the works.

The imposition of VAT on the sale or acquisition of property is influenced by the nature of the seller. For new properties sold by:

- Professional developers – they are legally bound to sell such properties with VAT included. However, in cases of renovations meeting the "60%" threshold, developers might choose not to consider the real estate asset as new (with application of registration duties instead of VAT).
- Non-professional developers – they have the option to apply VAT, requiring amongst others a prior declaration to VAT authorities. The exercise of this option must be reflected in the sales agreement and in the notarial deed that records the sale.

Under certain conditions, a reduced rate of 6% may apply to residential properties.

8.2 Mitigation of Tax Liability

When transferring shares of a company that owns real estate, such transactions do not, in principle, incur transfer taxes or any other real estate-related taxes (except in case of dispute by the tax administration over tax abuse, see **2.10 Taxes Applicable to a Transaction**). However, a legal entity shareholder may be subject to capital gains tax if its participation in the company (that owns real estate) does not meet the criteria to be eligible for the "dividend received deduction" (DRD). To be eligible for the DRD, the participation must notably:

- relate to a company subject to corporate income tax;
- relate to shares representing at least 10% of the shares outstanding or having an acquisition value of at least EUR2.5 million; and
- be held during a continuous period of at least one year.

The purchaser of a SPV's shares indirectly bears future capital gains tax on the SPV's real asset(s) in case of sale of such assets post-closing. To mitigate this, the seller and the buyer of the SPV's shares usually share the "tax latency" (the corporate income tax that would be due in an asset sale) by adjusting the SPV's share price with a negotiated discount.

In asset deals, some investors opt for long-term leases or right to build over full ownership transfers, due to lower registration duties (see **2.10 Taxes Applicable to a Transaction**).

8.3 Municipal Taxes

Local and regional taxes, often apply to different property types, business activities and infrastructures, including vacant properties, offices, retail spaces, parking and telecom structures (eg, pylons/antennas), the latter being often disputed initiated by telecom operators and subject of political discussions.

Additionally, a yearly real estate tax ("*précompte immobilier "/" onroerende voorheffing*") is levied on all property categories.

Office and retail leases often provide that the tenant will bear these taxes.

8.4 Income Tax Withholding for Foreign Investors

Acquisition by Foreign Investors of a Special Purpose Vehicle Holding Real Estate or a SREIF/B-REIT

When foreign investors purchase shares in a company that serves as a special purpose vehicle (SPV) holding real estate, or in a SREIF/B-REIT, the income generated by the SPV, including rental income and capital gains, is subject to Belgian taxation (at the standard corporate income tax in Belgium), at the level of the SPV (subject to specific tax regimes, such as the SREIF/B-REIT's specific tax provisions and potential double tax treaty provisions which may apply). Dividends and potentially interest earned by foreign investors from the SPV will be taxed according to the relevant double taxation agreements.

Dividends can in principle qualify for a withholding tax exemption if the DRD criteria are met (see **8.2 Mitigation of Tax Liability**). If such an exemption is not applicable, a 30% withholding tax shall apply (a reduced rate may be available under certain conditions). Double taxation treaties may offer various mechanisms that can lessen the impact of double taxation of the payment of dividends or interests to investors by SPVs.

It is important to note that SREIFs are legally bound to distribute dividends on a yearly basis and the shareholders of SREIFs have no right (or only a limited right, subject to specific conditions) to benefit from the DRD exemption. These dividends are typically also subject to a 30% withholding tax, although this rate may be decreased through exemptions or reductions available under pertinent double taxation treaties. Furthermore, and in principle, Belgium does not levy a withholding tax on dividends distributed by a SREIF (or a B-REIT) to foreign shareholders, provided that the dividends do not come from Belgian dividends or Belgian real estate income.

Acquisition by Foreign Investors, Through a Non-Belgian Entity

Regarding acquisitions made through a non-Belgian entity, foreign companies are allowed to acquire ownership or real rights over Belgian properties. Here, the relevant double-tax treaties come into play, with the general principle being that rental income and capital gains are taxable in Belgium at the ordinary corporate income tax rate.

8.5 Tax Benefits

Belgian law does not provide specific tax benefits granted with the ownership of real estate in Belgium. Usually, the ownership of real estate properties can be subject to amortisation, which will be tax deductible. There is, however, no amortisation on land.

Trends and Developments

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Linklaters is a leading global law firm, supporting clients in achieving their strategies wherever they do business. The firm uses its expertise and resources to help clients pursue opportunities and manage risk across emerging and developed markets around the world. In Belgium, Linklaters has a presence dating from 1969 and offices in both Brussels and Antwerp. The construction practice is part of the real estate practice, which has been organised in a unique way, offering an integrated one-stop approach combining all areas of relevance for real estate development and transactions. The team includes specialists in real estate M&A, real estate investment, real estate finance, projects and project finance, public law, construction, environment, planning/zoning, tax, real estate funds, capital markets derivatives and structured finance, construction and real estate disputes, and energy. This enables the real estate practice to perform market-leading international projects and deal from origination to financing and on to securitisation/capital markets.

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Ongoing Recodification of the Belgian Civil Code

Belgium is currently undergoing a significant legal transformation with the recodification of its Civil Code. This reform aims to modernise and consolidate the legislative framework, ensuring it is adapted to contemporary societal needs and legal practices. During the past few years, the real estate sector was deeply impacted by these changes – for example, with the update of Belgian property law, which entered into force on 1 September 2021 and is known as Book 3, and the more recently introduced Book 5 (on obligations), which entered into force on 1 January 2023. Coming next on the legislative agenda is Book 6 (concerning extracontractual liability), which the legislator aims to bring into force by 1 January 2025.

Contract law reform

Reform of the obligations regime of the Belgian Civil Code

A few novelties of Book 5 (on obligations) of the Civil Code are as follows.

- The introduction of hardship – the concept of hardship was previously rejected by the Belgian courts and, following the entry into force of Book 5, is now specifically recognised under Belgian law. Hardship cases occur where the performance of an obligation becomes excessively burdensome owing to unforeseen events. The legal provisions with regard to hardship allow for the renegotiation of contractual terms when events substantially alter the balance of the agreement, rendering obligations disproportionately onerous for one party. If the parties fail to reach a new agreement, the issue may be brought before the courts with jurisdiction, which can modify the contractual obligations to re-establish balance or terminate the agreement.

Previously, hardship was not accepted by the Belgian courts – although applied in public procurements, contracts governed by the (Vienna) Convention on Contracts for the International Sale of Goods and sometimes in arbitration proceedings.

The hardship provision is of suppletive law. As expected by various legal practitioners, it is not unusual to see clauses modulating, derogating or excluding the application of the hardship provisions in real estate agreements (including leases, construction agreements and transfer of ownership and real rights).

- The introduction of anticipatory termination and extrajudicial termination by notification – under Book 5, the Civil Code formally introduced the possibility for contracting parties to unilaterally terminate a reciprocal agreement by a mere notification (ie, without the need to go to a court) if the other party's non-performance is sufficiently serious.

Furthermore, the Civil Code also grants the option to terminate a contract before the actual due date of an obligation if the creditor reasonably expects that the other party will not fulfil this obligation within the agreed timeframe. This termination for anticipatory breach is subject to conditions and can occur only under exceptional circumstances.

In addition to the foregoing, the reformed contract law regime offers various new (or codified jurisprudential creations of) sanctions and remedies against a non-performing debtor (including unilateral extra-judiciary price reduction, substitution of the non-performing debtor, termination for (anticipated) non-performance, and the right to withhold performance).

- A disclosure obligation in the pre-contractual phase – Book 5 further codifies that during contract negotiations, all parties are required to disclose information as required by law, good faith, and customary practice. This obligation varies based on the parties' roles and expectations, as well as contract subject. In real estate transactions, for instance, professionals face stricter disclosure requirements than consumers (who are further protected by consumer laws). Specific legal disclosures, such as energy performance certificates, soil certificates and urban planning information, must also usually be provided in the context of asset deal transactions.

Extracontractual liability reform

A major cornerstone of the Civil Code reform is the recent approval of Book 6, which delves into the complexities of extracontractual liability. It is expected that the upcoming Book 6 will transform the six articles of the "old" Civil Code that constitute the current subject matter of the extracontractual liability legal regime in Belgium into a structured compilation of six comprehensive chapters.

A notable amendment introduced by Book 6 is the possible concurrence that will exist between contractual and extracontractual liability. In case of concurrence between extracontractual liability and contractual liability, the claimants will have the right to choose which of these two legal bases they will retain as foundation of their legal action. Such concurrence will be permitted between parties to a contract unless otherwise stated by the law or the contract. It is expected to become a common practice to add opt-in/opt-out clauses for concurrent liability regimes in real estate agreements, including in contracts that are currently being negotiated in anticipation of Book 6.

Additionally, one of Book 6's important changes concerns the abolition of the current regime of (quasi-) exemption from responsibility of "auxiliaries" (ie, in the majority of cases, subcontractors, directors, employees, and service providers) against the action of their principal creditor's co-contractor, as a co-contractor currently may not exercise any claim against such auxiliaries on a contractual basis nor an extracontractual one – except in various, limited cases, such as a purely extracontractual fault causing damages that are distinct from the ones relating to the breach of the agreement.

The draft Book 6 intends to amend the current regime and to allow claimants, acting as principal creditors, to exercise extracontractual claims against auxiliaries (such as subcontractors). This modification of the current well-established legal regime would consequently allow the principal creditor (eg, the owner of a property) to introduce contractual claims against the debtor (such as a company appointed to carry out renovation works in such property) and extracontractual claims against the auxiliaries. In order to mitigate the potential impact of the new regime, the auxiliary will be allowed to use the exemptions, exonerations and other means of defences included in the contract between the principal creditor and the principal debtor as well as in its own agreement with the principal debtor. This amended provision could consequently have a substantial impact – including in the insurance domain – on construction law, given the extensive use of subcontractors in the context of the performance of construction projects.

As regards liability for the act of another, the current draft of Book 6 formally states an objective liability principle for the principal (*commettant*/*aansteller*) in the event of harmful consequences caused by a fault (or any other source of liabil-

ity) by their appointee (*préposés/aangestelden*) to third parties during and on the occasion of the exercise of their duties. A new provision clearly defines the principal as someone exercising authority and supervision on their own behalf with regard to the actions undertaken by an appointee. A similar provision also applies the same principle for legal persons (eg, companies and associations): Book 6 provides that legal entities are liable for harmful consequences caused to third parties as a result of a fault (or any other source of liability) by the governing bodies (or the members of such governing bodies) during and on the occasion of the performance of their duties.

Book 6 further introduces a new article on the liability for defective goods which may impact the real estate sector in Belgium. The article of the old Civil Code that sets out a specific liability regime for harmful consequences caused by the ruin of a building disappears to be integrated into a new provision on defective things. Henceforth, the draft Book 6 sets out an objective liability regime of the "keeper" of defective goods. Under the new regime, the keeper is defined as someone with factual power of direction and control (that is not subordinated) over the defective (physical) thing. The draft Book 6 also encompasses a rebuttable presumption that the owner of the defective good is its keeper.

Increase in Registration Duties for Long-Term Leases and Right-to-Builds

From 1 January 2024, the registration duties (transfer tax) rate applicable in the event of granting long-term leases or right-to-build rights increased from 2% to 5%.

Additional Tax for Real Estate Investment Funds

As of 1 January 2024, a tax at a rate of 10% – in addition to the ordinary exit tax of 15% due (notably) upon entering the Specialised Real Estate Investment Fund (SREIF) regime – will be due if an SREIF ceases to be mentioned in the list published by the Ministry of Finances before the end of an uninterrupted period of at least five years.

Furthermore, a tax at a rate of 10% shall also apply if shares in the SREIF acquired following a contribution in kind of a real estate asset (or a branch of activity) in the SREIF are transferred before the end of an uninterrupted period of five years.

Preference Right for Residential Tenants in the Brussels-Capital Region

On 27 December 2023, an ordinance amending the Brussels Housing Code was adopted in the Brussels Capital-Region. This ordinance introduces a preference right for tenants whose main residence is offered for sale. The preference right will be granted to the tenant, domiciled in the residential property to be sold, as well as their spouse, legal or factual cohabitant, or the descendants or adopted children of their spouse or cohabitant (provided that they are also domiciled in that property).

The preference right will only apply for leases with a long-term duration (more than three years) – intended for main residence purpose – and if the sale does not fall within the grounds for exclusion provided by law. Such exclusion grounds, pursuant to which no preference right shall be granted, are notably constituted by the event of a sale:

- to family members (up to the third degree) or cohabitants;
- of the bare ownership, usufruct right or any other rights in rem as well;
- of the leased premises in the context of a sale of a building (including multiple housing units) occupied by different tenants;
- of residential properties following mergers, demergers or liquidation of companies or in the case of a share deal; and
- of a building subject to an expropriation order for reasons of public utility.

Upon notification of the landlord's intention to sell the leased premises (which must include the essential terms of the sale and the price requested by the landlord), the tenant will benefit from a period of 30 days to inform the landlord of their intention to purchase the property at the price requested by the landlord. If the property is then offered to another buyer at a more favourable price or on better terms, the tenant will then benefit from a period of seven days to exercise their preference right (which, in such case, is actually a pre-emption right).

Environmental/Regulatory Trends in Real Estate

PFAS contamination

Concerns related to soil contamination with per- and polyfluoroalkyl substances (PFAS) are becoming more significant in real estate deals, particularly in the Flemish region, where the relevant agency OVAM (*Openbare Afvalstoffenmaatschappij voor het Vlaams Gewest* (Public Waste Agency of Flanders)) is intensifying its scrutiny. The emergence of this trend while the legal framework has not yet been clearly established causes legal uncertainty and affects the timing of transactions.

Nitrogen deposits

In a number of decisions, the Flemish Council for Permit Disputes declared the Flemish government's temporary non-binding guidelines on assessing the effect of nitrogen deposits on protected nature areas to be unlawful. The Flemish Council for Permit Disputes considers that the guidelines (applying general threshold margins on such deposits, which differ for industry and agriculture) lack a scientific basis and fail to protect these areas from excessive nitrogen deposition. This means they are not compliant with the EU Habitats Directive. As a result, projects located in the Flemish region and emitting nitrogen were facing serious legal uncertainty concerning their pending permit applications. A few high-profile projects saw their permit refused or annulled on that basis.

In order to remedy the issue, a new Decree was recently approved by the Flemish Parliament to again place more solid ground under permitting practice in the Flemish region. It forms part of a larger deal struck within the governing coalition, involving a trade-off between the interests of the building, agricultural and industrial sectors. Nonetheless, some of the legal concerns remain (and were also raised by the Council of State in its advice on the draft Decree) – notably, around the use of differing thresholds for agriculture and industry, which is maintained in the Nitrogen Decree. It remains to be seen how the policy around nitrogen and permitting in the Flemish region will continue to develop, under or around the new Decree, and whether the Nitrogen Decree – if challenged before the Constitutional Court – will stand.

ESG

ESG is everywhere and this is no different in the real estate sector. Various ESG-related legislative and non-legislative developments and ini-

tiatives are worth looking into, both at EU and Belgian (federal and regional) levels.

Emissions Trading System for buildings

On 18 and 25 April 2023, the European Parliament and the Council respectively adopted key legislation to reform the European Emissions Trading System (ETS). As part of this reform, a new separate ETS II will be rolled out, covering emissions from fuel supplied to road transport, buildings and parts of the manufacturing industry (not already covered by the existing ETS). ETS II will put a price on these emissions as from 2027 – although this could yet be postponed to 2028 to protect consumers if energy prices are exceptionally high at that time.

It is clear that the additional cost of suppliers in complying with their ETS II obligations will be passed on to building owners and tenants, who will need to decide how to account for this. Investments in energy efficiency/energy neutrality and distributed generation to make buildings self-sufficient will become (even) more important. The new Social Climate Fund (to be funded in part by revenue from the auction of allowances under the new ETS II) will be used to ease the burden on (vulnerable) consumers, among other things, through temporary direct income support measures.

In the context of emissions reduction, it will also be important to look at "embodied carbon". This refers to CO2 emitted in the construction and demolition of a building, as opposed to its operation. Studies show that the embodied emissions of a building range between 67–76% of a building's total carbon emissions over a lifetime. This emphasises the need to take a whole-life-cycle approach to calculating a building's carbon footprint.

Energy efficiency and energy performance

On 10 March 2023, the European Parliament and the Council reached political agreement on a substantial amendment (recast) of the Energy Efficiency Directive (EED). On 7 December 2023, an amendment (recast) of the Energy Performance of Buildings Directive (EPBD) followed suit. These key pieces of "Fit for 55" legislation represent a significant push to decarbonise the EU's building stock and facilitate renovation. The (binding and non-binding) targets for energy efficiency and energy performance will trickle down into the real estate sector through national implementing legislation, including in Belgium.

The recast EED sets a headline target of at least a 11.7% reduction in final energy consumption in the EU by 2030, compared with 2020 forecasts. This headline target will be binding for the EU collectively but will translate into indicative targets per member state, to be reflected in their national energy and climate plans (NECPs). These national targets will be set using formulae based on – among other things – energy intensity, GDP per capita, and the potential for renewables and energy savings. Counting towards these targets, EU member states will be able to take into account savings realised through policy measures under the (current and revised) EPBD and the ETS II.

Governments will need to integrate an "energy efficiency first" principle in their policy, planning and investment decisions (including public procurement) and lead by example by – among other things – achieving a (mandatory) renovation target of 3% annually of the total floor area owned by public bodies (not just central governments), which will need to be transformed into nearly net-zero buildings.

The EED also deals with energy performance contracts for large (more than 1,000 square metres) non-residential buildings to support renovation, requiring one-stop shops and private sector input.

The recast EPBD sets as an ambitious target that new buildings constructed within the EU must be zero-emission buildings by 2030 and new "public" buildings must be zero-emission buildings by 2028. In addition to the requirement to construct and renovate zero-emission buildings, from 2030, the "life cycle global warming potential" of new buildings will need to be calculated in accordance with the "levels" framework (an assessment and reporting tool for the sustainability performance of buildings) to ensure that the whole-life-cycle carbon emissions of the building are measured.

Compared to the EC's initial proposal, the part concerning renovation in the EPBD has been watered down, as it no longer sets out binding EU-level minimum energy performance standards for the worst-performing buildings. The energy performance certificate itself will be revamped for consistency across the EU. Within 24 months following the EPBD's entry into force, all energy performance certificates must be issued in a digital format, based on a harmonised scale of energy performance classes (ranging from A to G) and comply with a template. The validity of energy performance certificates of the lower grades (D to G) will be reduced from ten to five years.

Separately, the Flemish region also introduced new obligations, effective from 1 January 2022 for non-residential buildings and from 1 January 2023 for residential buildings, which arise on the passing of a notarial deed of sale or the vesting of a long-term lease right or a right to build. Such buildings will need to meet certain minimum energy performance levels (eg, concerning roof insulation, glazing, central heat generators and cooling systems) or minimum energy labels within a maximum period of five years from the date of the relevant deed.

The EPBD also pays much attention to the accessibility and interoperability of (smart) data by imposing upon EU member states an obligation to set up national databases for energy performance certificates and renovation passports.

The wide range and depth of these targets and proposals, once implemented, will affect all players in the real estate sector.

Mandatory corporate disclosures

The Taxonomy Regulation applies in Belgium. The EU taxonomy provides for a classification system to assess whether an economic activity is "environmentally sustainable" according to six environmental objectives. The criteria for the first two environmental objectives, climate change mitigation and climate change adaptation, came into force on 1 January 2022. The assessment is made on the basis of the "technical screening criteria" established in the Climate Delegated Act, which includes criteria specific to the construction and real estate sector. Among such criteria are the reduction of primary energy demand, the use of sustainable technologies and the use of hazardous materials.

Under Article 8 of the Taxonomy Regulation, companies covered by the Non-Financial Reporting Directive (NFRD) must include in their non-financial reporting how and to what extent their activities align with the Taxonomy Regulation. Under the future Corporate Sustainability Reporting Directive (CSRD), which will gradually enter into force between 2025 and 2029

and replaces the NFRD, in-scope companies will have to report information on the full range of ESG issues relevant to their business – in accordance with mandatory EU sustainability reporting standards based on the EU taxonomy.

Voluntary actions

In addition to the mandatory disclosure obligations at (group) corporate level, real estate companies have a range of voluntary schemes and options at their disposal to boost their ESG profile.

Certification schemes

A sustainability certificate is not legally required in Belgium, but there are several reasons why companies engage in obtaining the certificate. The most commonly used certification system in Belgium is BREEAM (Building Research Establishment Environmental Assessment Method). It establishes an overall sustainability score for new and existing buildings. Although originally developed for the office market, the measuring method has been extended so that it can also be used for retail, industry, schools, hospitals, courts and prisons. In general terms, a BREEAM-certified building will have a higher occupancy rate as well as a higher rent value, which – for long- and mid-term investments – outweighs the additional investment costs. Other certification systems that are commonly used are LEED (Leadership in Energy and Environmental Design) and the WELL Building Standard.

Investors are increasingly looking at the global ESG benchmark for real assets (Global Real Estate Sustainability Benchmark, or GRESB). It aims to assess and benchmark ESG and other related performance of real assets and to provide standardised and validated data to investors. Each year, the Real Estate and Real Estate Development Benchmark is generated as part of the GRESB assessments, which are guided by what investors consider to be material issues and are aligned with international reporting frameworks such as the Paris Climate Agreement, the Task Force on Climate-related Financial Disclosures and the United Nations Sustainable Development Goals.

Against this backdrop, investors can monitor their investments, engage with their fund managers and make ESG-informed decisions. In Europe, in particular, investors increasingly require fund managers to achieve a sufficiently robust GRESB rating (eg, four out of five stars and/or higher than 80% scores) – failing which, they may not be prepared to invest in their funds or even look to withdraw their investment. Nonetheless, this remains a voluntary framework. The GRESB can be applied to companies and funds, rather than individual assets. It differs in that respect from asset-based green certification schemes that apply to individual buildings (such as BREEAM, LEED, WELL or NABERS (the National Australian Built Environment Rating System)).

Green (clauses in) leases

Another area of development relates to green leases, under which landlords and/or tenants undertake certain obligations relating to maintenance and use of buildings, energy and water consumption, environmental performance, etc.

Green clauses in leases are becoming increasingly common in Belgium for non-residential buildings. The relevance thereof can be understood in light of the increasing importance of the obligations resulting from the Taxonomy Regulation. As such, green leases can become an asset to investors reporting against their increasingly expansive environmental and other (eg, energy efficiency and performance) obliga-

tions – in much the same way as green bonds or loans on the balance of financial investors. In countries where they are common, green leases have contributed to preserving the asset value of investments (especially where buildings were constructed to high energy and environmental performance standards imposed by local authorities or prospective tenants), lower operational costs, higher occupancy rates and higher rents.

Although the need to address ESG concerns in the real estate sector was translated into an array of legislation on various occasions, Belgium does not have any legislation defining or imposing green clauses in leases to date (unlike its neighbouring countries).

In large residential, office or commercial real estate projects, there is an increasing demand for the incorporation of clauses with a sustainability dimension. Such clauses relate, among other things, to waste treatment and recycling, lighting and heating policies. Even though such green clauses can be included in any lease, full-blown green leases are typically still confined to non-residential properties, which can be partly explained by the fact that the requirement for an efficiently operated property – as mentioned in the technical screening criteria under the EU Taxonomy Regulation – only applies to non-residential buildings. Evaluating a property's environmental impact often involves considering its energy efficiency rating as one of the most common factors.

However, a property's environmental impact encompasses more than just its energy efficiency rating. It also includes aspects such as waste generation, travel to and from the building, and materials used in the fit-out.

Green and sustainability-linked lending

Without going into further detail, investors in real estate may increasingly rely on green and sustainability-linked loans and bonds – respectively linked to achieving green (ie, EU taxonomy-aligned) objectives or incorporating sustainability-linked key performance indicators – when taking out external financing.

Urban planning and social housing

Urban planning regulations in Belgium contain a variety of urban planning prescriptions. Such urban planning prescriptions are diverse. They can include the obligation to design green areas in a development project, as well as social and public functions. Such obligations are often inserted in the building permits for development projects (eg, the obligation to have a minimum offer of social housing in the framework of a residential development). In parallel, a lot of attention is paid to:

- the quality-oriented management of the residential environment;
- the efficient use of the soil and its resources;
- the preservation and development of the cultural, natural and landscape heritage; and
- the improvement of the energy performance of the buildings.

Moreover, building permits for development projects often contain specific urban planning charges with some sort of ESG angle (such as the construction of community parks and green spaces and the redevelopment of public infrastructures).

Electromobility

Under the existing EPBD, non-residential buildings that have more than ten parking spaces must install at least one electric vehicle (EV) charging station and install cabling for one in

every five spots so that charging points can be installed at a future date.

The recast EPBD amends the existing law to:

- extend the obligation to non-residential buildings and to non-residential buildings undergoing major renovation with more than five parking spaces; and
- mandate cabling for at least 50% of car parking spaces to enable the installation of recharging points for EVs at a later stage.

Non-residential structures with more than 20 parking spaces will be required to install at least one charging station for every ten spaces by the beginning of 2027. Newly built and renovated office buildings must also install at least one EV charging point for every two parking spaces. An existing exemption for SMEs is also removed.

In addition, mandatory bicycle parking spaces in new buildings and buildings undergoing major renovation are introduced. This aims to remove barriers to cycling becoming a central element of sustainable, zero-emission mobility.

More granular and, in some cases, more stringent obligations have been and are being introduced by various Belgian regional governments, implementing existing and/or anticipating future EU law.

BRAZIL



Law and Practice

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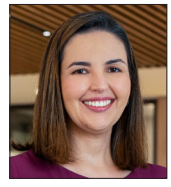
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Mattos Filho is a full-service firm with offices in São Paulo, Campinas, Rio de Janeiro, Brasília, New York and London. Mattos Filho is widely recognised as one of the best law firms in Latin America, winning several important international awards. It provides top-grade legal services to domestic and foreign clients from virtually all business sectors, advising them on a wide range of activities and businesses, representing financial institutions, investors, non-profit organisations, and governmental and multilateral agencies. The firm's real estate practice provides personalised, efficient legal solutions for real estate demands across a diverse range of sectors, such as commercial, industrial and residential real estate, logistics, data centres, hotels, hospitals, infrastructure and agribusiness. The team's multidisciplinary understanding and extensive experience in transactions of varying sizes allow it to anticipate potential issues and present alternatives, allowing its clients to attain the best possible results for their business.

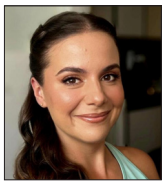
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1. General

1.1 Main Sources of Law

The main sources of Real Estate Law in Brazil are:

- the Federal Constitution (1988);
- the Civil Code (Federal Law No 10,406/2002);
- the Urban Land Statute (Federal Law No 10,257/2001);
- the Public Registration Law (Federal Law No 6,015/1973);
- the Real Estate Development Law (Federal Law No 4,591/1964);
- the Urban Ground Parcelling Law (Federal Law No 6,766/1979);
- the Urban Lease Law (Federal Law No 8,245/1991);
- the Rural Land Statute (Federal Law No 4,504/1964);
- the Forestry Code (Federal Law No 12,651/2012);
- the Security Framework Law (Federal Law No 14,711/2023);
- municipal laws on construction and zoning rules; and
- case law.

1.2 Main Market Trends and Deals

Inflation has improved and a downward trajectory in interest rates was initiated by the Brazilian Central Bank in the second half of 2023.

This has bolstered investor confidence and increased real estate transaction activity. Other factors that may influence the pace of the 2024 market include the upcoming elections around the world and the ongoing geopolitical tensions. Brazil is less exposed to such factors and therefore more attractive to investments in the near-term, as compared to other jurisdictions.

The accelerated growth of AI is driving the increase in the demand for data storage and data centres. As a result, there has been a growth in the data centre sector.

Once considered a subsector, the cash and carry business has become mainstream in the retail sector and fund allocations have shifted accordingly to replace, remodel or expand underperforming core asset classes, such as local markets and supermarkets.

In 2023, there was a decrease in new hotel launches compared to 2022, when Perse was at its peak. The hotel sector is warming up and the economy and super economy segment makes up the majority of new launches. The business and events segment is expected to perform better than in the years immediately following the COVID-19 pandemic. The performance of the leisure segment performance depends on the respective region. High-end hospitality at leisure destinations (eg, the North East) has seen an upward trend.

Climate change effects have been seen all over the globe, as evidenced by natural disasters. As 40% of the emissions originate from real estate projects, stakeholders are driving investments aiming their reduction or the generation of carbon credits.

These are some significant real estate deals in the last 12 months in which Mattos Filho has participated.

- Logistics: sale, by GTIS Brazil Logistics FII to CSHG Logística FII of its BRL1.37 billion logistics portfolio comprising four logistic buildings in the state of São Paulo.
- Cash and carry: highly complex, multidisciplinary and multijurisdictional transaction for the

acquisition by the Muffato Group (fourth largest retail group in Brazil) from Makro (Dutch SHV Group) of 16 stores, 11 petrol stations and other assets located in the state of São Paulo.
- Hospitality: entrance of the Anantara (Minor Group) for the operation of the super high-end brand, located in the states of Bahia and Ceará.
- Carbon credits: acquisition of rural property of approximately 150,000 hectares and respective forestry assets located in the Amazon region (state of Acre) for the purpose of conservation of the native forest and issuance of carbon credits thought a highly complex project finance transaction.

Mattos Filho also participated in the sale of Faria Lima 3500, an AAA office building that was originally built to suit the headquarters of Itaú BBA, considered the largest Brazilian office building deal in 2023 (BRL1.5 billion).

1.3 Proposals for Reform

The most relevant legislative proposal that may affect real estate law is the so-called Tax Reform and reform of the Civil Code.

The Civil Code Amendment Bill is still in its early stages and will likely undergo a series of changes until its approval by the National Congress. Based on proposals so far, the limit on the acquisition of rural land by way of adverse possession per person would have a significant impact on real estate ownership.

2. Sale and Purchase

2.1 Categories of Property Rights

Ownership

The property right that grants to the owner the exclusive right to use, enjoy, dispose of, and reclaim the property. Co-ownership is permitted and each co-owner has rights over an ideal share/percentage of a property – similar to a common law tenancy in common.

The Real Estate Development Law also contemplates a specific kind of co-ownership, under which each owner has full ownership of its independent unit and an undivided interest in the land and in any common areas of the development.

Co-ownership can also be in the form of timeshare – each owner holds a fraction of time in which they can exercise exclusive rights over the property.

Useful Domain

The useful domain of a specific public property may be granted to private persons by the relevant governmental authority.

Surface Rights

Once created, the landowner continues to own the land and the grantee of the surface right becomes the owner of its surface.

Other In Rem Rights

- Right of the buyer to a commitment of purchase and sale (deed or agreement): provided the deed/agreement is irrevocable, its registration in the relevant real estate record file grants in rem rights in favour of the buyer, but ownership is not transferred until the purchase and sale deed is executed and registered in the respective real estate record

file (or a court order is entered in favour of the buyer determining the transfer, in case the seller refuses to grant the deed).
- Usufruct: may be granted by the owner of a property to a person (usufructuary) to use and collect profits from the property for a definite period and under certain conditions mandatory by law.
- Easement: is a right established between properties. The owners of the dominant and the servient properties must be different persons.

2.2 Laws Applicable to Transfer of Title

The transfer of title of real properties in Brazil is essentially governed by the Civil Code and the Public Registration Law. As a rule, these laws apply to all types of property transfers.

Acquisitions of federal real properties by private persons are subject to specific rules under Law Nos 9,636/1998 and 13,240/2015.

2.3 Effecting Lawful and Proper Transfer of Title

Except as provided in specific laws (eg, Law on the Housing Finance System, Corporations Law), transfer of title requires a deed.

Real estate is subject to a registration system that records all forms of property rights and most events involving them. This system is centred on judicial districts, which may have one or more real estate registration offices. This is particularly important in case of due diligence because information must be obtained from the relevant judicial district of each property that is analysed.

Transfer of title is only perfected upon its registration in the appropriate real estate record file of the relevant real estate registration office of the judicial district of the real estate.

The limitations caused by the COVID-19 pandemic resulted in important improvements to the process of completing real estate transactions in Brazil, such as remote online deeds which are still being used.

Title insurance is not common in Brazil. Local insurance companies do not offer it as a product.

2.4 Real Estate Due Diligence

Real estate legal due diligence is carried out by lawyers retained by the buyers. It analyses, at least, in relation to:

- real estate: the ownership, existence of liens, compliance with zoning rules, licences, construction and environmental issues and tax debts; and
- owners aiming to identify:
  (a) the existence of debts exceeding its assets, which could result in the annulment of the acquisition of the real estate by a court for fraud; and
  (b) the existence of any legal proceedings that could prevent or jeopardise the acquisition of title, the exercise of any in rem rights or its possession.

For the same reasons, the chain of title and its previous owners are analysed.

2.5 Typical Representations and Warranties

Main and most common representations and warranties made by the seller in connection with the real estate refer to:

- lawful, valid and good ownership and/or possession;
- no liens, legal and administrative proceedings, disputes, agreements, debts or other

claims that could otherwise affect the sale; and
- compliance with the municipal, state and federal laws in respect of licences, construction, zoning and environmental matters.

In connection with the seller, they include at least:

- legal capacity and authority;
- solvency; and
- compliance with anti-corruption laws.

The seller is liable for the indemnification in the case of loss of title. This is the most typical indemnification due by the seller. Only when expressly waived is the indemnification not due by the seller. Usually, the cap is the price paid by the buyer for the real estate plus adjustment for inflation. The statute of limitation is ten years from the transfer of title.

It is also usual that the seller be liable for losses and damages incurred by a buyer due to misrepresentation and patent or latent defects. The parties often cap damages at the price of the transaction.

Representations and warranties commonly survive until the lapse of each item's statute of limitations, which is usually five years, but in certain cases may be up to ten years.

Standard representations and warranties were not affected by the pandemic. However, parties now negotiate whether they would accept a pandemic as a material adverse effect which may prevent a transaction from closing.

2.6 Important Areas of Law for Investors

In addition to the Civil Code and the laws mentioned in items **1.1 Main Sources of Law** and **2.2 Main Market Trends and Deals**, the most important areas of law that investors should consider are corporate, tax, environmental and compliance laws.

2.7 Soil Pollution or Environmental Contamination

As a rule, from an environmental law perspective and considering legal precedents in Brazil's Superior Tribunal of Justice, the liability for soil pollution or environmental contamination is propter rem. Therefore, it is connected to the real estate asset itself.

As a result, the buyer of a real estate asset is liable for pollution or contamination even if it did not cause it.

Propter rem liability does not affect the buyer's right of redress against the seller, provided that the real estate purchase and sale agreement contemplates this right.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Each municipality is competent to legislate on land use, zoning and parcelling in accordance with its territorial planning. Buyers can ascertain the permitted uses of a parcel of real estate under applicable zoning or planning laws by either consulting such local legislation, or the relevant municipality or urban planning authorities directly. Zoning maps and guidelines should be provided in the municipal legislation and can be freely consulted.

During the process of issuance of the relevant licences an integration between the developer and local authorities is common by means of the appropriate proceedings.

2.9 Condemnation, Expropriation or Compulsory Purchase

Under the Federal Constitution public authorities may expropriate private land.

There are two types of expropriation in Brazil, both must be preceded by legal proceedings.

- Expropriation on the grounds of public need, public utility or social interest. They can be carried out by federal, state, or local governments subject to:
  (a) the takings clause, requiring fair prior compensation;
  (b) the due process clause, which requires a legal proceeding that allows the landowner to challenge (i) the public interest; or (ii) the amount of the compensation offered.
- Expropriation as a penalty (less common) where:
  (a) land (urban or rural) is not used according to its social function; or
  (b) unlawful psychotropic plants are cultivated or slave work is exploited.

2.10 Taxes Applicable to a Transaction

In a purchase and sale of real estate through an asset transaction, the applicable taxes and fees are:

- notary fees (when documented through a deed);
- registration fees: for registration of the transfer instrument with the real estate registration office;
- ITBI: municipal tax owed on transfers of real property or property rights – rates and exemptions depend on each municipality; and
- *laudêmio:* transfers of useful domain of public land to or between private parties trigger this tax, payable to the government.

Notary and registration fees are determined at the State level, and, as a rule, are calculated based on the highest value of either the price of the transaction or the value of the real estate property as determined by the municipality.

Transfers of shares in the property owning company and partial ownership transfers (eg, change of control) are usually documented in private instruments, and therefore notary fees do not apply.

If there is a change of control in the property owning company but the real estate continues to be owned by the same entity, ITBI is not applicable.

ITBI immunity and exemption may be available in certain cases of transfer of real estate or rights of a legal entity in a capital increase, or transfer of assets or rights resulting from the merger, incorporation, spin-off or split-off, or termination of an entity.

Usually, it is the buyer that bears the tax and fees for transfer of title and seller that bears the broker fees and its income tax on any profit made on the sale of the real estate.

On the due diligence side, the seller bears the costs relating to data room (documents and certificates), whereas the buyer pays the costs of the professionals that will perform the due diligence. Parties share certain specific costs, such as environmental studies.

2.11 Legal Restrictions on Foreign Investors

- Urban real properties: there are no restrictions on foreign investors acquiring or creating in remrights over urban real estate in Brazil.

- Rural real properties: Federal Law No 5,709/1971 and Federal Decree No 74,965/1974 establish certain conditions for the direct or indirect acquisition of rural properties by foreign entities and individuals. There are ongoing discussions before the Brazilian Supreme Court and within the executive branch of the government concerning the applicability or not of such conditions to the acquisition of rural real properties by Brazilian companies whose majority of the capital stock is held by foreign companies or individuals or that are controlled by such foreign parties.
- Rural real properties located in the Brazilian border strip: pursuant to Federal Law No 6,634/1979 and Federal Decree No 85,064/1980, prior consent from the National Defense Council is required for the direct or indirect acquisition of ownership, possession or any other in rem right over rural real properties located within 150 km of the country's national border. Such consent is also required for the participation of a foreign entity or individual in any manner in a company which owns, possesses or holds any in rem right over rural properties located in the Brazilian border strip.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Usually, private funding finances the acquisition of commercial real estate. Private funding has been boosted by Federal Law No 9,514/1997, which introduced Brazil's Housing Finance System. Commercial real estate is generally financed by (i) the circulation of bonds and securities backed by real estate receivables, negotiable on the capital markets; and (ii) more effective types of security, such as fiduciary sale, discussed in **3.2 Typical Security Created by Commercial Investors**.

3.2 Typical Security Created by Commercial Investors

Two forms of security are typically created by a commercial real estate investor who is borrowing funds to acquire or develop real estate: mortgages and fiduciary sales (*alienação fiduciária*).

A fiduciary sale has been the most typical security as it transfers to the creditor the fiduciary/conditional ownership of the property (therefore, the property is not affected by the insolvency of the debtor) and allows a nonjudicial foreclosure procedure.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on the granting and foreclosing of security over urban and rural land for foreign lenders.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

ITBI does not apply to the creation of security, but is levied on the enforcement of fiduciary sales because in this case an actual transfer of full title to the creditor occurs.

Notary fees are owed in the event of execution of deeds, and registration fees are owed upon registration of the security documents with the relevant Real Estate Registration Office. Such fees are determined at the State level and vary in accordance with the amount of the debt.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no legal rules or requirements that must be complied with before an entity can give valid security over its real estate assets.

3.6 Formalities When a Borrower Is in Default

In 2023, the Security Framework Law implemented important amendments to the security laws. One of the most relevant changes was to allow mortgages to be foreclosed out of court, which makes the procedure less time-consuming: a nonjudicial foreclosure may be completed in three to six months.

The nonjudicial foreclosure procedure works as follows.

- After the debtor is in default, in accordance with the relevant loan agreement, the creditor requests the competent Real Estate Registration Officer to notify the debtor to cure the default within 15 days.
- In the case of fiduciary sales, if debtor fails to cure the default, the Real Estate Registration Officer will request the creditor to pay ITBI and perfect the transfer of full title in the name of the creditor.
- Subsequently, the first auction will be scheduled and, if it is not successful, another auction must occur. If both auctions are unsuccessful, in the case of a fiduciary sale, the lender will keep the full title to property and, in case of a mortgage, the creditor will receive the property as payment-in-kind of the debt.

3.7 Subordinating Existing Debt to Newly Created Debt

Secured claims are affected by judicial reorganisation and can be restructured under an approved reorganisation plan. During this period, enforcement proceedings are typically suspended until the debtor fulfils its obligations under the reorganisation plan. However, security of the credit remains in place unless stated otherwise in the reorganisation plan or consented to by the relevant creditor.

Fiduciary sales are not subject to reorganisation or bankruptcy proceedings.

3.8 Lenders' Liability Under Environmental Laws

See **2.7 Soil Pollution or Environmental Contamination**.

3.9 Effects of a Borrower Becoming Insolvent

Security interests created over real estate in favour of a lender cannot be made void if the borrower becomes insolvent. However, in a bankruptcy scenario, creditors are categorised based on the nature of their claims and some of them have priority over secured claims, such as labour claims.

Fiduciary sales are not affected by insolvency.

3.10 Taxes on Loans

See **2.10 Taxes Applicable to a Transaction** and **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Federal Constitution recognises the competence of municipalities to promote adequate territorial planning. The Urban Land Statute, which is a federal law, provides the general rules that

should be applied in the municipal laws. For example, it provides that the parcelling, use and occupation of the land should follow the municipality's planning ("Master Plan"), which is mandatory for municipalities with more than 20,000 inhabitants. The Master Plan should be reviewed at least every ten years to reflect urban growth and development.

Therefore, municipalities are authorised to legislate, issue licences and inspect the compliance of real estate developments with their zoning rules, except for in relation to environmental aspects, which are, in general, under the competence of states.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Each municipality has its Land Use and Occupation Law, which is the statute that provides rules for land use with the aim of guiding and ordering the growth of municipalities, controlling urban spaces and establishing zoning rules.

The Land Use and Occupation Law also governs the design and construction of buildings. These regulations may include requirements for allowances, building height limitations and other construction parameters.

The Building Code is the municipal statute that provides for the general and specific rules to be followed in relation to the design, permitting, building and maintenance of buildings.

Additionally, the Brazilian Association for Technical Standards has issued standards addressing methodologies and guidelines to standardise construction processes.

4.3 Regulatory Authorities

Each municipality has a Housing Secretariat and the Representative Body, which are responsible for regulating the development and designated use of individual parcels of real estate.

Please also refer to **4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning** and **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction** for the applicable legislation.

For parcelling of real estate, certain legal requirements should be observed, among them, the size and minimum boundaries of the lot and the need of an environmental impact study for projects over 100 hectares. For commercial and residential developments, among other urban parameters, the developer should observe the building height, occupancy rate and the maximum built area allowed.

4.4 Obtaining Entitlements to Develop a New Project

Obtaining entitlements for development projects involves initial planning and analysis of local legislation, followed by the submission of technical and graphic design to the Housing Secretariat of the Municipality, which will analyse whether the project is within legal parameters and its impacts, and which licences and authorisations will be required. This process also provides an opportunity to know if a project is viable. Depending on the project's impact, public participation is mandatory, usually through public hearings, allowing interested parties to express their concerns. Municipal authorities make the final decision, which can be appealed, if necessary. Third parties retain the right to participate and raise objections throughout the process if they believe the project could adversely affect

their interests or the community. The Public Prosecutor and neighbourhood associations can seek to protect diffuse or collective interests and hold liable any person responsible for damages to protected property.

4.5 Right of Appeal Against an Authority's Decision

An administrative appeal is available against the approval of a construction project or issuance of an operating licence authorising activities in a property. It is also possible to apply for injunctive relief in court.

4.6 Agreements With Local or Governmental Authorities

To obtain permits and approvals, it may be possible or necessary to enter into agreements with local or other governmental authorities, agencies or utility suppliers. Some projects invariably depend on the municipality to guarantee some compensation from the developer, to contribute to society, and mitigate as many impacts of the project as possible. These agreements are entered into by and between the developer, the municipality and related parties to cover infrastructure impacts, development guidelines, planned urbanisation and other obligations.

4.7 Enforcement of Restrictions on Development and Designated Use

Enforcement of restrictions on development and designated use by the municipality involves refusal to issue licences, inspections, shutdowns, charge of penalties and legal action.

Additionally, the Public Prosecutor or neighbourhood associations may participate by filing judicial measures against the developer or the municipality that has permitted the project without observing legal restrictions.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

There are several types of entities through which investors can hold real estate assets. Traditional real estate investment vehicles include corporate entities, among which the most common are limited liability companies (LLCs) and corporations.

Real Estate Funds (FIIs) are popular due to their investor-friendly features, including limited liability rules, ring-fencing, governance, tax benefits and regulatory framework.

Real Estate Agricultural Funds (FIAGRO) are now an emerging structure for investment in rural land.

Foreign investors often invest in Private Equity Funds (FIPs) that invest in shares or debentures (among other securities) of corporations that hold real estate.

Foreign investments made in any type of vehicle must be registered with the Brazilian Central Bank for exchange control purposes.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

LLCs and corporations are subject to corporate taxation, and are incorporated through the execution of their constating documents, which are filed with the Commercial Registry of the State in which the head office of the company is to be located.

LLCs and corporations have similar maintenance and accounting costs, but for companies with an annual revenue lower than BRL300 million the LLC is a preferred choice from a cost perspec-

tive since this kind of entity is not obligated to audit and publish its financial documents.

Also, in an LLC the share capital may be paid in full through the incorporation of shareholders' assets, with the respective value set and agreed upon by the shareholders, while in a corporation the law requires such assets to be evaluated by a specialised valuation firm.

Furthermore, in a corporation when the share capital is fully paid in cash the law requires at least 10% of the share capital to be paid on the date of the incorporation, while with the LLC the entirety of the share capital payment may be postponed or paid in instalments.

Although some costs may differ from case to case, the choice of the corporate entity for investment is much more related to the client's desirable governance and liability management than to the maintenance costs itself.

FIIs and FIAGRO are closed-end funds for investment, respectively, in real estate and rural land. Investment funds do not have corporate personality and their assets consist of the assets and rights acquired, in a fiduciary capacity, by a fund manager authorised by the Brazilian Securities Commission.

Such funds shall bear management fees as well as other recurring expenses of the fund, such as fees paid to accounting and valuation firms, regulatory fees and expenses related to the underlying real estate assets. Such organisational and operating costs may impose a threshold on the formation of FIIs depending on the size and volume of the envisaged transactions, which shall be assessed on a case-by-case basis.

Such funds are designed to provide investors with a recurrent flow of proceeds. As such, the laws mandate FIIs and FIAGRO to distribute at least 95% of net profits (cash basis) based on biannual balance sheets. On the other hand, the law provides individuals with a 0% tax rate over such recurring distributions if certain requirements are met. International investors may also benefit from exemption over the capital gains arising from the sale of such funds interest on the Brazilian stock exchange.

5.3 REITs

There is no real estate investment trust (REIT) available. FIIs and FIAGRO are similar to REIT. Please refer to **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**.

Although their fundraising can take both private and public forms, they must fulfil statutory rules and are subject to regulation by the Brazilian Securities Commission.

If certain legal requirements are fulfilled, the income and capital gains earned by FIIs and FIAGRO may be exempted from income tax, which is owed at the investor level.

Foreign investors may invest in such funds.

5.4 Minimum Capital Requirement

A minimum capital requirement is not required by law. Please refer to **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity** for further information on costs.

5.5 Applicable Governance Requirements

Corporations

The management of a corporation is carried out by a board of officers, and a board of directors,

or solely by a board of officers. The board of directors is optional, except for listed companies or privately held companies with authorised capital.

LLCs

The management of an LLC is carried out by one or more individuals, appointed as managers in the company's articles of association or in a separate document. Managers may or may not be partners of the company.

If an LLC elects to be supplementarily ruled by Federal Law No 6,404/1976, then it may also elect to have a board of directors.

In both cases, mechanisms such as the creation of committees, internal audit and independent audit are commonly used to monitor and control the company's activities.

FIIs and FIAGRO

Their management is carried out by a fiduciary agent, authorised by the Brazilian Securities Commission, who serves as the fiduciary owner of the real estate assets and rights of the funds. Additionally, other authorised third-party financial services providers are allowed, such as investment advisers, asset managers (to oversee portfolio asset management) and consultants.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual entity maintenance and accounting compliance costs are determined on a case-by-case basis. Please refer to **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity** for further information on costs.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A person or entity may occupy and use a property for a limited period – without buying it outright – pursuant to the following arrangements:

- leases;
- free leases;
- rural partnership (only for rural land);
- surface rights;
- easements;
- usufruct; and
- assignment of use.

6.2 Types of Commercial Leases

Commercial/non-residential leases may be classified as follows.

- Typical urban lease agreement for property located in the urban areas (except for public properties, hotels, parking lots, and areas intended for advertisement), which is regulated by the Urban Lease Law.
- Typical lease agreement for urban properties not included in the Urban Lease Agreement (except for hotels and public properties), which is regulated by the Civil Code.
- Atypical urban lease agreements: the following qualify as atypical urban lease agreements, as per the Urban Lease Law: (i) build-to-suit (BTS) agreements; and (ii) leases of stores located in shopping centres. Atypical Urban Lease Agreements allow the parties to waive certain rights that would otherwise have the nature of public policy.

6.3 Regulation of Rents or Lease Terms

The Urban Lease Law contemplates general rules for the landlord and tenant relationship

during the term of the lease. Most of its provisions have the nature of public policy, and therefore even if those provisions are not expressly included in the lease agreement, they must be observed by the parties. Any matter that is not covered by the Urban Lease Law may be lawfully negotiated.

The parties may freely establish the monthly rent amount, which must be in Reais.

There is no material ongoing regulation of rents or lease terms that resulted from the COVID-19 pandemic.

6.4 Typical Terms of a Lease

Typical Urban Lease Agreements

- Length of lease term: there are no statutory restrictions concerning the length of lease agreements in Brazil. A non-residential lease agreement that has a minimum five-year term may be renewed for five years at the discretion of the tenant. If the landlord refuses to renew the lease, the tenant may initiate legal proceedings (renewal action) within one year, but no less than six months, of the expiration of the lease to request the court to grant the renewal.
- Maintenance and repair of the leased real estate: the tenant is responsible for maintaining the premises on good repair, order and the other conditions present at the start of the lease, except for regular wear and tear. The landlord is responsible for repairs or construction works related to the building structure of the leased premises.
- Frequency of rent payments: there are no statutory restrictions concerning the frequency of rent payments in Brazil. It is common practice to establish monthly payments. However, monthly rent cannot be paid in advance, except if the tenant does not provide any security for the payment of rent under the lease agreement.
- COVID-19 pandemic issues: parties are now providing better definitions of force majeure in lease agreements and, in some cases, specific penalties in the case of early termination of the lease due to situations such as pandemics.

6.5 Rent Variation

Every 12 months, rent may be adjusted by a legally accepted inflation index provided in the lease agreement.

For typical urban lease agreements, rent can be reviewed every 36 months to be adjusted to market rates.

6.6 Determination of New Rent

If the rent is to be changed or increased, the new rent will be determined by mutual agreement, by hiring an appraiser or judicially.

6.7 Payment of VAT

Value-added tax on sales of goods and services (ICMS) is a state tax levied, among other events, on the sale and on the import of goods. However, it is not applicable to real estate rent.

In general, rent revenue stream recognised by Brazilian companies is subject to monthly taxation: Social Integration Program (PIS) and Social Security Funding Contribution (COFINS), except for companies subject to the cumulative regime whose purpose is not to lease real estate.

The Brazilian Consumption Tax Reform enacted on 20 December 2023, introduced a new taxation framework, replacing several taxes (including ISS, ICMS, PIS and COFINS) with three new ones (IBS, CBS and IS), set to transition from 2026 to 2033. Specifically, PIS and COFINS will

be replaced with CBS (Contribution on Goods and Services).

6.8 Costs Payable by a Tenant at the Start of a Lease

In typical urban lease agreements, the landlord is not authorised to charge any amounts other than rent at the start of a lease.

6.9 Payment of Maintenance and Repair

Under the Real Estate Development Law areas that are not for private use are registered as common use areas.

If the leased real estate is part of a condominium, as per the Real Estate Development Law, the tenant will pay the common charges (ie, ordinary expenses of the common use areas).

The landlord is responsible for the extraordinary property maintenance expenses in relation to the common areas, which are those that do not refer to routine building maintenance expenses.

6.10 Payment of Utilities and Telecommunications

Lease agreements typically regulate how utilities and telecommunications are to be paid. Some lease agreements include utilities and telecommunication services as part of the overall rent. In this case, the landlord covers these costs directly. Alternatively, tenants may be responsible for arranging and paying their utilities and telecommunication services directly to the respective service providers. Each tenant has individual accounts (and meters) and is billed separately for their consumption.

6.11 Insurance Issues

When landlords are responsible for obtaining insurance coverage for the property, the cost of insurance is often included in the operating expenses of the property, which are passed on to tenants through common area maintenance charges or similar mechanisms.

Alternatively, the lease agreement may require tenants to obtain their own insurance coverage for their leased space. This can include renter's insurance or business insurance to protect against liability and property damage.

The events causing damage that are usually covered by the insurance policy typically depend on the specific terms of each insurance policy. Common events covered by property insurance include fire, theft, vandalism, natural disasters and water damage.

In relation to tenants who file legal actions to discuss matters related to lease agreements, the firm was able to verify the filing of actions aimed at:

- reducing the rental value, in which the judiciary has decided to reduce the monthly rent by up to 50%;
- replacement for a less onerous guarantee for the lessee; and even
- the suspension of the term of the lease while the COVID-19 pandemic was taking place.

6.12 Restrictions on the Use of Real Estate

Restrictions on the use of real estate can be imposed by the landlord on the tenant, or by the Condominium By-laws. These restrictions are typically specified in the lease agreement or in the Condominium By-laws.

There are also restrictions imposed by law, such as zoning, non-disturbance, environmental, health and safety laws, which the tenant must obey.

6.13 Tenant's Ability to Alter and Improve Real Estate

Changes to be made by tenant in the leased property require landlord's written consent, except if there is a provision in the lease agreement waiving this requirement.

It is common practice for landlords to require the inclusion of a provision assuring that necessary and useful improvements are incorporated to the property, and if not indemnified by the landlord, they can be removed, provided that such removal does not cause damage to the property.

6.14 Specific Regulations

Typical urban lease agreements are regulated by the Urban Lease Law, which applies to real estate located in urban areas, except for public properties, hotels, car parks, and areas intended for advertisement, which are governed by the Civil Code.

Leases can be classified as residential, non-residential and seasonal (temporary living period not exceeding 90 days), all of them with specific provisions in the Urban Lease Law.

There are also specific provisions in the Urban Lease Law for schools and hospitals, which make those properties less attractive to landlords.

In relation to rural land, the Rural Land Statute, which regulates the rural lease agreements, also imposes on the tenant and landlord certain provisions of public policy. Additionally, some restrictions apply to foreign companies and individuals in relation to lease of rural properties in Brazil; please refer to **2.11 Legal Restrictions on Foreign Investors**.

6.15 Effect of the Tenant's Insolvency

Under the Urban Lease Law, the insolvency of either party does not authorise the counterparty to terminate the typical urban lease agreement.

Therefore, only if the tenant is in default the landlord may terminate the lease. In such case, the landlord may proceed in due course with the collection of any outstanding balances owed by the tenant and seek other remedies guaranteed by law, such as eviction.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The Urban Lease Law contemplates four forms of security that may be provided by a tenant. The types of security are:

- security deposit in cash or pledge of movable or real properties – if offered as cash, it must not exceed the amount of three monthly rents;
- guarantee: the landlord may require a new guarantor or a change in the type of security in case of death or insolvency of guarantor;
- rent insurance: must cover all of tenant's obligations; and
- shares in investment funds.

The landlord may require a new guarantor or substitution of the type of security in case of liquidation or winding-up of the investment fund. Under penalty of criminal or civil law, it is forbidden to require more than one type of security for the same lease term.

6.17 Right to Occupy After Termination or Expiry of a Lease

According to the Urban Lease Law, if the term of the lease is not extended by an amendment, and the tenant continues to occupy the leased

property and this remains unchallenged by the landlord, the lease agreement will be considered renewed for an indefinite term. In such case, any of the parties may terminate the agreement at any time upon a 30-day prior written notice, without paying any penalty, except in case of leases protected by the especial regime provided by the Urban Lease Law.

To ensure that a tenant leaves on the date originally agreed it is recommendable for the landlord to send a written notice to the tenant of its intention to recover the property, scheduling the inspection of the property at least 30 days before the intended date of the expiry of the lease, if not provided otherwise in the lease agreement.

6.18 Right to Assign a Leasehold Interest

According to the Urban Lease Law, the tenant is not entitled to sublease, assign, free lease or lend the property subject to the lease agreement without the landlord's prior written consent, which can be authorised in advance in the lease agreement.

It is common practice for the landlord to grant prior authorisation in the lease agreement for the assignment/sublease of the leased property to companies of tenant's economic group.

6.19 Right to Terminate a Lease

Pursuant to the Urban Lease Law, the tenant may terminate the typical lease agreement at any time during the lease term, provided that it pays the penalty in which a defaulting party incurs in the case of any breach of the agreement (usually equal to three monthly rents), reduced proportionally to the period of the lease already elapsed. The tenant has the right to terminate the lease agreement early, without a penalty, if the property needs repairs that would take more than 30 days to complete.

If the tenant is in compliance with its obligations pursuant to the agreement, the landlord cannot reclaim the leased property during the term of the lease. However, the landlord has the right to terminate the lease agreement to make emergency repairs determined by the Public Authorities, which cannot normally be carried out while the tenant remains in the property and provided that they take more than 30 days to complete.

The lease may also be terminated by the landlord as a result of a legal or contractual infraction by tenant, especially failure to pay rent and other charges.

Lastly, if the lease agreement is not registered and the leased property is sold to a third party during the lease term, provided that tenant's right of first refusal was duly observed, the new owner will be entitled to terminate the lease upon a 90-day prior written notice to the tenant.

6.20 Registration Requirements

Registration of leases is not required by law. However, if the lease agreement is registered in the leased property's real estate record file with the Real Estate Registration Office, which gives publicity to the lease, the tenant will have the right to claim the real property in case the landlord does not observe its right of first refusal. If the lease agreement is not registered in the real estate record file, the tenant will only be entitled to pursue indemnification for losses and damages against the landlord/seller, as the right of first refusal is a provision of public policy.

Additionally, the registration of the lease agreement containing (i) a validity clause and (ii) a definite lease term with the competent Real Estate

Registration Office allows the tenant to maintain all terms and conditions of such lease agreement in full force and effect in the event of the sale of the leased premises during its term.

Once registered, the registration fees will be applicable, and the tenant is the one the usually pays them; please refer to **2.10 Taxes Applicable to a Transaction**.

6.21 Forced Eviction

The tenant may be evicted in the event of a legal or contractual breach, especially failure to pay rent and other charges. In these cases, to recover its property, the remedy of the landlord is to commence judicial eviction proceedings, aiming to have the real property vacated. According to the National Council of Justice, the estimated average period is two years and one month until the first court decision, and ten months in the case of appeal. Considering that 97.2% of new procedures were filed in electronic format in 2021, it is estimated that this period will become increasingly shorter.

The real property must be vacated within 30 days of the eviction order issued by the judge, except if (i) the interval between the service of process and the judgment is longer than four months; or (ii) the eviction arises from failure to comply with the lease agreement, lack of payment or other circumstances set out in the Urban Lease Law and provided that a deposit is provided in the amount equivalent to three months' rent, in which case the injunction will be granted by the judge to vacate of the property within 15 days.

During the COVID-19 pandemic, a law was enacted to suspend eviction proceedings, which is no longer in force.

6.22 Termination by a Third Party

A lease may be terminated by public authorities in the following events:

- expropriation, which may be due to public need or utility, or social interest, through fair and prior compensation in cash;
- imminent public danger; or
- to carry out urgent repairs that cannot be carried out while the tenant remains in the real property (or if the tenant refuses to agree with the repairs).

The period of the judicial procedure may vary but is usually a timing consuming process.

The public authorities must pay the compensation to the property owner. If the real property is leased, the tenant may also claim compensation in separate proceedings.

6.23 Remedies/Damages for Breach

In a typical lease agreement, the penalty in which the tenant incurs in the case of a breach of the agreement is usually equal to three monthly rents, reduced proportionally to the period of the lease already elapsed. In atypical leases it is legally possible charging the remaining rent.

Additionally, if the landlord identifies damage to the property, it is possible to claim indemnification/losses and damages and to enforce the security provided by the tenant, if applicable. For a discussion on the forms of security, please refer to **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations**.

7. Construction

7.1 Common Structures Used to Price Construction Projects

In Brazil, the pricing structures for construction projects typically fall into one of the following categories.

- Lump-sum: this structure stipulates a fixed price for the entire scope of work in the construction project.
- Cost-plus: under this arrangement, the project owner bears all construction costs, which are then reimbursed to the construction company. In addition to these costs, the construction company receives a profit margin, which may be a fixed fee or a percentage of the construction costs.
- Capped cost-plus (PMG): this is a variation of the cost-plus model where a maximum limit is set on the costs that the project owner will reimburse. This model is increasingly popular in Brazil as it incentivises the construction company to manage costs efficiently.

7.2 Assigning Responsibility for the Design and Construction of a Project

The division of responsibilities for design and construction is influenced by the project owner's familiarity with the construction industry and the complexity of the project.

For less complex projects or for owners with limited industry knowledge, it is typical for the construction company to assume responsibility for both the design verification and the construction. In contrast, for more intricate projects or for owners with extensive construction experience, the design responsibilities, including the selection of certain materials or equipment, are often retained by the project owner. The construction company's role is then focused on executing the project according to the owner's specifications.

7.3 Management of Construction Risk

To manage construction risks, the following contractual mechanisms are commonly employed.

- Contractual allocation of responsibilities: this involves determining the roles and obligations of each party under the contract.
- Indemnification rights and warranties: these provisions allow for compensation for losses or damages incurred due to the actions of the other party and respective warranties and security.
- Limitations and waivers: the parties may agree to limit liability or waive certain types of damages, such as indirect losses or loss of profits.

While parties have significant freedom in allocating responsibilities, certain mandatory legal provisions must be observed. For instance, Brazilian law mandates that construction companies are liable for the structural integrity and safety of a building for five years following the completion of construction.

7.4 Management of Schedule-Related Risk

Construction projects are legally required to contain a completion date. While construction companies are permitted to extend the completion date by up to 180 days without penalties, interim project milestones are frequently established to work as incentives, particularly for financing purposes. These milestones may be tied to the release of financing instalments upon achievement.

Additionally, Brazilian law permits the inclusion of monetary penalties in contracts for failure to meet established milestones.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

In Brazil, it is common for project owners to require additional security to guarantee contractor performance, given the legal framework that supports such practices. These include:

- performance bonds, which guarantee project completion in accordance with contractual terms;
- letters of credit and escrow accounts, regulated by banking laws, which offer financial assurances by holding funds until contract conditions are satisfied;
- parent guarantees, where a parent company backs the contractor's obligations, which are supported by corporate law provisions; and
- third-party sureties, similar to performance bonds, which provide a guarantee from insurance companies based on insurance laws and regulations.

These mechanisms are aligned with Brazil's emphasis on protecting project investments and ensuring contractual compliance.

7.6 Liens or Encumbrances in the Event of Non-payment

Owners usually resort to a "right of retention" in the case of non-performance of professionals such as builders, contractors and designers. This right allows them to retain the payment until the work is completed. The opposite is not usual in Brazil. However, in the case of non-payment, contractors and/or designers are permitted to file a lawsuit against the defaulting owner to ensure the right to payment.

7.7 Requirements Before Use or Inhabitation

In Brazil, for a building to be lawfully occupied, it is necessary to first obtain an occupancy permit (*habite-se*) certifying the construction's compliance with municipal regulations. Only with the occupancy permit and the fire brigade's inspection certificate (AVCB), among other documents, will the company obtain the operating licence which is required to develop any non-residential activity in the real property and to obtain insurance or loans.

8. Tax

8.1 VAT and Sales Tax

The following taxes are directly levied on the transfer of real properties:

- in the event the transfer occurs against consideration, ITBI is charged by the municipality; and
- if the transfer is carried out as a donation or arises from inheritance the Tax on Donation (ITCMD) is charged by the relevant state.

The rates of such taxes may vary from one municipality or state to another.

Additionally, in the event of transfer of the useful domain of a specific public property to private party, the transfer of said rights is subject to the payment of a specific charge called *laudêmio*.

8.2 Mitigation of Tax Liability

According to Brazilian laws, the buyer (new owner) of real estate is responsible for property in rem taxes. Therefore, it is always recommended to the buyer to perform due diligence that will review the municipal tax and liabilities clearance certificate. Although the mitigation of tax liability

on real estate transactions must be evaluated on a case-by-case basis, hold backs and escrow accounts as collateral for any tax liability are the most usual methods.

8.3 Municipal Taxes

There is not a specific tax paid on the occupation of business premises. However, there are municipal taxes relating to the property that are usually transferred to its user, such as Urban Property Tax (IPTU) and waste collection tax. The rate of IPTU may vary from one municipality to another. In general, the assessment of IPTU is based on the value of the property's built and land area enrolled with the municipality.

Exemptions from the payment of IPTU may be granted due to (i) characteristics of the taxpayer (eg, retirees, pensioners); or (ii) characteristics of the property.

8.4 Income Tax Withholding for Foreign Investors

Usually, foreign investors prefer to invest in real estate through Brazilian vehicles.

Notwithstanding, as a rule, income and gains earned by foreign investors in relation to direct investments in real estate located in Brazil are subject to Withholding Income Tax (WHT) in Brazil.

Rental income from real estate located in Brazil earned by foreign investors is subject to WHT at a 15% rate. The respective WHT levy on the net value of the rent, that is, after deducting the expenses related to taxes and fees levied on the relevant real estate, the expenses paid for collection or receipt of the rent, and common charges, among others.

WHT must be withheld and collected on the date of the taxable event by the foreign investor's attorney-in-fact in Brazil.

On the other hand, capital gains realised by foreign investors from the sale of real property located in Brazil are subject to progressive rates ranging from 15% to 22.5%. Capital gain is the positive difference between (i) the price received from the disposal of the asset and (ii) the corresponding acquisition cost for the seller.

If the country of residence of the foreign investor has entered into a treaty to avoid double taxation with Brazil, the WHT levied on rental income and/or capital gain from the disposal of real estate may be subject to different tax rates than the ones mentioned above.

8.5 Tax Benefits

Brazilian companies subject to corporate income taxes under the taxable income method may deduct from the calculation basis the expenses of depreciation, maintenance, repair, conservation, taxes, fees, insurance, and any other expenses with real estate, provided that such real estate is intrinsically related to the production or sale of goods and services of the respective companies.

Conversely, Brazilian individuals, foreign investors and Brazilian companies subject to corporate income taxes under other methods (eg, estimated profit method) are not entitled to deduct the expenses of depreciation, repair and conservation of the real estate from their corporate income tax calculation basis.

Trends and Developments

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Campos Mello Advogados is a full-service law firm that works in co-operation with DLA Piper assisting national and international companies. The firm's clients have access to a broad, global service platform and are quickly advised by professionals located in 90 offices in over 40 countries, which allows for in-depth knowledge of different industries and company sizes. This unique network also ensures best practices and highly qualified information. This results in a more efficient and business-oriented performance, in pursuit of integrated and innovative solutions.

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Overview

The outlook for the real estate market in 2024 is more positive than the scenario that was unfolding in 2023.

At the beginning of last year, the country was dealing with the pressure of inflation and high interest rates, which directly impact the purchasing power of the population and the financing.

Nevertheless, the market did not perform poorly. According to Abrainc (Brazilian Association of Real Estate Developers), the number of real properties sold between January and September 2023 was 22% higher than in the same period the previous year.

At present, the scenario is more conducive to a heating up of the Brazilian real estate market in 2024, notably due to the following factors.

Prospects for interest rate reduction

The basic interest rate (Selic) is the main reference for the cost of loans and financing in the country. In general, when it rises, lending money becomes more expensive, which ends up discouraging the economy as a whole. However, this is a mechanism to curb inflation when prices are rising rapidly.

As inflation pressure is decreasing (in 2023, IPCA (National Broad Consumer Price Index) stayed within the target, after two years of exceeding it), the Brazilian Central Bank has been lowering interest rates and indicates that it could continue in this direction.

This benefits the real estate market in two ways:

- stimulating the economy as a whole, which increases job creation and income; and
- allowing real estate financing with less restrictive conditions and lower interest rates.

Improvement of the economy as a whole

In addition to the decline in interest rates, data and expectations of improvement in the overall economy also paint a promising scenario for the real estate market in 2024.

Unemployment measured by IBGE (Brazilian Institute of Geography and Statistics), for example, stood at 7.5% in November 2023, the lowest figure since February 2015.

Last year's GDP growth prospects reached 3%, well above what was expected at the turn of the previous year.

Not to mention that inflation closed below 5%, within the established target, which helps preserve the purchasing power of the customers.

In this scenario, Brazilians want to buy more real properties. According to a survey by the consultancy Brain, 39% of people intend to purchase property in the country within two years.

Government fostering

In addition to the favourable scenario for the real estate market, there are government incentives for low-income families to acquire their own property, including:

- the expansion of *"Minha Casa, Minha Vida"* (My House, My Life) programme (federal housing programme), with an increase in the values that qualify for the main subsidy bracket;
- the approval of a budget of BRL117 billion for FGTS (Guarantee Fund for Length of Service) to finance housing for low-income families; and

- the implementation of programmes that discourage family indebtedness, and the limitation of interest rates charged on credit card revolving credit.

Significant recent legislative innovations are set out below; these innovations will certainly keep impacting the real estate market in 2024 and beyond.

Law 14,620/2023

Law 14,620/2023 was responsible for restarting the *Minha Casa Minha Vida* programme and also implemented a number of changes to real estate provisions, affecting the Public Registry, regulated by Law 6,015/73, as well as:

- the Electronic System (Law 14,382/22);
- the Real Estate Development and Building Condominium Law (Law 4,591/1964);
- the Urban Ground Division Law (Law 6,766/1979);
- the Civil Code (Law 10,406/2002); and
- the Rural and Urban Land Regularisation Law (Law 13,465/2017).

Minha Casa, Minha Vida

Minha Casa, Minha Vida is a federal housing programme in Brazil, created in March 2009, which facilitates housing credit for low- income families.

In July 2023, the programme was modified with the publication of Law 14,620, with the aim of increasing the number of beneficiaries. This was pursued through the following changes.

- Increase in the limit for financing properties: *Minha Casa, Minha Vida* finances up to 80% of the value of the property, with the remainder being the entrance payment, which can be reduced with government subsidies and the use of the FGTS, and the value of each instalment can be up to a maximum of 30% of the combined income of the buyers of the property.
- Increased subsidies: if FGTS resources are used, families in the programme will have a greater discount on the entrance payment for the purchase of the property; lower-income families will have government assistance to reduce the value of the financing instalments; and the subsidy for the purchase of the property will be up to BRL55,000.
- Interest rate reduction: for families earning up to BRL2,000 a month, the interest rate has been reduced to 4%, from 4.25%.

Changes in the Public Registries Law and in the Electronic System of Public Registries Law (SERP)

The Public Registries Law (Law 14,620/2023) has included several new provisions, such as:

- the possibility to open real estate records for properties originally acquired if it affects parts of previously registered properties or affects more than one previously registered property;
- the Federal Government, States, Federal District and Municipalities can request the opening of real estate records for urban properties without previous registration, whose ownership has been guaranteed to them by law; and
- private agreements authorised by law, administrative contracts and terms related to extrajudicial expropriations are admitted for registration in the competent real estate registry office.

The Electronic System of Public Registries Law (Law 14,620/2023) has allowed electronic statements related to real estate, produced by financial institutions authorised to enter into instru-

ments with the character of a public deed, to be submitted electronically to the competent real estate registry office.

Changes to the Real Estate Development and Building Condominium Law

A provision was included in the Real Estate Development and Building Condominium Law to establish that the assets and rights that make up the segregate asset can only be used as a guarantee in credit operations whose value is fully intended to be used for the construction and delivery of housing units to buyers.

Changes to the Urban Ground Division Law

Law 14,620/2023 brought important changes to the legislation on allotments, some of the main ones being:

- the allotments can be subject to a special segregation regime, where the land, infrastructure and other assets are separated from the subdivider's assets, constituting a segregated asset to guarantee the development and delivery of the lots to the purchasers; and
- the allotment developer has specific obligations, including promoting good administration and preserving the segregated assets, keeping the assets of the allotment separate, raising funds for the development and providing periodic statements on the status of the work.

Changes to the Civil Code

Law 14,620/2023 has introduced changes related to rights in rem and mortgages.

- Rights in rem: inclusion of the concession of the right in rem to use the slab and the rights arising from the provisional imposition of possession, when granted to public entities and their delegates, and the respective assignment and promise of assignment as rights in rem.
- Mortgages: expansion of the objects that can be mortgaged to include surface rights and introduction of the rights arising from the provisional imposition of possession, when granted to public entities and their delegates, and the respective assignment and promise of assignment.

Changes to the Rural and Urban Land Regularisation Law

Law 14,620/2023 brought important changes to Rural and Urban Land Regularisation Law, such as:

- the responsibility of municipalities to regularise informal urban areas within their jurisdictions;
- the obligation of public authorities to implement basic infrastructure, community equipment and housing improvements through public and private resources;
- the prior transfer of the right to build to make regularisation projects viable; and
- specific procedures for registering properties resulting from land regularisation projects.

Acquisition of Farmland by Foreign Capital

The National Congress initiated two Bills (Nos 2963/2019 and 2964/2022), which propose, in short, the removal of restrictions and impediments for Brazilian companies controlled by foreign capital to make investments in farmlands through acquisition or lease, except in the Legal Amazon, coastal and border areas, thus also respecting national security. The Bills would still maintain the restrictions on all foreign individuals or legal entities, and restrictions in the case of acquisition or lease by certain entities such as NGOs, foundations, sovereign funds, entities and companies controlled at any level by states,

which will need to request prior authorisation from the National Security Council.

If approved, the Bills will be an important change which will certainly contribute to the desired rise in investment in the Brazilian economy and agribusiness, such as a possible occupation and use of rural areas by foreign investors in the energy and energy distribution sectors.

Legal Landmark on Guarantees

The Legal Landmark on Guarantees (Law No 14,711/2023), published at the end of 2023, was created to modernise the existing legislation on the subject, aiming to provide greater legal certainty to the guarantees provided, notably mortgage and fiduciary sale, as well as to facilitate their enforcement and reduce the risks related to debtors' default.

This comprehensive legislative amendment, which impacts not only real estate law but also banking operations, seeks, among other things, to revitalise the mortgage institute, optimise the functioning of fiduciary sale, and promote a more conducive environment for taking out real estate loans, by reducing their interest rates, as it facilitates the location of assets and their enforcement by the creditor.

A significant change is the possibility of establishing subsequent fiduciary sale on the same real estate property. This means that a real estate property already encumbered by fiduciary sale may be further encumbered by subsequent fiduciary sale, aiming to secure obligations distinct from those that led to the initial encumbrance. Thus, in the event of enforcement of property encumbered with more than one fiduciary sale, the previous ones will have priority over the subsequent ones, with the rights of subsequent creditors subrogating to the price obtained from the sale of the real property. If the creditor pays the debtor's debt, they will be subrogated both in the credit and in the fiduciary ownership.

The subsequent fiduciary sale can be registered in the real estate registry from the date of its execution, but it only becomes effective upon the cancellation of the previously constituted fiduciary ownership.

The new rules optimise the functioning of real estate fiduciary sale in Brazil because, unlike the previous model, where there used to be a mismatch between the debt value and the property value (especially in the final instalments of the obligation payment), the property remained "tied" to a debt much lower than its value. Thus, with subsequent fiduciary sales, properties can be involved in various obligations, and their value is not restricted to securing a single debt.

Two other novelties that have been introduced are also worth mentioning.

- There is a legal provision for the parties to include in the contract that, in the case of default, the creditor may declare due the other obligations secured by the same property of which they are the holder.
- The possibility of fiduciary sale being contracted to guarantee third-party debts, in addition to one's own debt, has been formalised.

The new Law also brought changes to the property consolidation procedure. From now on, the contract may define the grace period for the issuance of the notification, and if there is no such provision, it will be issued within 15 days. Furthermore, provisions were created to prevent the debtor from benefiting from their absence. An example of this is that, henceforth, it is pre-

sumed that the debtor and, if applicable, the third-party grantor, are in an unknown place when they are not found at the property location given as collateral or at the last address they provided, and it is considered inaccessible if the employee refuses to accept the notification or if there is no employee available for this purpose.

Also, in the second auction referring to the collection procedure, default remedy, consolidation of fiduciary ownership, and auction resulting from financing for the acquisition or construction of residential property, the minimum bid to purchase the property is composed of the debt guaranteed by the oldest fiduciary sale, plus expenses and charges; and if there is no bid meeting the minimum requirement for purchase, the debt will be considered extinguished, with reciprocal discharge, in which case the creditor will have the free availability.

As for the collection, default remedy, consolidation of fiduciary ownership, and auction resulting from financing for the acquisition or construction of non-residential property, the minimum bid in the second auction will be the debt plus expenses and charges. However, if no bid reaches that value, the fiduciary creditor may choose one that corresponds to at least half of the property's appraisal value, and the creditor may judicially enforce the remaining amount. Therefore, unlike fiduciary sale of residential property, the debt guaranteed by fiduciary sale of non-residential property is not extinguished with the foreclosure of the guarantee.

Once the property is consolidated in the name of the fiduciary creditor, the auction of the property will be promoted within 60 days. The existence of real rights of guarantee, or any encumbrances and unavailability of any kind on the real acquisition rights of the grantor, do not prevent the consolidation of the real property and the sale of the real property. In this case, the holders of real rights are subrogated to the grantor's right to receive the balance that may remain from the proceeds of the sale.

The deadline for holding the public auction for the sale of the real property has doubled: it is now 60 days from the consolidation of ownership.

The mortgage, in turn, also included changes in the aforementioned law. It can now be executed out-of-court through two auctions, with the debtor or the mortgage guarantor being granted the right to redeem the execution by paying the entire debt, plus the expenses of the collection and auction procedures, within three days.

Default on the obligation guaranteed by the mortgage allows the creditor to declare due the other obligations they hold guaranteed by the same property.

Finally, it is worth noting that the mortgage and fiduciary sale may be extended to guarantee new obligations in favour of the same creditor – in the case of fiduciary sale, provided that there is no obligation contracted with a different creditor guaranteed by the same property – so that if the creditor pays the debts guaranteed by the mortgages or fiduciary sales earlier, they will be subrogated to their rights.

CANADA



Law and Practice

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Stikeman Elliott LLP is a global leader in Canadian business law and the first call for businesses working in and with Canada. The firm has offices in Montreal, Toronto, Ottawa, Calgary, Vancouver, New York, London and Sydney. It provides clients with high-quality counsel, strategic advice and workable solutions. The firm has an exceptional track record in major US and international locations on multi-jurisdictional matters and ranks as a top firm in primary practice areas, including mergers and acquisitions, securities, business litigation, banking and finance, competition and foreign investment, tax, restructuring, energy, mining, real estate, project development, employment and labour, and pensions.

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Stikeman Elliott

1. General

1.1 Main Sources of Law

Under Canada's federal constitution, laws relating to real estate fall within provincial jurisdiction. Each Canadian province enacts its own legislation with respect to the ownership structures, use, acquisitions and dispositions, financing and development of real property. Such laws tend to be similar across most of Canada's provinces, as well as in the three northern territories. The exception is the civil law jurisdiction of Quebec. In recent years and in response to surges in residential property prices and availability, many Canadian provinces have enacted legislation imposing increased transfer tax, owner transparency and foreign ownership restrictions and obligations; at the federal level, the Prohibition on the Purchase of Residential Property by Non-Canadians Act (see **2.11 Legal Restrictions on Foreign Investors**) was recently introduced.

In Canada's common-law jurisdictions – that is, all provinces and territories other than Quebec – common-law jurisprudence is a key component of real estate law. In addition, some real estate-related common-law principles have been codified in legislation in Canada's common-law jurisdictions. In Quebec, the Civil Code (similar to those in use in many European countries) serves as the primary source of law, although case law clarifies issues that remain after the application of the Civil Code of Quebec.

International law is not a significant source of real estate law in Canada. Nevertheless, international treaties are occasionally reflected in Canadian real estate legislation. Orders of foreign courts are enforceable in Canada under certain conditions.

1.2 Main Market Trends and Deals

Access to Capital

Canada's real estate market post-pandemic has experienced rising interest rates, which have slowed the exuberance in the post-pandemic deployment of capital to a degree. As interest rates have risen, the market has experienced a trend of tightened lending conditions and requirements in order to access more capital. Fluctuating market dynamics have created additional market tension, and uncertainty around valuations is expected to remain a concern for real estate companies. Going forward, access to debt and equity capital will also continue to impact real estate companies and their investment strategies.

Institutional and private funds continue to dominate the market, with active participation from new private, pooled funds. Financings and refinancings remain active, although the spike in interest rates has had a cooling effect.

ESG and Green Building Initiatives

With federal government commitments to achieve net-zero emissions by 2050 and environmental, social and governance (ESG) reporting and disclosure requirements becoming more prevalent, asset managers across several sectors, including the real estate industry, are focusing on ESG performance, strategic planning, and environmental stewardship and management. This trend is demonstrated by both the increased prevalence of green building initiatives in leases and the ongoing dialogue between owners and tenants regarding cost allocation for these initiatives. While the downtown office sector has seen tenants compressing operations and an active sublease market, rent payments have largely been kept current and many businesses are planning on, or actualising, a hybrid or full return to the office.

The Industrial, Retail and Residential Sectors

The Canadian real estate market has not yet been significantly impacted by potentially disruptive developments such as blockchain, DeFi and proptech.

The industrial sector remained strong throughout the early days of the pandemic, and has since far exceeded its pre-pandemic buoyancy. The explosive growth of online commerce, plus even greater demand due to the exponential need for logistics and distribution centres as a result of the pandemic, has sustained and increased pressure on the industrial real estate market, as major online distributors vie for scarce urban space in which to house new fulfilment centres.

The retail sector has seen something of a resurgence, with a focus on larger regional shopping centres and properties with large anchor tenants doing well.

The residential sector has shifted in focus as the demand for suburban and recreational property has enjoyed a strong boost, such that this sector has generally returned to very strong levels. In particular, multi-residential and purpose-built rentals remain strong sectors for developers.

Notable Transactions

Some of the larger real estate transactions in Canada in 2023 were:

- Allied Properties REIT sale of Toronto-based data centre portfolio to KDDI Corporation for CAD1.35 billion;
- TPG's acquisition of a 75% interest in two Oxford Properties industrial business parks for CAD990 million; and
- the Ivanhoe Cambridge sale of a 49% interest in the Vaughan Mills shopping centre to LaSalle Management.

1.3 Proposals for Reform

Legislative reform at the provincial and federal levels is driven by motivations to create affordable housing and increase transparency of ownership of real estate in Canada.

While Ontario and Quebec impose transfer taxes on unregistered (or "beneficial") transfers of land, other jurisdictions, such as British Columbia, are considering taxing beneficial transfers, while a third group, including Alberta, do not tax either transfers of title or beneficial interest transfers. Onerous transparency and disclosure requirements are on the rise, with notable legislative implementation in British Columbia and Ontario.

Taxation

Both British Columbia and Ontario have already instituted foreign-buyer taxes in respect of certain residential properties in certain geographic areas, and in Ontario, the City of Toronto is considering a similar additional tax at the municipal level. In British Columbia and in the Cities of Toronto and Ottawa, annual taxes are imposed to target owners who own real estate that is neither their principal residence nor made available for long-term rental, to encourage rental of under-used residential properties in major urban centres. The annual tax rates in Toronto and Ottawa for 2023 were 1% of assessed value (in Toronto the rate will be 3% in 2024) and in British Columbia, the rate varies from 0.5% to 2% of the property's assessed value. The federal government has additionally passed Bill C-8, containing the "Underused Housing Tax Act", with a 1% annual tax on the value of certain residential property owned by non-permanent residents or non-citizens considered to be vacant or underused, effective as of 1 January 2022.

Transparency and Disclosure Requirements

Ontario has also imposed onerous disclosure requirements as part of its land transfer tax regime, including details of shareholdings and beneficial ownership for transfers of agricultural land and certain residential properties. Similarly, in British Columbia, legislation exists to increase transparency of hidden (beneficial) ownership of real estate. A publicly accessible registry of indirect owners of land came into effect on 30 November 2020, and became accessible to the public on 30 April 2021. While certain information is publicly available on such registry, more sensitive information is only available to law enforcement/government agencies. Disclosure of these material interest-holders is required on a retroactive and ongoing basis.

Social or Affordable Housing

In Quebec, all municipalities, intermunicipal boards and transit authorities were recently given powers that used to be only available to the City of Montreal to acquire properties, notably for the purposes of social or affordable housing.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights fall within the jurisdiction of the provinces or territories, and differ across the country. Each jurisdiction has statutes that govern the acquisition, ownership, use, financing and development of real estate. In common-law jurisdictions, a freehold estate in real property is a right or interest that exists for an indefinite duration. Conversely, leasehold estates have a fixed duration. A fee-simple estate is the most common freehold estate in Canada and is considered absolute ownership of real property. A leasehold estate is not absolute but confers an exclusive right of possession during the lease term to the tenant.

Other non-possessory rights in land include:

- easements and rights-of-way to use a portion of land for a specified purpose; and
- restrictive covenants restricting the use of land.

Licences to use land are contractual, do not create an interest in land and generally do not grant exclusive possession.

In Quebec, real estate is generally governed by the Civil Code of Quebec, which distinguishes between personal rights and real rights.

2.2 Laws Applicable to Transfer of Title

Transfers of title are governed by provincial and territorial statute. Certain jurisdictions (Alberta, Manitoba, Prince Edward Island, Quebec and Saskatchewan) restrict the ownership of farmland or rural recreational land by non-residents. In Quebec, non-residents who are restricted from acquiring farmland include residents of other Canadian provinces or countries (in the case of individuals) and those whose directors and ultimate shareholders are not domiciled in Quebec (in the case of corporate entities). See also **2.11 Legal Restrictions on Foreign Investors** regarding the federal Prohibition on the Purchase of Residential Property by Non-Canadians Act.

2.3 Effecting Lawful and Proper Transfer of Title

In common-law jurisdictions, registered (legal) title is typically transferred to the buyer upon registration of a deed or transfer in the relevant land registry office. In Quebec, ownership is transferred as soon as there is a “meeting of

the minds", but the sale may not be opposable against third parties until a deed is registered.

Land Registration Systems

There are two types of land registration systems in Canada:

- the registry system – a public record of instruments affecting land; and
- the Torrens (land title) system – which is government-operated and effectively guarantees title, subject to certain limitations.

Each province and territory uses either one or a combination of these systems. However, most common-law jurisdictions have converted or are converting to the more modern Torrens system.

Registration of Instruments

Requirements for registration of instruments affecting land differ across the various provinces and territories and may include procedural, format and content requirements. Electronic registration of instruments is increasingly available in most jurisdictions. All registered instruments in Quebec must be submitted in French only.

Title Insurance

Title insurance is commonly used in Canada, but somewhat less in provinces with a Torrens system (ie, with a statutory assurance of title). Many lenders require borrowers to obtain title insurance. Title insurance can also insure against matters otherwise typically covered by diligence, such as when a legal survey is not available, or when unusual title risks exist.

Documentation and Transactions

The pandemic has resulted in increased flexibility and new processes for documentation and completion of real estate transactions in Canada, including remote witnessing through videoconference and use of affidavits of execution for remote execution of land title documents in certain provinces. Electronic filing of documentation with government authorities has been further expanded, such as transfer tax filings and certain land registry filings which previously required paper submissions.

2.4 Real Estate Due Diligence

Typically, a buyer and seller will enter into a conditional purchase agreement, following which due diligence is conducted. If the buyer is satisfied with its investigations, it will waive its due diligence condition and the transaction will become "firm", provided any other conditions have also been satisfied.

Real estate due diligence generally consists of:

- examining title and zoning;
- conducting inquiries with government authorities and utilities;
- reviewing leases, property contracts and surveys; and
- commissioning environmental and building condition assessments.

2.5 Typical Representations and Warranties

Typical contractual representations and warranties that a seller gives a buyer depend on market conditions and the relative bargaining power of the parties. Depending on market leverage, sellers typically seek to sell their real property on an "as is" basis, with limited warranties as to factual matters that might be difficult for a buyer to verify independently, such as the fact that the seller:

- has delivered all contracts, leases and reports in its possession or control; and

- has not received notices of legal non-compliance, environmental contamination or expropriation.

There has been no developed practice in respect of specific representations and warranties relating to the COVID-19 pandemic.

In common-law jurisdictions, no general duty of disclosure is imposed on a seller, and the principle of caveat emptor ("buyer beware") applies to the purchaser. However, certain exceptions oblige the seller to disclose matters such as known environmental contamination or defects that render the property dangerous or uninhabitable.

In Quebec, warranties as to ownership and the absence of latent defects apply, unless excluded or limited under the deed of sale. A professional seller may not exclude or limit these warranties in respect of undisclosed defects of which it is aware or should be aware. A non-professional seller, however, may exclude or limit these warranties based on the Quebec caveat emptor equivalent. However, all sellers are bound to act in good faith under Quebec civil law, and failure to disclose a known defect would likely amount to fraud.

Across Canada, caveat emptor does not apply to fraud. A seller is liable for latent defects where the failure to disclose them amounts to fraudulent misrepresentation. In common-law jurisdictions, a seller may be liable to a buyer for innocent, negligent or fraudulent misrepresentation for which the remedies include rescission (the setting-aside of the contract) and/or damages, depending on the circumstances.

Depending on the parties' intent expressed in their contract, a seller's representations and warranties may either expire or survive completion for agreed periods. Survival periods tend to be limited as the market or the relevant risks permit. Liability caps are not commonly used unless the specified risks are known, but are sometimes found in larger transactions with institutional parties (often subject to certain exceptions for such cap). A purchaser's remedies for a breach of representation and warranty will be determined by what is in the contract, and may include an unsatisfied condition to closing or the ability to pursue a claim for such breach.

Typically, the buyer has no security for the enforcement of remedies. The buyer may consider obtaining security in the form of a letter of credit, hold-back, or set-off under a vendor take-back mortgage, or obtaining a guarantee or indemnity from a related vendor party. Representation and warranty insurance has become increasingly common in Canada.

2.6 Important Areas of Law for Investors

An investor will seek comfort that the value of the property and its revenue stream is retained over time. An investor will conduct investigations to determine whether any registered or unregistered agreements affect the land, and whether the land is free from undisclosed liabilities impacting use and value. Applicable zoning/land-use legislation should be reviewed to determine the current and intended uses of the land.

Transfer-tax considerations are increasingly impacting real estate transactions in most jurisdictions in Canada – see **2.10 Taxes Applicable to a Transaction**.

2.7 Soil Pollution or Environmental Contamination

Environmental contamination and remediation of real property is governed by both federal

and provincial or territorial legislation; however, enforcement is primarily at the provincial or territorial level, and clean-up requirements vary. Although responsibility and liability to regulators, buyers and third parties for remediation generally rests with the seller or person that caused the contamination, subsequent owners, occupiers and those exercising control over real property can be liable for that contamination. This generally occurs when the subsequent owner/occupier fails to perform diligence, knowingly accepts the environmental condition of the lands, and/or contractually assumes environmental liability.

Between buyers and sellers, environmental risk and liability are often allocated contractually by representations, warranties and indemnities and, in some cases, adjustment of the purchase price. However, parties cannot contract out of regulatory liability; their liability for environmental contamination is potentially unlimited, although certain provincial governments recognise the contractual allocation of liability.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Permitted uses of a parcel under applicable zoning or planning law can be ascertained through enquiries with local planning authorities and review of municipal land-use by-law regulations. For larger developments, developers must enter into agreements with the applicable municipality to facilitate the development, whether to obtain construction approvals, subdivide the land, or change the applicable land-use by-laws. These agreements commonly relate to servicing and public facilities commitments, land dedications and bonding.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation of real estate falls under both federal and provincial regulatory regimes. The federal government has authority to expropriate interests in land for public works or other public purposes, pursuant to the Expropriation Act (Canada). Each province and territory has similar legislation.

Expropriation legislation across the country sets out procedural requirements for expropriating authorities, such as prescribed notice periods. Compensation is generally based on fair market value of the subject lands and may include costs and damages.

2.10 Taxes Applicable to a Transaction

Transfer tax is imposed at the provincial level and is typically payable upon registration of the transfer instrument in the relevant land registry. Certain municipalities (such as the City of Toronto, Ontario and various municipalities in Quebec) may levy land transfer tax in addition to the tax levied by the province. In Quebec, municipalities charge and collect transfer duties. Taxation rates vary across the country, from a high of 5% of the consideration for certain residential properties in Toronto, to no tax at all in Alberta, Newfoundland and Labrador, and parts of Nova Scotia. All provinces charge registration fees, which are generally nominal.

In Ontario and Quebec, unregistered transfers of beneficial interests in real property are also taxed, subject to some exceptions. In Ontario (but not in Quebec), the transfer of an interest in a partnership that owns land is considered a taxable transfer of beneficial interest in that land.

In most jurisdictions, the buyer is liable for the payment of land transfer tax and is typically

responsible for paying the applicable sales taxes, registration fees and other expenses relating to the purchase.

Taxation on Property Transfers to Foreign Nationals/Corporations

British Columbia and Ontario impose taxes of 20% and 25%, respectively, on the transfer of certain residential properties in certain urban areas to foreign nationals, foreign corporations or trustees for a beneficial owner that is a foreign national or foreign corporation.

2.11 Legal Restrictions on Foreign Investors

The federal Prohibition on the Purchase of Residential Property by Non-Canadians Act enacted on 1 January 2023 currently imposes a four-year restriction on certain persons purchasing residential property in Canada. Residential property is defined to include a detached or semi-detached (townhouse) house and a condominium unit that is located within specified urban areas, including major cities such as Toronto and Vancouver. The prohibition applies to non-Canadians, including individuals who are not Canadian citizens or permanent residents, and corporations and other entities (such as partnerships) which are controlled by a non-Canadian. Notably, control is defined as direct or indirect ownership in an entity that represents at least 10% of the value of the entity or that carries 10% or more of the voting rights, or control of that entity on a factual basis. It is currently unclear what "factual control" means for the purposes of this prohibition.

Exceptions to these restrictions include:

- certain temporary workers may purchase residential property;
- non-Canadians who purchase residential property with their spouse or common-law partner if such spouse or common-law partner is permitted to acquire residential property under this Act; and
- certain persons prescribed under the Regulations.

A purchase does not include:

- an acquisition of a right resulting from death, divorce, separation or a gift;
- rental of a dwelling unit to a tenant for that tenant's occupation;
- transfer under a trust that existed prior to this Act coming into force;
- transfers from the exercise of a security interest or secured right by a secured creditor; or
- acquisition by a non-Canadian of residential property for the purposes of development.

Also at the federal level, the Competition Act and the Investment Canada Act require notification to, or review by, the federal government in certain circumstances involving acquisitions by non-resident purchasers. The federal Citizenship Act also permits each province and territory to enact laws restricting ownership of real property by non-residents.

At the provincial and territorial level, most jurisdictions have taken measures to preserve farm or non-urban land, and certain jurisdictions limit the amount of farmland that can be owned by non-residents. Some provinces and territories also require that non-Canadian corporations obtain an extra-provincial licence or complete certain registrations to own real estate.

For discussion of the Ontario and British Columbia foreign buyer taxes and under-used housing

taxes and the federal under-used housing tax, see **1.3 Proposals for Reform**.

As mentioned in **2.10 Taxes Applicable to a Transaction**, British Columbia and Ontario also impose additional taxes on foreign investors.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are typically financed through mortgage debt provided by financial institutions such as banks, insurers, trust companies, pension funds, credit unions and other entities that lend money in the ordinary course of business.

Some companies may also be able to utilise equity financing or (in the case of larger companies) corporate level financing to fund acquisitions of real estate.

3.2 Typical Security Created by Commercial Investors

Real estate financing is commonly secured by granting a mortgage and a general assignment of rents and leases (an immovable hypothec in Quebec), of the borrower's interest in the subject real estate, along with a general security agreement (a movable hypothec in Quebec), with respect to the borrower's personal property. These security interests are created by the execution of security documents and are perfected by registration in the applicable land title and personal property registries. Lenders may also require additional security, such as an assignment of contracts, or third-party indemnities or guarantees.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Although any person may lend money and take a mortgage (hypothec in Quebec) to secure real-estate loans, certain financial institutions are regulated by statute, with special provisions applying to foreign financial institutions, and mortgage brokerage legislation applying to lending on the security of real property in several provinces. For the registration of security, certain land title registries require foreign lenders to provide evidence of their existence and good standing. Others require foreign lenders to be extra-provincially registered with the provincial corporate registry in order to take security over real property in the province. Although mortgage interests may be exempt from restrictions on foreign ownership of land, the act of realising upon security (or the ownership of the affected land for a period of time after realising upon security) may contravene such restrictions.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Nominal registration fees apply to the registration of a mortgage, an assignment of rents, a hypothec or any other registered real property security.

Apart from typical legal and other enforcement costs, there are no specific registration fees payable in connection with the enforcement of security over real property.

3.5 Legal Requirements Before an Entity Can Give Valid Security

While giving financial assistance has traditionally been legally restricted or prohibited, many Canadian jurisdictions have recently eased or eliminated the requirements. However, legislation in some provinces still contains express disclosure and reporting requirements. Even where financial

assistance is not directly prohibited or restricted by statute, directors must observe their fiduciary duty to act in the best interest of the corporation when approving such arrangements.

In addition, when dealing with non-individuals (ie, corporations, trusts, partnerships), the organisational documents may contain restrictions or limitations on certain activities.

3.6 Formalities When a Borrower Is in Default

Available Remedies

In the common-law provinces, remedies for mortgage lenders generally include foreclosure, action on the covenant, appointment of a receiver, judicial sale, power of sale and possession. Power of sale is a sale of the mortgaged property by the mortgage lender without court proceedings or supervision, pursuant to either the provisions of the mortgage which expressly grant the lender the power to sell the mortgaged property upon default, or the applicable mortgage legislation (a power of sale is not available as a remedy in all common-law provinces). In Quebec, analogous remedies include a personal right of action against the debtor, as well as the hypothecary rights of taking in payment, sale by a secured creditor, sale by judicial authority and taking possession for the purposes of administration.

A lender is obliged to give "reasonable notice" before making a demand for payment and will generally be required to send notices under federal bankruptcy legislation before seeking to enforce its security over the interest in land. In Ontario, New Brunswick, Prince Edward Island and Quebec, the lender is free to sell the property privately by a prescribed process, while reserving the right to sue the borrower for any deficiency in the sale proceeds. In British Columbia, Alberta, Ontario and Quebec, the lender can sue for foreclosure (resulting in title to the property passing to the lender in full satisfaction of the debt). More commonly, most provinces also permit a lender to apply to court for a judicial sale of the property, with the borrower remaining liable for any resulting deficiency.

While lenders will often seek to find a commercial solution for problematic loans (including by way of forbearance), in an environment of higher interest rates and reduced access to capital for some real estate investors, it appears that lenders are more willing in the current climate to pursue enforcement of their security.

Timeframe

The range of time for a lender to successfully enforce and realise on real property security will be highly fact-dependent, however, three to six months would not be unusual in uncontested cases where there is little to no equity in the project. While court closures and access restrictions resulting from the pandemic may have resulted in enforcement delays, legislation restricting a lender's ability to foreclose or realise on collateral has not been implemented.

3.7 Subordinating Existing Debt to Newly Created Debt

Certain statutory liens for property taxes, pension deficits, construction liens or other statutory remittance obligations may have priority over secured debt, even if the secured debt was registered/perfected prior to creation of the lien. Otherwise, debt secured by registration may generally only be subordinated to new debt by agreement of the existing secured party.

3.8 Lenders' Liability Under Environmental Laws

Holding security will not generally expose a lender to environmental liability, although the value

of the secured asset could be reduced if that liability arises during the term of the loan. Upon realising on the security and taking possession or control of the subject lands, a lender (or its receiver) could be exposed to environmental liability.

3.9 Effects of a Borrower Becoming Insolvent

If security interests are granted by a borrower on a legitimate bona fide basis, for good consideration, the subsequent insolvency of the borrower will not generally affect the enforceability of the security interest. However, the secured party's enforcement proceedings may then be subject to court oversight and associated delays. If security was granted for little or no consideration, or on any basis where the intent of the grant of security was to prefer certain debts over others, federal legislation imposes "claw-back" rules that could impair or invalidate the security.

3.10 Taxes on Loans

As discussed in **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**, nominal registration fees apply to the registration of a mortgage, an assignment of rents, a hypothec or any other registered real property security.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Provincial governments are responsible for land-use planning (other than on federal lands), but delegate most planning and zoning functions to municipalities. Much of the regulation of real property is in the form of zoning by-laws and building by-laws (informed by provincial policies and plans, municipal official plans and *plans d'urbanisme*).

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Municipal by-laws regulate nearly all aspects of land use, the nature of buildings thereon, and the size and intensity of development of land. Building permits are required for construction and for additions/alterations to buildings. Building-permit fees are typically calculated based on the floor area of the proposed building or the value of the proposed construction, and the type and use of the building. Building by-laws, building-permit requirements and building-code standards govern the building materials, heating and ventilation systems, electrical systems, sewerage and water systems, fire safety, access and inspection. The National Building Code of Canada has largely been adopted by the municipalities of most provinces, resulting in a trend towards building regulation uniformity. Regulations may restrict redevelopment of a building having heritage value. For developments in specialised urban areas, additional design approvals may also be required.

4.3 Regulatory Authorities

Most provincial planning and zoning functions have been delegated to municipalities. Zoning and building by-laws designate geographic zones within the municipality and prescribe the uses allowed in each zone, limit density, dictate height and parcel size, and impose minimum building setbacks and parking requirements.

4.4 Obtaining Entitlements to Develop a New Project

Development projects typically require applications for subdivision, re-zoning and development permits. Each municipality has differing eligibil-

ity, procedural and documentary requirements for each category of development permissions, which range from applying and paying fees to meeting with municipal committees or the public, submitting plans and seeking the approval of municipal councils. Third parties (particularly neighbours) may have the right to be given notice of the application and to participate at a public hearing.

Certain developments may require consultation with affected indigenous peoples. While the Crown is constitutionally required to conduct such consultation, procedural aspects are often delegated to the proponent of the development.

4.5 Right of Appeal Against an Authority's Decision

The availability of a right of appeal in these matters varies. In some provinces, such as Alberta and Ontario, the decision of a municipality may be appealed to a specialised tribunal. In others, such as British Columbia, there is no such tribunal and municipal council decisions are not subject to judicial review on their merits (although they may be reviewable on formal grounds such as lack of jurisdiction, procedural fairness or natural justice).

4.6 Agreements With Local or Governmental Authorities

Large-scale developments by private real estate developers will typically require agreements with the municipality, setting out the terms and conditions for the development to proceed, relating to the construction of public facilities, land dedications, servicing commitments and financial obligations.

4.7 Enforcement of Restrictions on Development and Designated Use

Provincial legislation generally provides for fines and penalties for contravention of applicable zoning and building by-laws. Municipalities may also take direct enforcement action against an offender to bring about compliance, and may pursue injunctions and court orders.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Legal persons (corporations and natural persons) may hold real property in Canada by way of direct ownership by an individual or through ownership of shares in a corporation that owns real estate. Relationships may also be established for the ownership of land, such as co-ownerships, partnerships and trusts, largely based on tax consequences, liability concerns and business considerations. Corporations, partnerships, co-ownerships and trusts are the most popular real estate investment vehicles in Canada.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Corporations

Corporations are legal entities distinct from their shareholders. While corporations provide the benefit of limited liability for shareholders, the income, losses, gains and capital cost allowances of the corporation are taxed or deducted at the corporate level, followed by the taxation of dividends in the hands of the shareholders.

Partnerships

By contrast, a partnership is not a distinct legal entity, and constitutes a legal relationship among its partners and is governed by common law

and/or statute. Under Canadian law, there are two principal types of partnership – "general" and "limited":

- in a general partnership, all partners can participate in management and are subject to unlimited joint and several personal liability for the partnership's obligations; and
- in a limited partnership, partners are divided into "general" and "limited" partners, with the latter's liability being limited to the amount of their capital contributions, on the condition that they do not participate in the management of the business of the partnership.

A significant advantage of investment via a partnership is the tax treatment – although income and losses are calculated at the partnership level, they are taxed and deducted at the partner level.

Co-ownerships

Co-ownerships, like partnerships, are not separate legal entities but constitute a contractual relationship between landowners. Income and losses pass through to the co-owners, who may claim tax deductions separately from the other co-owners. Accordingly, co-ownership agreements must be drafted to avoid the possibility of the relationship being construed as one of partnership (where, for example, each partner can bind all the other partners) rather than co-ownership.

Trusts

Trusts are also not separate legal entities and constitute a relationship whereby a person holds property as a trustee for the benefit of others. Both trustees and beneficiaries can be personally liable in connection with the trust property, subject to indemnification. Additionally, publicly traded real estate investment trusts have certain legislative protections in this regard. Income may be taxed at the trust or beneficiary level.

5.3 REITs

Real estate investment trusts (REITs) are available to be used in Canada, and may be publicly traded or privately held. Foreign investors may invest in real estate in Canada through ownership of units in a REIT, subject to the restrictions noted in **2.11 Legal Restrictions on Foreign Investors** and **2.10 Taxes Applicable to a Transaction**.

The use of REITs permits individual investors to participate in real estate investment in multiple sectors without having direct ownership of real estate. However, income earned by a REIT is passed to the unitholders, giving investors similar investment income to that of direct ownership. An owner of real property may wish to establish a REIT as a means of attracting equity investment.

There is no specific legislation governing the organisational structure of a REIT. Principles of contract law and trust law will govern the REIT (see **5.5 Applicable Governance Requirements**). Both publicly traded and private REITs will be subject to securities laws requirements that will regulate the issuance and sale of units in REITs, although the sale of interests in private REITs may have additional transfer, redemption and sale restrictions. A REIT may wish to be a "mutual fund trust" under the Income Tax Act and, as such, would need to meet the requirements to qualify as such.

5.4 Minimum Capital Requirement

There is no minimum capital requirement for any of the aforementioned entities.

5.5 Applicable Governance Requirements

Corporations

Corporations can be incorporated either federally or provincially, and are required to file articles of incorporation. A corporation's governance framework can be shaped by its shareholders through its articles, shareholder agreements and corporate by-laws. The articles provide basic details such as the corporation's business name, registered office, first director(s), share capital and share provisions. By-laws are used to add to, or supplant, default provisions set out in the corporation's governing statute. Shareholder agreements may regulate how shares are sold, specify procedures by which important decisions are made, and provide protection for minority shareholders. Federal or provincial statutes stipulate corporate requirements such as the number and residency of the directors and fiduciary duties. Public corporations are also subject to applicable securities law requirements.

Partnerships

While partnership legislation may impose basic governance rules, most sophisticated parties enter into partnership agreements setting out matters of governance in detail. The agreement typically addresses capital contributions, business operations, profit/loss distributions and addition or removal of partners.

Co-ownerships

Based on the contractual nature of a co-ownership, governance requirements vary depending on the agreement between the parties, which may establish rights and restrictions relating to the underlying land, determine profit-sharing and delegate management responsibilities.

Trusts

Trusts are typically governed by the trust deed, under which the trustees' powers may be limited to merely holding title at the behest of the beneficial owner, or may extend to allowing the trustee to exercise full discretion over dealings with the subject lands. In all cases, the trustee holds all benefits derived from the land for the beneficial owner/beneficiary.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual legal costs for entity maintenance are typically less than CAD1,000.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Leases and licences are contracts that permit the occupancy and use of real estate for a period of time, without buying it outright. While leases provide for exclusive possession over a specific area for a limited period of time, licences might not grant exclusive possession, and do not constitute an interest in land.

6.2 Types of Commercial Leases

Commercial Leases

The most common categories of commercial lease include commercial/office leases, retail leases, and industrial/warehouse leases.

Commercial leases may be further categorised into "net leases" and, rarely, "gross leases". Under a net lease, all operating costs and expenses relating to the property are passed on to the tenant in addition to the payment of base rent, although responsibility for capital expenses may remain with the landlord. Under a gross

lease, tenants are charged an "all-in" fixed gross rent to cover the landlord's operating and capital costs and expenses, while providing the tenant certainty as to its financial obligations.

Ground Leases

Ground leases are generally long-term, with few landlord obligations and often include the right or obligation of the tenant to construct and control the improvements on the land. In Quebec, "emphyteutic leases" (a conveyance of a dismemberment of ownership for a term) are analogous to ground leases. Ground leases allow the tenant to invest in, and enjoy the depreciation of, the buildings on the land. Accordingly, the landlord will enjoy a low threshold of oversight and control, while the tenant will have greater contractual certainty to protect and finance its investment.

6.3 Regulation of Rents or Lease Terms

Rents and lease terms for commercial leases are freely negotiable, with the exception that the Quebec Civil Code caps the term at 100 years.

In response to the pandemic, temporary measures were introduced, such as the Canada Emergency Commercial Rent Assistance Program; Canada Emergency Rent Subsidy, Tourism and Hospitality Recovery Program; and the Hardest-Hit Business Recovery Program. These temporary measures have ended and there are no ongoing measures in place.

6.4 Typical Terms of a Lease

An initial lease term typically ranges between five and ten years, subject to a tenant's option to extend for one or more additional periods. A ground lease, in which the tenant will have financed and constructed the buildings on the land, will have a longer initial term and options to extend. In a typical multi-tenant complex, the tenant will commonly be responsible for repair and maintenance of the premises and leasehold improvements, while the landlord may remain responsible for repair and maintenance of the building (including structural items) and the common areas (typically subject to some cost reimbursement through the operating cost provisions – see **6.9 Payment of Maintenance and Repair**). In a single-tenant project, the landlord and the tenant may negotiate different repair and maintenance obligations. Rent is most commonly paid on a monthly basis.

As a result of COVID-19, both landlords and tenants have revisited limited lease provisions, including the definition and effect of force majeure provisions and quiet enjoyment covenants. However, landlords have typically not entertained rent abatements in the event of future pandemics, nor have landlords accommodated potential delays in construction build-out or supply chain issues.

6.5 Rent Variation

For commercial leases, rent is based on market conditions and negotiated prior to settling the lease agreement. Market conditions will determine whether there will be a fixed rental rate for the term, or whether the rental rate will increase throughout the term.

6.6 Determination of New Rent

Rent is commonly increased during renewal terms. The rent payable for an extension or renewal can be:

- fixed through negotiation between the landlord and tenant;
- set at the market rate for a comparable property at the time of extension or renewal; or
- increased based on an index (such as the Canadian Consumer Price Index).

6.7 Payment of VAT

Goods and services tax (GST), harmonized sales tax (HST) or Quebec sales tax (QST) is payable on rent and must be collected by landlords. If the commercial tenant is registered for GST/HST/QST purposes and is incurring the rent payments in the course of its commercial activities, up to 100% of those taxes should be recoverable by the tenant. GST/HST/QST paid by commercial landlords on their expenses is generally recoverable, whereas GST/HST/QST paid by residential landlords is not.

6.8 Costs Payable by a Tenant at the Start of a Lease

A security deposit or other security may be due at the commencement of a commercial lease. In some jurisdictions, transfer tax may be triggered if the lease term exceeds certain thresholds.

6.9 Payment of Maintenance and Repair

Tenants occupying leased commercial premises in a multi-tenanted development will typically pay a pro rata share of the expenses for maintaining and repairing common areas, as additional rent. In more landlord-friendly markets, responsibility for maintenance, repair and replacement costs will be allocated to the tenants, including for structural matters. However, major capital costs are often allocated to the tenant on an annual amortised/depreciated basis, so that the tenant's proportionate share of such major costs is not charged to the tenant all at once.

6.10 Payment of Utilities and Telecommunications

Tenants are typically responsible for the cost of their own utilities and telecommunications services, plus a proportionate share of such costs for common areas.

6.11 Insurance Issues

Landlords typically insure the buildings of a leased development, whereas tenants are responsible for insuring fixtures, trade fixtures and personal property. Insurance premiums paid by the landlord are typically recovered from tenants as additional rent. Tenants must typically carry "all-risks" physical damage insurance and general liability insurance.

The interpretation of business-interruption insurance provisions generally did not result in tenants being covered as a result of office closures during the COVID-19 pandemic.

6.12 Restrictions on the Use of Real Estate

Landlords may impose restrictions on how a tenant uses the real estate, in addition to generally applicable land use, zoning and planning laws. The use of real estate can also be affected by restrictive covenants.

6.13 Tenant's Ability to Alter and Improve Real Estate

The terms and conditions of a lease will determine whether a tenant is permitted to alter or improve leased premises or install tenant trade fixtures. Landlords often restrict work that affects the structure of the leased premises or affects or disturbs other tenants. Tenants will usually be responsible for the repair and maintenance of such work and, upon termination, the lease will dictate whether the work must be removed and the leased premises restored to their original state by the tenant, whether reasonable wear and tear is excepted, and whether improvements will become the property of the landlord.

6.14 Specific Regulations

All Canadian provinces and territories have residential tenancy legislation; in Quebec, it is

included in the Civil Code. Some provinces and territories also have legislation governing commercial tenancies generally, without specific provisions in respect of any particular category of commercial property.

Where legislation does not exist or does not address an issue, common-law principles apply. During the pandemic, rent-subsidy programmes and eviction moratoriums applied to commercial and residential tenancies, respectively.

6.15 Effect of the Tenant's Insolvency

Subject to the specific terms and conditions of a lease, a tenant's insolvency would likely trigger an event of default under the lease and permit a landlord to terminate the lease; however, bankruptcy legislation would apply to the tenancy relationship. In Alberta, the Landlord's Rights on Bankruptcy Act contains specific rules as to what may happen with a lease or sublease upon bankruptcy.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A landlord may require a tenant to pay a security deposit (which is typically paid in cash, but may be provided through a letter of credit) and may require the tenant to grant the landlord security over the tenant's personal property. Landlords may also require a third-party guarantee from a parent company or subsidiary of the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

Commercial tenants generally do not have the right to continue to occupy the relevant real estate after the expiry or termination of the lease term. However, leases often contain an "overholding" clause whereby a tenant may remain in possession on a monthly basis, usually at increased rent (up to 200% of the monthly rent payable during the term).

If a tenant continues in possession after the expiry or termination of the lease term, the landlord may be entitled to obtain a court order for delivery of possession.

6.18 Right to Assign a Leasehold Interest

Most leases provide that the landlord must first consent to any assignment of a lease, any subletting of the leased premises, or any change of corporate control of the tenant. The lease will dictate whether that consent may or may not be unreasonably withheld and will state the conditions for that consent. Most common-law jurisdictions dictate certain circumstances under which the landlord may withhold consent. Commercial leases may also give the landlord the right to terminate the lease upon a request for assignment, sublet or change of control, or to otherwise impose conditions on the granting of a consent.

6.19 Right to Terminate a Lease

A landlord will typically have the right to terminate a lease upon the tenant's failure to pay rent, upon another material breach that is not cured within a specified time, upon the tenant's insolvency, and upon substantial damage or destruction of the leased premises/building. Tenants typically either have no right to terminate a lease or may only do so in limited circumstances, such as upon damage or destruction of the leased premises. Where a tenant negotiates an early termination right, fees will often be payable, including for example based on the unamortised value of leasehold improvements paid for by the landlord.

6.20 Registration Requirements

In common-law jurisdictions, tenants are typically permitted to register evidence of their lease against title to the subject lands in the relevant land registry, although, other than in Quebec, the lease may allow the landlord to prohibit registration. Depending on the jurisdiction, the actual lease agreement, a caveat/notice of lease or a short form of lease can be recorded on title to the subject lands. Upon the registration of a lease, transfer tax may be payable in British Columbia and Ontario. Generally, the tenant is responsible to pay such transfer taxes. In Quebec, a lease with a term that exceeds 40 years, inclusive of renewals, triggers transfer duties.

6.21 Forced Eviction

A tenant may be forced to vacate leased premises in the event of default. Leases often provide that a breach must be material and go uncured beyond a specified grace period before the tenant can be dispossessed. In addition, in most jurisdictions a landlord is required to serve notice, specifying the breach and allowing a reasonable period to remedy the breach before they may re-enter the premises.

In response to the COVID-19 pandemic, eviction moratoriums were also instituted by most provinces, all of which have now concluded.

6.22 Termination by a Third Party

A lease may be terminated by government or municipal authorities pursuant to legislative authority relating to expropriation (ie, public taking) or condemnation of land. In such cases, compensation will depend on the relevant legislation and both the landlord and tenant may be compensated.

In some jurisdictions, a lease for a term longer than three years may become invalid, and therefore terminated, if a bona fide third party acquires a landlord's interest for value without notice of the lease. In such instances, however, equitable considerations may prevent an outright termination.

6.23 Remedies/Damages for Breach

In the event of a breach of a commercial lease, a landlord typically has four primary remedies:

- to refuse to accept the repudiation or breach and insist on performance of the lease, in which case the landlord may sue the tenant for rent or damages while the lease exists;
- to accept the tenant's repudiation of the lease and terminate the lease, retaining the right to sue for rent due until such termination, or for damages accrued up to the date of termination for previous breaches;
- to give notice to the tenant that the landlord wishes to re-let the premises on the tenant's account and re-possess the property on that basis, and sue for shortfall in rent where it occurs; and
- to terminate the lease on notice and re-possess the property while reserving the right to sue for prospective damages for the unexpired term of the lease (including unpaid future rent).

The exercise of the remedies available to the landlord is subject to the principles of common law. The primary restriction on the landlord is its duty to mitigate damages. In addition to common-law requirements, legislation in some jurisdictions also restricts how a landlord can exercise its right to distrain, prescribes notice requirements, and may provide a tenant relief from forfeiture.

A landlord will often hold a security deposit to secure future payment and performance of obli-

gations under a lease. As noted in **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations**, that is typically provided as cash but may also be a letter of credit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Canadian construction contracts generally adopt one or more of the following structures:

- fixed price – a predetermined, stipulated or lump-sum price;
- cost-plus – based on the contractor's actual costs, plus a percentage or fixed fee applied to actual costs, potentially subject to an overall guaranteed maximum price; or
- unit price – a predetermined fixed amount for each specified unit of work performed, which is multiplied by the measured quantity of work performed for each specified unit.

7.2 Assigning Responsibility for the Design and Construction of a Project

The allocation of responsibility for design and construction of Canadian construction projects is determined by the project delivery model, and the form of construction contract used by the owner.

Design-Build

The owner engages a single design-builder, who assumes overall responsibility for the design and construction of the project, including price, schedule and performance. The owner generally retains the risks associated with changes or unexpected conditions. Should the owner enter into separate contracts with the designer and the general contractor, the owner will assume the risk associated with co-ordination and conflict issues arising between those counterparties.

Owner and Multiple Contractors

The owner enters into separate contracts with different contractors for each portion of the work to be completed. This assigns the risk evenly among the contractors and creates a direct contractual relationship with each of them. The responsibility and risk associated with co-ordination and conflicts remains with the owner. Accordingly, an owner may engage a construction manager to enter into direct contracts with the contractors on the owner's behalf to help to manage or reallocate such risks.

7.3 Management of Construction Risk

Generally, construction risks are managed through the construction contract, by way of indemnities, warranties, retentions, liquidated damages, termination rights, exclusions, limitations and waivers of liability, force majeure and insurance requirements. Risk may also be managed using bonds, letters of credit or guarantees.

Any risk mitigation devices are subject to negotiation between the parties, and principles of common law (including relating to the enforceability of penalties – see **7.4 Management of Schedule-Related Risk**).

7.4 Management of Schedule-Related Risk

Responsibility

Schedule-related risks are generally managed through the contract, which will stipulate which party bears responsibility for different types of schedule impacts and delays.

Compensation

The parties may incorporate liquidated damage provisions such that an owner is entitled to compensation or set-off rights if certain milestone and completion dates are not achieved, subject generally to force majeure and owner-caused delays. The amount of the compensation must represent a genuine pre-estimate of the actual cost or loss to the owner attributable to such delay and not a penalty to the contractor, as Canadian law limits the enforcement of penalty clauses.

Incentives and Bonuses

Payment incentives and early-completion bonuses are also common features of construction contracts.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

While ultimately dependent on the nature and scope of the applicable construction project, as well as the parties involved, it is common for owners to seek additional types of security from a contractor. That security is most commonly in the form of labour, material and performance bonds, and letters of credit, although in some cases an owner may insist on some form of corporate guarantee.

7.6 Liens or Encumbrances in the Event of Non-payment

Each of the Canadian provinces gives statutory construction, builders' or mechanics' lien rights to those providing work, materials and/or services supplied to a construction project. The applicable legislation sets out the applicable rights and procedures. Generally, construction liens are registered against the project lands, with owners having the ability to remove the lien in two ways:

- by discharging the lien, which requires the lien claimant to deliver and register a release (typically following payment of the amount owing under the lien), or requires the owner to obtain a court order that the lien is invalid (ie, because the lien claimant has failed to meet the prescribed time periods for preserving and/or perfecting the lien); or
- by vacating the lien, which requires the owner (or the general contractor on their behalf) to pay, or to provide a bond or letter of credit for, the full amount of the claim for the lien to the court (such monies will stand as security for the claim in lieu of the property and the lien will be removed from the title to the project).

Most provincial construction lien statutes protect owners who abide by the hold-back provisions of the statute and retain the specified percentage (usually 10%) from each progress payment under the construction contract. These hold-back funds can be paid into court if a lien is registered against an owner's lands, to have the lien discharged from title to the lands. In so doing, the owner's liability is capped, provided the owner had no direct contractual obligations to the lien claimant.

In Quebec, construction liens (legal hypothecs) are governed by the Civil Code and subsist without registration for 30 days after the end of the work, after which they must be registered. There are no hold-back provisions in the Civil Code, and such legal hypothecs secure the value added by the work, services or supplied materials.

7.7 Requirements Before Use or Inhabitation

In most cases, an occupancy permit or final approval, based on compliance with building codes and other applicable regulations/standards, must be issued by the local municipality

before a project can be inhabited or used for its intended purpose.

8. Tax

8.1 VAT and Sales Tax

Goods and services tax (GST), harmonized sales tax (HST) and Quebec sales tax (QST) constitute all applicable VAT in Canada. Rates range from 5% to 15%, depending on the jurisdiction within Canada in which the transfer takes place.

GST/HST/QST generally apply to the transfer of commercial real property, as well as new residential real property. The seller is responsible for collecting the applicable VAT from the buyer, except where the buyer is entitled to self-assess VAT (ie, buyers that are registered for VAT purposes and acquire real estate in the course of their commercial activities). Used residential real estate is generally exempt from VAT. Additionally, transfers of real property in the context of the sale of a business may be exempt from GST/HST/QST.

8.2 Mitigation of Tax Liability

Where land transfer tax is imposed, it typically applies to the transfer of real estate and not to transfers of shares of a corporation or (with certain exceptions, including in Ontario and Quebec) interests in a partnership that owns real estate. In some jurisdictions, land transfer tax is payable on the conveyance of a leasehold interest in land if the lease term exceeds specified thresholds.

In British Columbia, property transfer tax is currently only payable on registered transfers of real property. Transfers of a beneficial interest in real estate do not trigger payment of property transfer tax. As a result, owners of commercial real estate often structure their ownership as a bare trust, with a nominee company holding the legal or registered title to the real estate in trust for the "real" or beneficial owner of the real estate. On closing, the seller transfers the shares of the nominee company and the beneficial interest in the property to the buyer, avoiding registration of a legal transfer of title in the Land Title Office. However, such transactions are anticipated to incur tax in the near future, as the British Columbia provincial government has established a beneficial ownership registry, as discussed in **1.3 Proposals for Reform**.

See also the description of the federal underused housing tax in the same section.

8.3 Municipal Taxes

Municipal property taxes are payable by the owner of the property and are generally passed on to tenants. These taxes are typically calculated based on the use and assessed value of the property. Some municipalities provide exemptions for public and/or non-profit organisations, or for geographical areas in which the municipality wishes to provide an incentive for development.

8.4 Income Tax Withholding for Foreign Investors

The taxation of rental income for a non-resident of Canada directly invested in Canadian real property depends partly on whether such income is characterised as income from property or income from carrying on a business. Generally, the more effort expended in respect of the property, the higher the likelihood it will constitute a business.

Tax on a Business

If the rental income constitutes carrying on business in Canada, the non-resident will generally

be subject to tax on their net income attributable to that rental business. The rate of tax paid is generally the same as that which is paid by Canadian resident corporations (approximately 26.5%). In addition to the mainstream Canadian tax on Canadian-source income, the non-resident will also be liable to pay a branch tax of 25% on its after-tax Canadian profits that are not reinvested in its Canadian business. The branch tax can be limited to 5% if the non-resident's members are corporations that are entitled to the benefits of the Canada-US Tax Treaty (with the first CAD500,000 of earnings being exempt from the branch tax).

Tax on Passive Payments

Passive payments such as dividends, interest, royalties and rent made by a Canadian resident to a non-resident are subject to Part XIII Canadian gross withholding tax of 25%, which may be reduced by virtue of a tax treaty between Canada and the state of residence of the non-resident.

As an alternative to the 25% gross withholding tax regime, a non-resident can make an election in respect of its passive rental income (a "Section 216 election") that will allow it to file a Canadian income tax return and be taxed on a net basis (ie, after deducting its expenses associated with the property). The rate of tax payable is the same as that paid by Canadian resident corporations (ie, approximately 26.5%).

Tax on Disposal of Taxable Canadian Property (TCP)

Non-residents are subject to Canadian income tax under the Canadian Income Tax Act (ITA) if, among other things, they dispose of taxable Canadian property (TCP). For these purposes, TCP includes a direct interest in real property or an interest in a private corporation, partnership or trust where, at any time in the last 60 months prior to the date of disposition, more than 50% of the value of the interest is derived primarily from real property situated in Canada. Relief may be available under an applicable income tax treaty if the sale of an interest in a corporation, partnership or trust does not, at the time of sale, derive more than 50% of its value primarily from real property situated in Canada.

Where a non-resident of Canada proposes to sell TCP, the purchaser may be required to withhold 25% (for non-depreciable capital property) or 50% (for depreciable property) from the purchase price, unless the non-resident applies for and is granted a clearance certificate by the Canada Revenue Agency in advance of the date the property is disposed of. In addition, a non-resident must notify the Canadian tax authorities about a disposition of TCP either before they dispose of the property or within ten days following the disposition.

VAT on Rent

For a discussion of VAT on rent, see **6.7 Payment of VAT**.

8.5 Tax Benefits

In computing net rental income (ie, where income is earned by a resident entity, where rental income earned by a non-resident constitutes business income, or where a Section 216 election has been made by a non-resident earning property income), certain expenses incurred in earning such income may generally be deducted for the purposes of calculating Canadian income tax, including operating expenses, reasonable financing costs and tax depreciation.

Tax depreciation may be claimed on buildings and other depreciable property used to earn rental income. Tax depreciation is allowed gener-

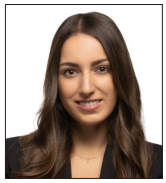
ally at rates varying from a 4% to 10% declining-balance rate on buildings and other structures. The amount claimed is discretionary, and claims may be made in whole or in part, although tax depreciation generally cannot be used to create or increase a rental loss. The rate in the year of acquisition is generally one half of the rate otherwise available.

Trends and Developments

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De Grandpré Chait has been specialising in real estate law for over 90 years and has some of the most experienced professionals in the industry in Quebec in its ranks. Continuously involved in significant real estate transactions in Quebec, the team at De Grandpré Chait have become the go-to experts in helping to make a project happen. From planning to acquisitions, from purchase to construction, from leasing to expropriation, they make sure the foundations on which their clients build their projects are immovable. Clients can also count on the firm's municipal team to anticipate and manage any zoning or environmental risk, thanks to the team's in-depth knowledge and practical strategies. Owners, developers and tenants approach the firm to defend their interests vis-à-vis public authorities, to resolve tax or valuation issues, and to obtain the required project authorisations.

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Introduction

In 2023, the Quebec real estate market witnessed a deepening of recent trends rooted in the post-pandemic environment. High interest rates, hefty construction costs, and the introduction of legislative measures on all government levels in an attempt to curb the housing crisis, are some of the trends and challenges that are expected to persist throughout 2024.

Montreal's real estate market has proved to be resilient in this challenging economic environment, having transacted CAD8 billion in volume throughout 2023, 75% of which came from the industrial and multi-family asset class. Strong growth in industries such as e-commerce has driven demand for modern industrial facilities in suburban locations in close proximity to major highways and other means of transportation.

All asset classes reported a setback in transaction activity in 2023, except for industrial, commercial and investment (ICI) land (ie, despite increased land and construction costs) and hotels. Industrial, multi-family and grocery-anchored retail were the top asset classes attracting investors. Office vacancies continued to rise and will likely continue to increase in the short term as the hybrid work environment remains prevalent.

The present article provides an overview of legal trends which have impacted and will continue to impact Quebec's real estate market in the coming years.

Legislative Updates – Affordable Housing

According to the Canadian Mortgage and Housing Corporation (CMHC), Quebec requires an additional 860,000 housing units by 2030 in order to meet demand and restore affordability in the residential market. The fourth quarter of 2023 saw residential vacancy rates drop to the lowest rate experienced in 20 years. The housing crisis remained a top policy concern for all levels of government throughout 2023. As such, legislative trends for this period remained focused on the implementation of policies to facilitate and incentivise development, and increase the supply and availability of residential housing. This trend is expected to continue to deepen over the coming years.

Bill 31 – housing

Following long-winded consultations and parliamentary debates which began in the fourth quarter of 2023, An Act to amend various legislative provisions with respect to housing ("Bill 31"), was adopted in early 2024 by Quebec's legislative assembly. The objective of this omnibus legislation is to address core issues related to the ongoing housing crisis, notably by facilitating the increase in supply and tightening the regulatory framework on evictions, rental increases, and lease assignments/subleases. Housing Minister France-Élaine Duranceau was quoted in the press as saying that the rationale for the new law was to "re-establish balance between renters and landlords and increase [the] housing supply".

Some of the key changes introduced by Bill 31 that have impacted the regulatory framework for residential leasing are as follows:

Eviction compensation

Residential landlords are entitled to evict a tenant for a variety of reasons that are not related to the tenant's default. However, whereas prior to Bill 31, tenant compensation for eviction was three months' rent plus reasonable moving expenses, under Bill 31, landlords must now pay tenants an indemnity ranging from three to 24 months' rent, depending on the number of uninterrupted years that a tenant has leased the premises, plus reasonable moving expenses. Furthermore, landlords are now required to demonstrate, on a balance of probabilities, that an eviction and/or repossession was carried out in good faith, failing which, tenants may recover damages in addition to applying for punitive damages in cases where the eviction and/or repossession is deemed to have been carried out in bad faith.

Rental increases

Procedures regarding rental increases have changed. Landlords are now required to include the maximum rent that they may charge for five years following the date on which the unit is ready to be leased (if the unit forms part of a new build or a building that has recently undergone a change of use). Punitive damages may also be claimed by tenants in contexts where a landlord intentionally: (i) omits to notify a new tenant of the lowest rent paid; (ii) omits to notify a new tenant of the last rent paid if the unit was vacant for more than 12 months; and/or (iii) falsifies information provided to the tenant with respect to items (i) and (ii).

Lease assignment

Traditionally, where a residential tenant requested the landlord's consent to assign the lease, the landlord could not withhold its consent without a "serious reason" (as such concept is used in the Civil Code of Quebec). Under Bill 31, landlords now have the right to withhold their consent to a proposed lease assignment for a reason other than a serious reason, without the necessity to provide any justification. In such a case, the lease is cancelled (resiliated) on the date of assignment indicated in the tenant's notice, at which point the tenant is released. Furthermore, since Bill 31 now prohibits tenants from assigning or subletting for a profit, the tenant has nothing to gain financially. In modifying the landlord's right to refuse its consent to a reasonable grounds standard, the landlord is given the option and not the obligation to terminate the lease, without having to justify its decision. Thus, Bill 31 creates a balance between the legitimate interests of both the landlord and the tenant.

In addition, Bill 31 allows for municipalities to temporarily override existing by-laws and regulations related to zoning and urban planning to

fast-track the authorisation and construction of projects which contain a social/affordable housing and/or student housing component. Municipalities with a population of 10,000 or more and a housing vacancy rate of less than 3% are also granted the power to authorise housing projects which may deviate from the zoning and/or urban planning regulations in force.

Bill 31 appears to form part of a wider government approach to the housing crisis. On the federal level, the industry witnessed a renewal of the ban on foreign investment, and the introduction of tax incentives for developers of purpose-built residential housing, both of which will be summarised in the sections below.

Prohibition Act – renewal

In 2022, the federal government passed the Prohibition on the Purchase of Residential Property by Non-Canadians Act (the "Prohibition Act") with the objective of restricting the purchase of certain residential property in Canada by foreign investors and non-residents. Shortly thereafter, the federal government passed the Prohibition on the Purchase of Residential Property by Non-Canadians Regulations, last modified in March 2023, which brought much-needed clarification to the unexpected implications that the Prohibition Act had on participants in the commercial real estate sector.

On 4 February 2024, the Deputy Prime Minister and Minister of Finance announced the federal government's intention to extend the existing ban by an additional two years, expiring on 1 January 2027. While critics have argued that this legislation has little practical effect on increasing supply and access to housing, the extension appears to form part of a larger strategy.

Bill C56 – GST Rental Rebate and Groceries Act

The December 2023 adoption of An Act to amend the Excise Tax Act and the Competition Act ("Bill C-56"), also known as the "Affordable Housing and Groceries Act", witnessed an increase in the Goods and Services Tax Rental Rebate ("GST Rental Rebate") on new rental housing go from 36% to 100%, while removing existing GST Rental Rebate phase-out thresholds for new rental housing projects. With the announcement of the GST Rental Rebate increase, industry players remain observant to similar fiscal incentives that can be adopted at the provincial and municipal levels. In addition to the GST Rental Rebate, the CMHC continues to provide incentives for the development of affordable rental units with programmes such as the CMHC Flex programme, which offers preferential terms on construction financings.

Bill C-56 also amends the federal Competition Act with the objective of enhancing competition, notably in the grocery sector. The amendments seek to expand the Competition Bureau's powers of investigation and enforcement related to anti-competitive activities where "one or more persons substantially or completely control a class or species of business throughout Canada or any area of Canada". Of particular note, the amendments will expand the scope of Section 90.1 of the Competition Act, providing the Competition Bureau with the discretionary power to seek orders which prohibit agreements or arrangements between and among non-competitors if "a significant purpose of the agreement or arrangement, or any part of it, is to prevent or lessen competition in any market". Originally, such power was limited to "agreements or arrangements between actual or potential competitors that prevent or lessen competition substantially". Moreover, the amendments pro-

vide for an increase in discretionary administrative monetary penalties for non-compliance to CAD25 million (as opposed to CAD10 million) for initial violations or three times the value of the benefit derived from the abusive conduct or, if that amount cannot be determined, 3% of the offender's worldwide turnover; and up to a maximum of CAD35 million (as opposed to CAD25 million) per subsequent violation or three times the value of the benefit derived from the abusive conduct or, if that amount cannot be determined, 3% of the offender's worldwide turnover.

With the amendments coming into force in December 2024, there is considerable uncertainty as to how the Competition Bureau will address the exclusivity, use restriction and radius clauses contained in commercial leases, which are essential to grocery and other anchor retailer decisions to locate a store within a given development. While the amendments are intended to target household-name players in the grocery industry, they are applicable across the board. As such, it is expected that landlords and tenants affected by the amendments will pay close attention to the evolution of this matter and revisit such clauses in their leases to minimise their exposure to the significant penalties proposed.

Legislative Updates – Miscellaneous

Property taxes on data centre equipment

In Quebec, municipalities are now entitled to levy property taxes on certain data centre equipment. Recent jurisprudence has shown the courts granting a large interpretation to the concept of "movable property that is permanently attached to an immovable" in Section 1 of the Act respecting municipal taxation (the "ARMT"). In Ville de Montréal v Société en commandite Locoshop Angus (for which the application for leave to appeal to the Supreme Court was dismissed, making the Court of Appeal's decision final), the Court of Appeal clarified that, movables such as equipment for hosting computer servers do not need to be physically attached to the ground to be considered "permanently attached". The Court found that a movable is "permanently attached" if: (i) it cannot be removed without being dismantled or without breaking down the building component in which it is placed; or (ii) an intellectual connection binds it to the immovable in which it is located. This ruling has effects beyond the data centre industry, and also affects industries such as the telecoms sector. For instance, in Ville de Québec v Vidéotron ltée, the Court of Appeal of Quebec considered Vidéotron's wireless telephone equipment to be physically attached to the concerned immovable and thus to be calculated in the immovable's municipal evaluation. The court's ruling is particularly important for Quebec as the province is one of Canada's largest hubs for data centres (eg, Amazon, Microsoft, Google and IBM), video game developers, visual effects studios and artificial intelligence research, namely because of the province's colder climate as well as its affordable and easily accessible energy from Hydro-Québec's electrical grid.

The ruling is expected to increase costs for both landlords and tenants in the technology sector, since the sophisticated equipment used has significant monetary value which will increase the property value and thus, property taxes. The ruling has been criticised as being a deterrent for business technology companies to remain and/or set up shop in Quebec. Note that the ARMT excludes the equipment used for the industrial, manufacturing and agricultural sectors from a property's municipal evaluation, an exclusion which the technology sector argues should also benefit them. Various sector groups have called

on the Quebec government to amend the ARMT in this respect.

Bill 22 and Bill 39 – land use, zoning and expropriation

In November 2023, An Act respecting expropriation ("Bill 22") was passed by the Quebec legislative assembly. Bill 22 is particularly noteworthy as it introduces a new framework regarding expropriations with the objective of streamlining critical infrastructure projects and amending compensation rules to the detriment of expropriated parties.

In addition, the real estate industry saw the Act to amend the Act respecting municipal taxation and other legislative provisions ("Bill 39") passed in December 2023. Bill 39, among other things, provides municipalities with the power to impose a property value-based tax on buildings containing vacant or under-used residential units – another attempt to increase housing supply amid record low-vacancy rates. Bill 39 also amends the Act respecting land use planning and development, whose amendments prevent expropriated parties from obtaining due compensation in certain contexts of disguised expropriations.

These two pieces of legislation are expected to significantly shape the real estate landscape in the coming years, readers are invited to refer to De Grandpré Chait's municipal group's September 2023 Chambers contribution to learn more: REAL ESTATE: An Introduction to Quebec Law | Chambers and Partners.

Bill 34 – back to in-person closings

In April 2020, as a means of ensuring the sound administration of justice in light of the COVID-19 pandemic, the Quebec Minister of Justice authorised notaries licensed to practice in Quebec to take signature of notarial acts (such as deeds of sale, deeds of hypothec, wills and declarations of co-ownership) remotely on recognised platforms such as Microsoft Teams, using approved technological means to obtain digital signatures (eg, Consigno Cloud). The decree was renewed in August 2021, 2022 and 2023, which many industry players viewed as effectively modernising notarial practice by facilitating the remote closing of real estate transactions in Quebec. However, on 24 October 2023, the Quebec government passed an Act to modernise notarial practice and promote access to justice ("Bill 34") by making digital signatures (ie, via phone, tablet or computer) *and* the physical presence of the parties mandatory, save for exceptional cases. The change was adopted to ensure the protection of the public during a period when the market saw an increase in title and mortgage fraud. Some members of the legal community responded negatively to Bill 34, considering the measures to be regressive compared to the existing efficient and modernised way of transacting in Quebec. However, several influential notarial groups, such as the *Association professionnelle des notaires du Québec* and the *Chambre des notaires* have actively supported and welcomed the adoption of Bill 34.

ESG Emergence in Quebec Real Estate

Throughout 2023, environmental, social and governance (ESG) considerations remained central to decision-making by various Quebec real estate industry stakeholders and continued to affect key aspects of real estate projects, including leasing, development, financing and legislation. It is interesting to note that while ESG standards in Europe are derived from regulation, ESG considerations in Quebec appear to stem from investors and major commercial developers. Current Quebec ESG leaders tend to be companies with assets held globally, including

regions where ESG rules are stricter or mandatory.

Leasing

The space that a large corporate tenant chooses to lease has the potential to directly or indirectly impact its ESG commitments. Accordingly, commercial tenants are seeking more energy-efficient spaces in which they can satisfy their ESG commitments to their stakeholders. This, in turn, will reduce their energy consumption and operating costs. For their part, with commercial buildings being among the biggest energy consumers, landlords are trying to attract and retain tenants by using sustainable materials and appliances (ie, upgrading heating, ventilation and air-conditioning systems, which reduces energy consumption) and by changing their operational procedures which, in turn, will make their buildings more marketable.

As a result, throughout 2023, there has been a significant rise in "green leases" in Quebec. These promote improved building energy consumption by incorporating sustainability into key clauses of a lease, and are intended to encourage collaboration between landlords and tenants to achieve sustainability-focused results. To serve as a roadmap for landlords and tenants, the Building Owners and Managers Association (BOMA) created a guide on green leases so parties can collaborate on sustainable practices, providing clauses to which they can refer during lease negotiations. Moreover, as technology is rapidly evolving and new opportunities are arising to improve buildings and reduce energy consumption, the green lease trend is expected to accelerate in 2024.

Financing

Sophisticated real estate lenders and investors are increasingly incorporating ESG factors when evaluating the financial risks involved in a real estate project, which is now commonly known as "sustainable" or "green" financing or investing. It has been noted that Quebec lenders are increasingly integrating ESG criteria into their due diligence process and working with borrowers towards achieving sustainability throughout the duration of the loan.

Montreal is establishing itself as a global centre for green financing, backed by a financial and business community with a strong ESG focus. On the financial side, Desjardins, a Quebec-based institutional lender, has recently introduced incentives such as cash back to encourage companies to invest according to ESG criteria and has committed to providing training in sustainable development to its employees, advisers and professionals to support transparency and reporting in sustainable finance. Key Montreal-based players with a growing global presence, such as National Bank, iA Financial Group, BDC and Fiera Capital, are also increasing their focus on green financing.

On the developer side, with the first phase nearing completion, the Royalmount project, the largest private development in Quebec, is one of the only 100% carbon-neutral mixed-use developments in Canada as well as the largest LEED Gold-certified retail project in Canada. The original Royalmount project was modified to add more housing and green space. Examples of Royalmount's sustainability efforts include the use of geothermal energy and a rainwater recovery system, white or vegetation-covered roofs, and the installation of 148 electrical charging stations in the underground parking lot, which significantly exceeds the minimum number required for LEED certification. The financing of the first phase of Royalmount was completed in

January 2023 by a syndicate of lenders, led by Bank of Montreal, as administrative agent.

Conclusion

In conclusion, despite economic challenges, the Quebec real estate market has proved once again to be resilient throughout 2023.

CAYMAN ISLANDS



Law and Practice

Contributed by:
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Appleby is a leading offshore law firm with close to 500 people, including 60 partners, operating from ten offices around the globe. The Cayman Islands real estate practice consists of seven experienced professionals who advise clients on all areas of commercial and residential property, including acquisitions and disposals, development, leasing and finance. The team acts for a range of high-profile clients and leading players in the market, including financial institutions, developers, hoteliers, government agencies and private investors. Appleby has been involved in many of the most significant transactions in the Cayman Islands, including continual representation of the leading banks in the Cayman Islands with respect to property financing transactions, acting on the development, financing, purchase and/or sale of almost every large resort project in the jurisdiction, and revolutionising mixed-use development projects with its unique approach to volumetric title structuring.

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1. General

1.1 Main Sources of Law

Real estate in the Cayman Islands is primarily governed by legislation and case law, although decisions in commonwealth jurisdictions may be considered in circumstances where there is no relevant local legislation or case law.

1.2 Main Market Trends and Deals

The Cayman Islands real estate market has continued to produce strong sales and price results over the last 12 months. Luxury condos along the famous Seven Mile Beach continue to attract overseas investment, at increasing prices. Several major projects are nearing completion.

The leisure and tourism sector remains active, with several projects underway. Developments of note include:

- Mandarin Oriental resort and residences at Beach Bay;
- Grand Hyatt resort and residences along Seven Mile Beach, which in the last 12 months secured its senior development financing and has recently commenced construction;
- Kailani Grand Cayman resort and residences along Seven Mile Beach;
- Hotel Indigo near Seven Mile Beach, which nears completion;
- ONE | GT hotel and residences located in George Town, a project that seeks to kick-start rejuvenation of the capital, and which in the last 12 months secured its senior development financing and commenced construction;
- Watermark residences, a premium luxury condominium complex along Seven Mile Beach nears completion;
- Lacovia, a premium luxury condominium complex along Seven Mile Beach secured its senior redevelopment financing and began demolition; and
- Prisma, a luxury townhome and condominium complex located in the Crystal Harbour development, recently commenced construction.

In addition, the Cayman Islands' largest developer, Dart Realty, recently broke ground on its new ten-story office building within in its self-sufficient town known as Camana Bay.

Remediation work on the George Town landfill site continues, with plans for new waste-to-ener-

gy and recycling infrastructure that will significantly reduce the amount of new landfill.

Rising inflation and associated increase in interest rates have certainly impacted developers, whose construction and carrying costs have increased significantly over the past 12 months. This has led to increased prices for end-buyers, a more innovative approach to value-engineering and a rise in private financing clubs to replace or supplement traditional bank borrowing.

1.3 Proposals for Reform

At the time of writing, there are proposals to reform the law applicable to mortgage enforcement, which will create a more consumer-friendly environment for those securing financing over Cayman Islands real estate.

There are also longstanding proposals to modernise the Strata Titles Registration Act (2013 Revision) and update the Development Plan 1997.

The Cayman Islands Land Registry continues its work to implement e-conveyancing, and plans to propose a number of legislative initiatives to further streamline the land registration process.

Proposals to increase the stamp duty applicable to real estate transactions in higher value areas of the jurisdiction, announced in Q4 2023, were in Q1 2024 put under further review.

2. Sale and Purchase

2.1 Categories of Property Rights

Real property can be held as freehold (held by the registered proprietor indefinitely) or leasehold (held by the registered proprietor for the term of the lease).

The Strata Titles Registration Act (2013 Revision) allows for the registration of a strata plan against a freehold or leasehold land parcel to create individual strata lots, each of which is registered with its own derivative title and the remainder held as "common property" by a strata corporation. Strata titles are often used as a mechanism to govern multi-unit developments such as office buildings, shopping centres and condominium developments.

The Registered Land Act (2018 Revision) allows for the registration of a volumetric plan against a land parcel, whereby a parcel can be subdivided into several three-dimensional parcels (which can include airspace).

A contractual licence can allow for the occupation or use of real property. However, this is a personal right and does not create a registerable interest.

2.2 Laws Applicable to Transfer of Title

All transfers of title of real estate are primarily governed by the Registered Land Act (2018 Revision). While not specifically related to the transfer of title, the carrying on of business from real estate within the Cayman Islands requires certain local licences, some of which are specific to property type.

2.3 Effecting Lawful and Proper Transfer of Title

Transfers of real estate must be registered at the Cayman Islands Land Registry.

Broadly speaking, the land register is definitive and is supported by a government-backed indemnity (although it can be rectified to deal with matters such as error and fraud). Title insurance is available only on the larger commercial transactions, but it is expensive and rarely used.

Unless the contrary is expressed in the register, a parcel of registered land is also subject to such of the following overriding interests as may for the time being subsist and affect the same, without their being noted on the register:

- rights of way, rights of water and any easement or profit subsisting at the time of first registration;
- natural rights of light, air, water and support;
- rights of compulsory acquisition, resumption, entry, search, user or limitation of user conferred by any law;
- leases or agreements for leases for a term not exceeding two years, and periodic tenancies;
- any unpaid moneys that are expressly declared by any law to be a charge upon the land;
- rights acquired or in the process of being acquired by virtue of any law (ie, adverse possession and prescriptive rights);
- the rights of a person in actual occupation of land or in receipt of the rents and profits thereof (save where inquiry is made of such person and the rights are not disclosed); and
- electric supply lines, telephone and telegraph lines or poles, pipelines, aqueducts, canals, weirs and dams erected, constructed or laid in pursuance or by virtue of any power conferred by any law.

In 2020, temporary measures were introduced in light of reduced in-person availability for document signing and notarisation caused by the COVID-19 pandemic. While those measures have since been rolled back, the Cayman Islands Land Registry has redoubled its efforts to implement a secure e-conveyancing system to reduce the reliance on physical documentation.

2.4 Real Estate Due Diligence

As there is no commonly accepted market standard of due diligence when acquiring real estate, the purchaser is responsible for determining the level of investigation that would be appropriate on a case-by-case basis.

The purchaser's attorney should do the following at the very least:

- review the title documents, including a copy of the land register for the subject parcel, a copy of any connected or superior interests (ie, the strata common property or the landlord's title), a copy of the registry map and a copy of all instruments noted on title;
- review the lease and any other ancillary documents, if the property is leasehold;
- review any leases to which the property is subject;
- raise any relevant enquiries with the seller (about the state and condition of the property, any disputes, compliance with laws, overriding interests, services, etc);
- consider whether any additional enquiries should be raised with public or other bodies (depending on the nature of the transaction), such as the Lands and Survey Department, the Department of Environment or the Department of Planning; and
- consider recommending a physical inspection or survey of the property by the purchaser and a professional.

Although uncommon, real property can be sold by way of transfer of the entity or structure through which it is held. In such cases, due diligence is usually the same, with some additional due diligence on the relevant entity or structure.

If the purchase of property is financed by third-party debt, the lender will typically require spe-

cific due diligence, often in the form of a report on title and a legal opinion.

2.5 Typical Representations and Warranties

Warranties are always subject to negotiation and should be expressly included in the sale and purchase agreement, although extensive warranties are not customary on anything but the largest commercial transactions. There is no customary approach to warranties, so the scope and duration would depend entirely upon the specifics of the transaction and the respective bargaining strengths of the parties.

Common purchaser remedies for misrepresentation or breach of warranty would include an action for damages, misrepresentation and/or rescission of the agreement, and a refund of any deposit paid.

Insurance is very rarely used outside of the largest international transactions.

2.6 Important Areas of Law for Investors

Any investor should consider the primary sources of law, including the Registered Land Act (2018 Revision), the Development and Planning Act (2021 Revision) and the Stamp Duty Act (2019 Revision). However, there are other laws that may be applicable, depending on the specifics of the transaction (such as the type of purchaser, the type of property and what activities the purchaser intends to carry out from the property).

There are generally no restrictions on foreign ownership of real estate in the Cayman Islands, although certain formalities may apply to different types of purchaser.

The carrying on of business from real estate within the Cayman Islands requires certain local licences, some of which are specific to property type.

It is always advisable to consult with a professional at the outset of a transaction in order to understand any applicable requirements.

2.7 Soil Pollution or Environmental Contamination

Although not common, environmental liabilities can be dealt with contractually between the parties by way of warranty and representation.

The Development and Planning Act (2021 Revision) enables the Central Planning Authority to serve a remediation notice where it considers that the amenity of an area is adversely affected by reason of, inter alia, the ruinous, dilapidated or other condition of any structure, or by the condition of land due to the deposit of any refuse or spoil. The remediation notice can be served on the owner or occupier of the land or building, or on the person responsible for causing the condition of the land or building.

The National Conservation Act, 2013 establishes a council, whose role is to promote the conservation of natural resources, including the preservation of wetlands and wetland resources, habitats and the conservation of wildlife. Pursuant to this Law, protected areas can be created on Crown and private land with the agreement of the proprietor of the land. Developers should consider the potential effects of this Law on any development plans, and should make the appropriate enquiries when purchasing raw land to ascertain whether any conservation agreements have been entered into with respect to the land.

Polluters, owners and occupiers could also be subjected to civil action for any environmental harm.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Any development of land requires a grant of planning permission.

"Development" encompasses the carrying out of building, engineering or other operations in, on, over or under any land, the making of any material change in the use of any building or other land, or the subdivision of land. However, it is subject to a number of exclusions, including any works for the maintenance, improvement or other alteration that only affect the interior of a building or do not materially affect the external appearance of the building.

Planning permission may be refused or granted unconditionally, or can be subject to such conditions as the relevant authority deems fit.

A record of all grants of planning permission, modifications, revocations and conditions attached to planning permission relating to Grand Cayman is maintained by the Central Planning Authority, and a record of grants relating to the sister islands, Cayman Brac and Little Cayman, is kept by the Development Control Board.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Cayman Islands government can compulsorily acquire any land. This is usually done for the purposes of establishing new public roads but can also be done in other circumstances.

Compensation is payable, typically at the property's market value.

2.10 Taxes Applicable to a Transaction

Ad valorem stamp duty is payable on the following (subject to certain exceptions that are at the discretion of the Minister of Finance).

A conveyance or transfer of any immovable property (freehold or leasehold):

- typically at a rate of 7.5% of the purchase price or of the market value, whichever is higher, although concessions or reduced rates may be available in specific circumstances (such as first-time Caymanian purchasers and purchasers of units in lower value newbuild homes); and
- usually paid by the purchaser.

A grant of a lease of any immovable property:

- if the term exceeds 30 years, 7.5% of the full market value of the leasehold interest in the real property; or
- if the term is 30 years or less:
  - (a) where any premium or other valuable consideration other than or in addition to rent is provided, 7.5% of the amount of the premium; and
  - (b) where the consideration or any part of the consideration is rent: (i) 5% of the aggregate rent if the term is less than one year; (ii) 5% of the average annual rent or of market rent, whichever is higher, if the term is one year or more but does not exceed five years; (iii) 10% of the average annual rent or of market rent, whichever is higher, if the term exceeds five years but does not exceed ten years; or (iv) 20% of the average annual rent or of market rent, whichever is higher, if the term exceeds ten years; and
- usually paid by the tenant.

Debentures and legal or equitable mortgages, or charges of immovable or movable property within the Cayman Islands:

- in the case of a debenture or a legal or equitable mortgage, or a charge of immovable property within the Cayman Islands:
  (a) 1% of the sum secured where the sum secured does not exceed KYD300,000; or
  (b) 1.5% of the sum secured where the sum secured is more than KYD300,000 (whether initially or after a further advance);
- in the case of a legal or equitable mortgage, or a charge of movable property within the Cayman Islands, 1.5% of the sum secured (subject to a maximum charge of KYD500 where the security instrument is granted by a Cayman Islands exempted company, a Cayman Islands ordinary non-resident company, a Cayman Islands exempted trust or a body corporate incorporated outside of the Cayman Islands, or where the security is over shares in a Cayman Islands exempted company or a Cayman Islands ordinary non-resident company); and
- usually paid by the borrower.

Policies of insurance for property within the Cayman Islands:

- 2% of the cost of new or renewed property insurance premiums; and
- usually added to insurance premiums.

Subject to limited exceptions, ad valorem share transfer tax is payable on the transfer or issue of equity capital in a land-holding corporation, at the rate of 7.5% of the proportionate value of the entire land holding. A land-holding corporation includes a partnership, foreign corporation, chartered corporation, mutual fund or incorporated company (but not a corporation sole or charitable corporation) that holds any legal or beneficial interest (excluding interests created pursuant to bona fide security instruments) in landed property in the Cayman Islands (or interest in another land-holding corporation). Landed property includes freehold interests in Cayman Islands real property and any leasehold interest where the original term exceeded 30 years.

Most other instruments and documents are subject to a fixed rate of stamp duty in comparatively nominal amounts. Registrable instruments are also subject to relatively immaterial registration fees.

Subject to limited exceptions, real estate used for paid tourist accommodation attracts tax at 13% of the amount charged to each tourist.

No other domestic taxes or municipal rates are currently payable on the occupation, acquisition, ownership or disposal of Cayman Islands real property or income deriving therefrom.

2.11 Legal Restrictions on Foreign Investors

There are generally no restrictions on foreign ownership of real estate in the Cayman Islands, although certain formalities may apply to different types of purchaser.

The carrying on of business from real estate within the Cayman Islands requires certain local licences, some of which are specific to property type.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The most typical forms of security for the financing of real estate are:

- legal charge;
- debenture (corporates only);
- legal or equitable mortgage/charge over shares in the company that holds the real property;
- assignment of any rental income;
- assignment of any sale contracts and/or any development contracts (usually for developments);
- assignment of insurance proceeds; and
- guarantees from directors, shareholders, related companies or individuals.

All legal charges over real property must be registered at the Cayman Islands Land Registry, and debentures creating fixed and floating charges are noted on the title for the real property if they are related to a registrable legal charge. Charges over shares in a Cayman Islands company will typically be noted on its register of members, and all security interests granted by a Cayman Islands company should be recorded in its register of mortgages and charges.

Assignments by way of security are usually created by deed, and notice must be given to the counterparty in order to perfect the security.

Due to the size of the Cayman Islands real estate market and the stamp duty payable on direct and indirect ownership interests in Cayman Islands real estate and the granting of security, it is generally not common to see large portfolios of real estate held by funds or investment trusts.

3.2 Typical Security Created by Commercial Investors

See **3.1 Financing Acquisitions of Commercial Real Estate**.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders, although a foreign company holding the benefit of a legal charge over Cayman Islands real estate must register as a foreign company in the Cayman Islands.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Ad valorem stamp duty is payable on debentures and legal or equitable mortgages, or on charges of immovable or movable property within the Cayman Islands (subject to certain exceptions that are at the discretion of the Minister of Finance).

In the case of a debenture or a legal or equitable mortgage, or a charge of immovable property within the Cayman Islands, where the sum secured does not exceed KYD300,000, duty is 1% of the sum secured; where the sum secured is more than KYD300,000 (whether initially or after a further advance), duty is 1.5% of the sum secured.

In the case of a legal or equitable mortgage, or a charge of movable property within the Cayman Islands, duty is 1.5% of the sum secured (subject to a maximum charge of KYD500 where the security instrument is granted by a Cayman Islands exempted company, a Cayman Islands ordinary non-resident company, a Cayman Islands exempted trust or a body corporate incorporated outside of the Cayman Islands, or where the security is over shares in a Cayman

Islands exempted company or a Cayman Islands ordinary non-resident company).

Where the amount of money to be advanced on the security of any property by way of mortgage is unlimited, the security is to be available for such an amount as the ad valorem duty paid thereon extends to cover. If any advance is made in excess of the amount covered by that duty, the original instrument may be stamped-up with the additional ad valorem duty required to cover the total amount then to be secured.

A mechanism exists through which "double duty" on separate security instruments that secure the same debt can be avoided. In such cases, the ad valorem duty may be paid on the primary security instrument, and the other security instruments can be expressed to be "collateral", "auxiliary", "additional" or "substituted", and attract a fixed rate of duty at KYD50.

Most other instruments and documents are subject to a fixed rate of stamp duty in comparatively nominal amounts. Registrable instruments (such as legal charges over real estate) are also subject to relatively immaterial registration fees.

A release of mortgage over immovable property attracts a fixed rate of duty at KYD50.

It is customary for stamp duty and registration fees to be paid by the borrower.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no legal rules or requirements that must be complied with before an entity can give valid security. Such entities must, however, be empowered to do so/not restricted from doing so by their constitutional documents. Often only board approval is necessary, although the entity's constitutional documents should be checked for any further requirements or approvals. It would be prudent to obtain shareholder approval in any case where an entity is guaranteeing or pledging assets as security for another party's liabilities.

3.6 Formalities When a Borrower Is in Default

The priority of enforcement options applicable to security interests, and the typical range of time needed to successfully enforce a security interest, would depend upon the type of security interest in question.

In terms of legal charges registered against Cayman Islands real estate, the security is enforceable pursuant to its terms in conjunction with the provisions of the Registered Land Act (2018 Revision).

The Registered Land Act (2018 Revision) provides a statutory power of sale by public auction, power to lease and power to appoint receivers. Commonly, a legal charge will vary and extend the statutory provisions to give the lender wider powers. To the extent the powers contained in the legal charge vary or are in addition to those created by the Registered Land Act (2018 Revision), they may not be acted on without an order of the court.

Proposals to reform mortgage enforcement have been published, but have not yet been finalised or implemented.

The priority of legal charges is determined by registration at the Cayman Islands Land Registry.

3.7 Subordinating Existing Debt to Newly Created Debt

Generally, the debt secured by a legal charge properly stamped and registered at the Cayman Islands Land Registry will rank in priority to any subsequently registered legal charge, any floating charge or any unsecured debt, in respect of the proceeds of realising such asset. It is possible for lenders to subordinate debt contractually, although this is not common.

3.8 Lenders' Liability Under Environmental Laws

There is currently no statute that has the effect of shifting any environmental liability on to a lender, although a lender can be exposed to potential liability once it takes possession of the premises after a default by the borrower.

3.9 Effects of a Borrower Becoming Insolvent

Security interests created by a borrower in favour of the lender will not be rendered void if the borrower becomes insolvent. However, security may be set aside – for example, where it constitutes a preference or a transaction at an undervalue.

Notwithstanding that a winding-up order has been made, a creditor who has security over the whole or part of the assets of a company may enforce their security without the leave of the court and without reference to the liquidator. With respect to security over real estate, the Registered Land Act (2018 Revision) provides a statutory power of sale by public auction, power to lease and power to appoint receivers. Commonly, a legal charge will vary and extend the statutory provisions to give the lender wider powers. To the extent the powers contained in the legal charge vary or are in addition to those created by the Registered Land Act (2018 Revision), they may not be acted on without an order of the court.

3.10 Taxes on Loans

See **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The following legislation regulates planning and zoning in real estate:

- the Development and Planning Act (2021 Revision);
- the Development and Planning Regulations (as revised);
- the Development Plan 1997 (currently under review);
- the Building Code Regulations (as revised); and
- the National Conservation Act, 2013 and subordinate legislation.

Any development of land requires a grant of planning permission. "Development" encompasses the carrying out of building, engineering or other operations in, on, over or under any land, the making of any material change in the use of any building or other land, or the subdivision of land.

However, it is subject to a number of exclusions, including any works for maintenance, improvement or other alteration that only affect the interior of a building or do not materially affect the external appearance of the building.

Planning permission may be refused or granted unconditionally, or it can be subject to such conditions as the relevant authority deems fit.

The Central Planning Authority for Grand Cayman and the Development Control Board for the sister islands are responsible for reviewing and considering applications to obtain planning permission. The Director of Planning is empowered to take enforcement action where necessary.

A record of all grants of planning permission, modifications, revocations and conditions attached to planning permission relating to Grand Cayman is maintained by the Central Planning Authority; a record of those relating to the sister islands, Cayman Brac and Little Cayman, is kept by the Development Control Board.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Planning permission is required for any proposed development or a material change in use of any building or land. However, planning permission will not be necessary if certain exclusions apply – for example, if the works are carried out for maintenance, improvement or other alteration and affect only the interior of the building or do not materially affect the external appearance of the building.

A permit is also required under the Building Code Regulations before construction or a change to a building or structure is carried out, or before any work that requires planning permission takes place. All such works must be carried out in the manner authorised by the permit.

4.3 Regulatory Authorities

Responsibility for the regulation of development and the designated use of individual parcels lays with the Central Planning Authority for Grand Cayman and with the Development Control Board for the sister islands.

4.4 Obtaining Entitlements to Develop a New Project

Third parties that own land within a radius of 1,000 feet will receive notice of applications for the approval of larger developments (including places of public assembly, gas stations, clubs, restaurants, bars, cinemas and other similar establishments), and may lodge their objections with the Central Planning Authority (or the Development Control Board for the sister islands).

For all other applications for planning permission, only adjacent owners will receive notice of an application and are able to make objections to it.

Those property owners who are entitled to receive notice and who have objected may appeal to a tribunal against a decision on the grounds that it is erroneous in law, unreasonable, contrary to the principles of natural justice, or not in accordance with the Development Plan.

4.5 Right of Appeal Against an Authority's Decision

Any person who has applied for planning permission (or who has objected to an application for planning permission) may appeal against that decision to a tribunal, within 14 days of notification of the decision. Any person aggrieved by the decision of the tribunal may appeal to the Grand Court. If aggrieved by the decision of the Grand Court, an appeal may be made to the Court of Appeal, whose decision will be final and binding upon the affected parties.

4.6 Agreements With Local or Governmental Authorities

Planning permission may be granted subject to such conditions as the relevant authority sees fit. A prudent developer would engage with utility suppliers at the outset of a project to incorporate their input into their plans. Planning permission runs with the land, although any agreements will be personal to the parties.

4.7 Enforcement of Restrictions on Development and Designated Use

Where any development of land (including material changes in use) has been carried out without the applicable planning permission or not in compliance with any conditions attached to a grant of planning permission, the Director of Planning may serve an enforcement notice on the owner or occupier of the land within five years of the alleged breach.

Non-compliance with an enforcement notice is an offence and attracts a fine.

If the steps required to be taken by the enforcement notice are not carried out within the allotted period, the Director of Planning may enter on the land and take those steps, and may recover their costs as a debt from the owner of the land.

The Director of Planning may also apply to the Grand Court for an injunction.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The structures most commonly used to acquire real estate are corporate structures, including Cayman Islands companies and foreign companies.

Because the Cayman Islands is a non-direct taxation jurisdiction and real estate activities can be achieved through different structures, foreign investors are able to select their investment model based on factors not driven by Cayman regulation (eg, taxation and investment regulation), except where participation may be marketed in the Cayman Islands.

The choice of investment vehicle will also often be influenced by whether the investor also intends to carry on business within the Cayman Islands, as there is a local business licensing regime in the jurisdiction.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A Cayman Islands company's constitutional documents will set out its governance framework, including the powers of its board of directors, who ordinarily manage the day-to-day operation of the business. In relation to a company incorporated as a company limited by shares, the liability of its shareholders is limited to the amount (if any) unpaid on their shares.

5.3 REITs

REITs and real estate derivatives from Cayman Islands real estate are quite uncommon due to the relatively small size of the jurisdiction and the taxable event that arises when an interest in land (including the equity capital of a land-holding corporation) is transferred (see **2.10 Taxes Applicable to a Transaction**), although there have been a few occurrences of foreign REITs acquiring Cayman Islands commercial property and at least one occurrence of a domestic REIT that is in the process of being formed.

Institutional investment in the Cayman Islands is increasing as the sizes of projects require large

amounts of capital. However, the majority of commercial real estate is held privately.

5.4 Minimum Capital Requirement

There are no minimum capital requirements for a Cayman Islands company.

5.5 Applicable Governance Requirements

The subscribers of the memorandum of association of a Cayman Islands company are deemed to have agreed to become shareholders of the company, and every other person who has agreed to become a member of a company and whose name is entered on the register of members will be deemed to be shareholders of the company. The company will typically have one or more directors who manage the day-to-day business of the company. The constitutional documents set out the governance framework, along with the Companies Act (as revised).

5.6 Annual Entity Maintenance and Accounting Compliance

Cayman Islands companies are obliged to pay annual fees in January to the Cayman Islands General Registry.

A schedule of incorporation and annual fees levied by the Cayman Islands government for different types of company can be found on the Cayman Islands General Registry website.

Exempted companies and foreign companies are required to engage a registered office provider in the Cayman Islands, for which additional annual fees will apply.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

There are two types of arrangements that allow a person, company or other organisation to occupy and use real estate for a limited period without buying it outright.

- A lease grants a tenant the right of exclusive possession of a property for a specified period of time. It gives a tenant contractual and proprietary rights in the property, which can typically be transferred to a third party, subject to any restrictions in the lease.
- A licence allows a landowner to grant permission for the use and occupation of a property. The occupier of a property does not have exclusive possession, however, and their rights under the licence cannot be transferred. A licence is merely a personal right and does not create a registrable interest.

6.2 Types of Commercial Leases

There are no specified types of commercial leases. Given the relatively small size of the jurisdiction, there are relatively few sophisticated landlords of large-scale developments, so landlords use their own form of lease.

Most commonly, leases of part will be for a net rent, with a separate common area maintenance charge levied for landlord insurance, the maintenance of common parts, etc.

Leases of whole are less common but would often impose full repair and insurance obligations on the tenant.

Freehold title to a portion of the valuable Seven Mile Beach corridor is owned by the Crown.

Originally this was the subject of a long ground lease to facilitate development, but over time has been subdivided into several smaller leases that have been varied to extend their term upon payment of large premiums to the Cayman Islands government.

6.3 Regulation of Rents or Lease Terms

All terms of leases are freely negotiable, although certain covenants by the landlord and by the tenant are implied by the Registered Land Act (2018 Revision), unless modified by the lease.

Covenants implied on behalf of the landlord include the following:

- that a tenant shall and may peaceably and quietly possess and enjoy the leased premises during the period of the lease without any lawful interruption from or by the landlord, or any person rightfully claiming through the landlord, so long as said tenant pays the rent and observes and performs the agreements and conditions contained or implied in the lease and to be observed and performed on their part;
- not to use or permit to be used any adjoining or neighbouring land of which they are the proprietor or lessee in any way that would render the leased premises unfit or materially less fit for the purpose for which they were leased;
- where only part of a building is leased, to keep the roof, main walls, main drains, common passages and common installations in repair;
- where any dwelling house, flat or room is leased furnished, that such house, flat or room is fit for habitation at the commencement of the tenancy; and
- that if, at any time, the leased premises or any part thereof are destroyed or damaged by fire, earthquake, hurricane, flood, civil commotion or accident not attributable to the negligence of the tenant, their servants or their licensees, so as to render the leased premises or any part thereof wholly or partially unfit for occupation or use, the rent or a just proportion thereof according to the nature and extent of the damage sustained shall be suspended and cease to be payable until the leased premises have again been rendered fit for occupation and use; if the leased premises have not been so rendered fit for occupation and use within six months of their destruction or damage as aforesaid, the tenant may terminate the lease, at their option and upon giving one month's written notice of their intention so to do.

Covenants implied on behalf of the tenant include:

- to pay the rent reserved by the lease at the times and in the manner specified therein;
- to pay all rates, taxes and other outgoings that are at any time payable in respect of the leased premises during the continuance of the lease, unless they are payable exclusively by the landlord by virtue of any written law;
- in the case of agricultural land, to farm said land in accordance with the rules of good husbandry and to yield up the land at the end of the term in good heart;
- to keep all buildings comprised in the lease and all boundary marks in repair, except where only part of a building is leased, or where a dwelling house is leased furnished;
- to keep the leased premises, except the roof, main walls, main drains, common passages and common installations, in repair where only part of a building is leased, or where a dwelling house is leased furnished;

- where the lease is of furnished premises, to keep the furniture in as good a condition as it was at the commencement of the period, fair wear and tear only excepted, and to replace such articles as are lost, destroyed or so damaged as to be beyond repair with articles of equal value to those so lost, destroyed or damaged;
- to permit the landlord or their agent, with or without workers or others, at all convenient times and after reasonable notice, to enter the leased premises and examine their condition;
- to repair or otherwise make good any defect or breach of agreement for which the tenant is responsible and of which notice has been given by the landlord to the tenant, within such reasonable period as may be specified in the notice; and
- not to transfer, charge, sublease or otherwise part with the possession of the leased premises or any part thereof without the previous written consent of the landlord (such consent shall not be unreasonable withheld).

With the exception of a temporary domestic lockdown period, the Cayman Islands government did not take any action to enact legislation to specifically regulate lease terms as a result of the COVID-19 pandemic.

6.4 Typical Terms of a Lease

Because of the stamp duty treatment on the grant of longer leases (see **6.7 Payment of VAT**), a lease term of five years (or less) is relatively common, and may include an option for the parties to renew for one or two further terms.

Responsibility for repairing the demised premises is typically assigned to the tenant. The landlord is usually under an obligation to insure and maintain the building and the common parts, and will usually recoup these costs from the tenant through rental payments or common area maintenance charges.

Although always subject to agreement between the parties, rent is commonly paid monthly or quarterly in advance or arrears.

Following the outbreak of the COVID-19 pandemic, parties are advised to pay close attention to force majeure and rent abatement provisions.

6.5 Rent Variation

It is typical for commercial leases to make provisions for rent to be reviewed.

6.6 Determination of New Rent

Typically, rent is reviewed in line with the consumer price index (CPI), by a fixed percentage or by market review.

6.7 Payment of VAT

No VAT is payable on rent, although stamp duty is payable on the lease.

Stamp duty is usually paid by the tenant and is calculated at the following ad valorem rates:

- if the term exceeds 30 years, 7.5% of the full market value of the leasehold interest in the real property; or
- if the term is 30 years or less:
  - (a) where any premium or valuable consideration other than or in addition to rent us provided, 7.5% of the amount of the premium; and
  - (b) where the consideration or any part of the consideration is rent:
    - (i) if the term is less than one year, 5% of the aggregate rent;
    - (ii) if the term is between one and five years, 5% of the average annual rent or of market rent, whichever is

higher;
(iii) if the term is between five and ten years, 10% of the average annual rent or of market rent, whichever is higher; or
(iv) if the term exceeds ten years, 20% of the average annual rent or of market rent, whichever is higher.

6.8 Costs Payable by a Tenant at the Start of a Lease

Stamp duty (see **6.7 Payment of VAT**), any registration fees (nominal) and a security deposit are typically paid by the tenant at the start of the lease.

6.9 Payment of Maintenance and Repair

It is common for the lease to assign responsibility to the landlord for the maintenance and insurance of the common areas, and the landlord typically recovers their costs from the tenant through rent or common area maintenance charges.

6.10 Payment of Utilities and Telecommunications

Where tenants have not purchased their electricity, water, gas and telecommunications services directly from suppliers, they will typically pay a share of these services provided by the landlord by reference to the size of their demised premises, or the landlord will separately meter each premises.

6.11 Insurance Issues

Typically, the landlord will be responsible for insuring the building and common parts (passing costs on to tenants through rent or common area charges), while the tenant insures the demised premises. Typical insured risks would include fire, earthquake, hurricane, flood and civil commotion.

6.12 Restrictions on the Use of Real Estate

It is usual for a landlord to restrict the use of the demised premises and common areas. Planning permissions and zoning constraints would also apply.

6.13 Tenant's Ability to Alter and Improve Real Estate

A lease will ordinarily prohibit the tenant from making alterations or improvements to the real estate without the prior consent of the landlord.

6.14 Specific Regulations

There are no specific regulations and/or laws that apply to leases of particular categories of real estate. All leases are primarily governed by the Registered Land Act (2018 Revision) and the Registered Land Rules (2018 Revision). Parties generally have the freedom to contract as they wish, although the Registered Land Act does imply certain covenants on the landlord and tenant, unless modified in the lease (see **6.3 Regulation of Rents or Lease Terms**).

6.15 Effect of the Tenant's Insolvency

The terms of the lease usually allow a landlord to terminate the lease if the tenant becomes insolvent. Subject to any provisions to the contrary in the lease, the Registered Land Act (2018 Revision) also provides landlords with the right to forfeit the lease if a tenant is adjudicated bankrupt (if an individual) or goes into liquidation (if a company).

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is common for a landlord to take a security deposit at the outset of a lease, and they may require guarantees from directors, shareholders or related companies.

Security deposits are freely negotiable but would likely include at least one rental payment. Security deposits are not regulated, so the terms of the lease would govern.

6.17 Right to Occupy After Termination or Expiry of a Lease

Unless expressly provided for in the lease, tenants do not have security of occupation or a right to renew at the end of the term. However, a tenant that continues to occupy the premises with the consent of the landlord after the termination of the lease will be deemed to be a tenant holding the premises on a periodic tenancy on the same conditions as those of the expired lease, insofar as those conditions are appropriate to a periodic tenancy.

6.18 Right to Assign a Leasehold Interest

The Registered Land Act (2018 Revision) implies a covenant on the tenant preventing alienation without the landlord's consent (which is not to be unreasonably withheld). A landlord would typically impose a more stringent covenant in a well-drafted lease (for example, setting out specific circumstances in which it is prepared to permit assignment, subletting or sharing, and reserving to itself absolute discretion to refuse outside of those circumstances), and a tenant would typically look for more flexibility.

It is therefore a point that is often the subject of some negotiation, but a well-advised landlord would look for at least some assurances on the financial standing and commercial reputation of the incoming tenant in order to protect its interest in the remainder of the estate.

6.19 Right to Terminate a Lease

Typically, a lease would provide for the landlord to terminate in the event of a material breach by the tenant (subject to any negotiated cure periods) or an insolvency event of the tenant. Either the landlord or the tenant would ordinarily be given the right to terminate the lease if the leased premises are substantially destroyed or damaged and not repaired within a specified period. Tenant break options are generally uncommon, but could be negotiated.

6.20 Registration Requirements

All leases attract stamp duty (see **6.7 Payment of VAT)** but only leases exceeding a term of two years (whether as an initial term, through extension or renewal options or where expressed to be for the life of one of the parties) require registration (shorter leases are overriding interests).

Registerable leases require a front sheet in prescribed form but otherwise the parties are free to negotiate the form and content of the bulk of the terms. Leases of part of a registered freehold must be accompanied by a plan.

Registration expenses are minimal.

6.21 Forced Eviction

It is common for a lease to contain forfeiture clauses that allow the landlord to evict the tenant. However, the tenant has a statutory right to apply to the court for relief against forfeiture, so the timeframe for the forfeiture process can vary.

6.22 Termination by a Third Party

The Cayman Islands government can compulsorily acquire any land. This is usually done for the purposes of establishing new public roads but can also be done in other circumstances.

Compensation is payable, typically at the market value of the interest acquired.

6.23 Remedies/Damages for Breach

A landlord may sue for damages for breach of contract so as to compensate it for loss arising from the breach. Typically, a prudent landlord would hold a security deposit equal to between one and three months' rent, and the lease would provide that this may be forfeited in the event of breach. If the landlord used the security deposit to remedy a breach but did not terminate the lease, a well drafted lease would oblige the tenant to top-up the security deposit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Due to the relatively small size of the jurisdiction, significant construction projects are few in number at any one time. There is no commonly accepted market standard of contract, so parties are free to agree terms as they see fit, with the format and complexity of the contract often being driven by the sophistication of the parties and the type of project.

However, most larger construction contracts will typically follow a US style (such as the American Institute of Architects), a UK style (such as the joint contracts tribunal), a combination of the two, or even the contractor's (or developer's) own standard terms.

7.2 Assigning Responsibility for the Design and Construction of a Project

See **7.1 Common Structures Used to Price Construction Projects**.

7.3 Management of Construction Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.4 Management of Schedule-Related Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

See **7.1 Common Structures Used to Price Construction Projects**.

7.6 Liens or Encumbrances in the Event of Non-payment

See **7.1 Common Structures Used to Price Construction Projects**.

7.7 Requirements Before Use or Inhabitation

Certificates of fitness for occupancy must be obtained from the Central Planning Authority (or the Development Control Board in relation to property in the sister islands) before any new buildings are occupied.

8. Tax

8.1 VAT and Sales Tax

Ad valorem stamp duty is payable on the following (subject to certain exceptions that are at the discretion of the Minister of Finance) on the following:

- a conveyance or transfer of any immovable property (freehold or leasehold), typically at a rate of 7.5% of the purchase price or of the market value, whichever is higher, although concessions or reduced rates may be available in specific circumstances (such as first-time Caymanian purchasers and purchasers of units in lower value newbuild homes); and
- a grant of a lease of any immovable property:

(a) if the term exceeds 30 years, 7.5% of the full market value of the leasehold interest in the real property; or
(b) if the term is 30 years or less:
  (i) where any premium or other valuable consideration other than or in addition to rent is provided, 7.5% of the amount of the premium; and
  (ii) where the consideration or any part of the consideration is rent: (i) 5% of the aggregate rent if the term is less than one year; (ii) 5% of the average annual rent or of market rent, whichever is higher, if the term is one year or more but does not exceed five years; (iii) 10% of the average annual rent or of market rent, whichever is higher, if the term exceeds five years but does not exceed ten years; or (iv) 20% of the average annual rent or of market rent, whichever is higher, if the term exceeds ten years.

Subject to limited exceptions, ad valorem share transfer tax is payable on the transfer or issue of equity capital in a land-holding corporation, at the rate of 7.5% of the proportionate value of the entire land holding. A land-holding corporation includes a partnership, foreign corporation, chartered corporation, mutual fund or incorporated company (but not a corporation sole or charitable corporation) that holds any legal or beneficial interest (excluding interests created pursuant to bona fide security instruments) in landed property in the Cayman Islands (or interest in another land-holding corporation). Landed property includes freehold interests in Cayman Islands real property and any leasehold interest where the original term exceeded 30 years.

In addition, ad valorem stamp duty is payable (subject to certain exceptions that are again at the discretion of the Minister of Finance) on debentures and legal or equitable mortgages or charges of immovable or movable property within the Cayman Islands.

The following applies for a debenture or a legal or equitable mortgage or a charge of immovable property within the Cayman Islands:

- where the sum secured does not exceed KYD300,000, duty is 1% of the sum secured; and
- where the sum secured is more than KYD300,000 (whether initially or after a further advance), duty is 1.5% of the sum secured.

In the case of a legal or equitable mortgage or a charge of movable property within the Cayman Islands, duty is 1.5% of the sum secured (subject to a maximum charge of KYD500 where the security instrument is granted by a Cayman Islands exempted company, a Cayman Islands ordinary non-resident company, a Cayman Islands exempted trust or a body corporate incorporated outside of the Cayman Islands, or where the security is over shares in a Cayman Islands exempted company or a Cayman Islands ordinary non-resident company).

Finally, policies of insurance for property within the Cayman Islands attract ad valorem stamp duty of 2% of the cost of the new or renewed property insurance premiums, which is usually added to insurance premiums.

Most other related instruments and documents are subject to a fixed rate of stamp duty in comparatively nominal amounts. Registrable instruments are also subject to relatively immaterial registration fees.

Subject to limited exceptions, real estate used for paid tourist accommodation attracts tax at a rate of 13% of the amount charged to each tourist.

There are no other domestic taxes or municipal rates currently payable on the occupation, acquisition, ownership or disposal of Cayman Islands real property or income deriving therefrom.

Generally, the buyer/tenant will be responsible for paying any stamp duty and registration fees.

8.2 Mitigation of Tax Liability

There are no commonly used methods that can be employed to mitigate stamp duty on large real estate portfolio purchases. However, a purchaser is free to apply for a discretionary waiver or reduction of stamp duty from the Minister of Finance.

Where the acquisition is financed and secured by Cayman Islands assets, a mechanism exists to avoid paying "double duty" on separate security instruments that secure the same debt. In such cases, the ad valorem duty may be paid on the primary security instrument, and the other security instruments can be expressed to be "collateral", "auxiliary", "additional" or "substituted", and attract a fixed rate of duty at KYD50.

8.3 Municipal Taxes

There are no municipal taxes paid on the occupation of business premises. However, subject to limited exceptions, real estate used for paid tourist accommodation attracts tax at a rate of 13% of the amount charged to each tourist.

8.4 Income Tax Withholding for Foreign Investors

The Cayman Islands does not directly tax income or capital gains.

8.5 Tax Benefits

The Cayman Islands does not directly tax income or capital gains.

CHINA

Law and Practice

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JunHe was founded in Beijing in 1989 and is one of the first private partnership law firms in China. Since then, the firm has become one of the largest and most widely recognised Chinese law firms. It has 14 offices worldwide and a team of more than 1300 professionals, including over 300 partners and legal counsel, as well as over 1000 associates and paralegals. JunHe is committed to providing top-tier legal services in commercial transactions and litigation, and is well known as a pioneer innovator and leader in the re-establishment and development of the modern legal profession in China. The firm has experience in advising international clients on China's constantly changing legal environment affecting their investments and operations. In addition, the lawyers often concurrently hold high posts in international organisations, government agencies, trade associations and arbitration tribunals.

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1. General

1.1 Main Sources of Law

The laws promulgated at the national level include:

- the Civil Code;
- the Land Administration Law;
- the Urban and Rural Planning Law;
- the Construction Law; and
- the Urban Real Estate Administration Law.

1.2 Main Market Trends and Deals

During 2023, office space remained the most sought-after asset class in terms of transaction value in the real estate market of the PRC, representing 45% of the total transaction value, retail properties accounted for 10%, representing a substantial increase of approximately 7% compared to the previous year, apartment buildings and hotels accounted for 15%, with a notable increase of about 5% (Source: Colliers International Group Inc, Review and Analysis of the Bulk Trading Markets in Major Chinese Cities in 2023, 2 February 2024). The majority of transactions continue to be driven by domestic demand, accounting for a staggering 89% of all transactions.

Notable transactions in 2023 include Bain's acquisition of Chindata for RMB22.8 billion. Chindata Group Holdings Ltd (Nasdaq: CD) stands as a leading Chinese hyperscale data centre solution provider with more than 33 hyperscale data centres worldwide. Additionally, Swire Properties acquired the equity interests in two project companies of Lujiazui Group, each of whom owns a piece of mixed-use land in Yangjing and New Bund respectively, at a total price of RMB9,709.97 million.

China sustained a remarkably low inflation rate in 2023 and continued implementing interest rate cuts throughout the year. However, the real estate industry did not experience a positive bounce back in 2023 (source: China Lianhe Credit Rating Co., Ltd, Review of the Real Estate Industry in 2023 and Prospect for 2024, 27 December 2023).

1.3 Proposals for Reform

The PRC Company Law (as amended and republished on 29 December 2023), effective on 1 July 2024, has made material amendments in respect of company registration, corporate governance, equity capital, shareholders' rights, employees' rights, and special rules governing state-capital companies and public companies.

2. Sale and Purchase

2.1 Categories of Property Rights

There are two main categories of property rights under PRC laws.

- Ownership right is the right to possess, use, receive proceeds from and dispose of the properties of the owner. Under PRC law, land may only be owned by the state or collectively owned by farmers.
- Usufructuary right is the right to possess, use and receive proceeds from the properties owned by other persons, such as land use rights, contracting rights for farmland, farmer's rights to homestead land, rights of habitation and easement rights.

2.2 Laws Applicable to Transfer of Title

National laws and regulations mainly include:

- the Civil Code;
- Urban Real Estate Administration Law;

- the Interim Regulations Concerning the Assignment and Transfer of the Right to the Use of State-Owned Land in Urban Areas; and
- the Interim Regulation on Real Estate Registration.

2.3 Effecting Lawful and Proper Transfer of Title

No transfer of real estate is valid unless it is duly registered or otherwise provided by law. For example, a court judgment, arbitration award or, in the event of government taking or expropriation, an administrative decision of government, may serve to effect a title transfer if the same is effectively issued.

Title insurance is not common in the PRC.

2.4 Real Estate Due Diligence

A buyer typically performs due diligence investigations on various aspects, such as legal, tax, financial, environmental and technical.

Asset Deal

In terms of legal due diligence, the scope for an asset deal focuses more on the property, such as title, existing encumbrances, zoning and licence requirements, environmental compliance, leasing, operation and management status, but also covers verification of key aspects of the seller, which may prevent or materially affect the sale of the property, such as the corporate governance structure and legal capacity of the seller, restrictions under financing obligations, and ongoing or pending material litigation, arbitration and administrative penalties involving the property.

Equity Deal

The scope for an equity deal is generally a comprehensive investigation, subject to the client's specific instruction, of the target company, in addition to the investigation upon the target property. The investigation of the target company generally covers the corporate history, corporate governance structure, business operation, material contracts (including financing contracts), environmental compliance, material litigation, arbitration and administrative penalty, intellectual property, labour and employment, taxes, subsidiaries and investment into other entities.

2.5 Typical Representations and Warranties

A buyer generally requests the seller to make representations and warranties on itself and on the target (ie, the target property in an asset deal, and the target property, the target company and the target equity/shares in the target company in the event of an equity deal). Typical representations and warranties on the seller include capacity, power, authority, solvency of the seller, all authorisations, consents and approvals obtained, the binding effect of the contract and the sale of the target without contravention or claim by third parties or other contracts.

Target Property

Typical representation and warranties on the target property in an asset deal include clean title to the target property (free from encumbrances or, as the case might be, with disclosed existing encumbrances), the state of the target property, leasing status, no pending fees and no knowledge of taking, seizure or expropriation.

Target Equity/Shares

In an equity deal, sellers are often requested to make additional representations and warranties on the clean title to the target equity/shares (free from encumbrances or, as the case might be, with disclosed existing encumbrances), legal capacity and status, financial condition, tax mat-

ters, compliance with laws, environmental matters, indebtedness and loans, leases and other material contracts, employees, intellectual property and no pending litigation in respect of the target company.

Coverage of Representation and Warranties

The coverage of representation and warranties is subject to business negotiations between the parties to a transaction. In general, parties to cross-border transactions are more comfortable with standard broad representation and warranties provisions, while domestic players tend to welcome a shorter version of an asset or equity transfer agreement; ie, a more condensed coverage of representation and warranties.

Breach of Representations and Warranties

If the seller is in breach of the relevant representations and warranties, the buyer is generally entitled, in accordance with the contract or relevant PRC laws, to claim for damages, refuse to proceed with the closing or even terminate the contract.

A sophisticated seller may insist that the buyer may only refuse to proceed with the closing or terminate the contract when the seller is in breach of fundamental representations and warranties, and otherwise only claim for damages in the event of breach of general representations and warranties.

The seller's representations and warranties apply primarily to the facts and circumstances existing at the time of contract execution and are deemed to have been remade on and as of the closing date. A sophisticated seller may insist on adding a time limit for bringing claims for breach of such representations or warranties and capping the seller's liability for breach of the same. A typical cap for the aggregate of all the claims is 100% of the total contract price, while a sophisticated seller generally sets different sub-caps for different categories of claims.

Representation and warranty insurance is more often seen in cross-border transactions involving international players, mostly taken out by purchasers in cross-border transactions. Local parties, particularly state-owned enterprises, are becoming increasingly aware of and interested in such insurance.

2.6 Important Areas of Law for Investors

See **1.1 Main Sources of Law**, **2.2 Laws Applicable to Transfer of Title**, **2.11 Legal Restrictions on Foreign Investors** and **5.5 Applicable Governance Requirements**.

2.7 Soil Pollution or Environmental Contamination

The Environmental Protection Law and Soil Pollution Prevention and Control Law of provide that the person causing the soil pollution (the "causing person") is responsible for managing the soil pollution risks and the remediation of the soil pollution it caused. However, if the causing person cannot be identified, the land use right owner (eventually the buyer, unfortunately) is responsible for managing the soil pollution risks and remediation of the same, even if the land use right owner did not cause the pollution or contamination.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can ascertain the permitted use of a parcel of real estate by viewing the construction land planning permit (建设用地规划许可证 in Chinese), land grant contract (土地出让合同 in Chinese), the construction works planning permit (建设工程规划许可证 in Chinese), other relevant zoning documents and the title certificate. In addition, a

buyer may make further verification by accessing, with the authorisation of the seller, the relevant files of the real estate at the competent planning and natural resources authority (the Planning and Natural Resources Commission or PNRC) or the competent local urban construction archives.

2.9 Condemnation, Expropriation or Compulsory Purchase

The state may, in the public interest:

- expropriate real estate, including land collectively owned by farmers and buildings or other real estate owned by any entities or individuals, with appropriate compensation; or
- temporarily requisition the real estate of any entities and individuals which will be returned to the said entities and individuals after such use.

The power of expropriation and temporary requisition must be exercised with due authority and legitimate process.

Compensation

The compensation must be fair and reasonable in the case of expropriation and temporary requisition. Where the land to be expropriated is collectively owned by farmers, they shall be compensated according to the principle that their living standard is not negatively affected; while the land user, in respect of land under a land grant contract to be taken back by the government for public interest, shall be compensated, considering the actual elapsed term of the land use and the status and condition of the developments made on the land. In the case of requisition, compensation shall be made for any damage to or destruction of the requisitioned real estate.

2.10 Taxes Applicable to a Transaction

In respect of the purchase and sale of real estate, taxes payable may differ depending on the different transaction structures.

Asset Deal

In an asset deal, taxes payable include:

- enterprise income tax/individual income tax;
- VAT and surcharges; and
- land appreciation tax, stamp duty and deed tax.

Of these:

- the seller is obliged to pay enterprise income tax/individual income tax, value added tax and surcharges, land appreciation tax, and stamp duty; and
- the buyer is obliged to pay deed tax and stamp duty.

Equity Deal

In an equity deal (regardless of whether to purchase all or a portion of the equity/shares), taxes payable include:

- enterprise income tax/individual income tax, which the seller is obliged to pay; and
- stamp duty, which the seller and the buyer are both obliged to pay.

In addition, see **7.2 Assigning Responsibility for the Design and Construction of a Project** for the potential exposure to land appreciation tax in an equity deal.

Tax Rates

Enterprise income tax

The rate ranges from 10% to 25%. The individual income tax rate is generally 20%, but an individual who transfers their sole residential

housing after holding it for more than five years is exempt from individual income tax payment.

VAT

The rate ranges from 5% to 9%. Surcharges imposed on the VAT payable include tax for maintenance and construction of cities at an applicable rate ranging from 1% to 7%; education surtax at an applicable rate of 3%; and local education surtax, the rate of which varies in different localities. See **7.1 Common Structures Used to Price Construction Projects** for more detailed analysis.

Land appreciation tax

The rate for this is progressive, ranging from 30% to 60%, but an individual who transfers their residential housing is exempt from paying this tax.

Deed tax

This generally ranges from 3% to 5%, but an individual who purchases a sole residence for their family (including their spouse and underage children) with a gross floor area of more than 90 square metres is eligible for a reduced rate of 1.5% and with a gross floor area of no more than 90 square metres, of 1%.

Stamp duty

The rate is generally 0.05% for the seller and the buyer. Currently, an individual who purchases or transfers residential housing is exempt from paying this tax.

2.11 Legal Restrictions on Foreign Investors

Foreign entities or individuals cannot acquire real estate in the PRC for non-personal use unless a foreign-invested enterprise is established or has been established in the PRC to own and operate the real property. The following restrictions also apply to foreign investors:

- a foreign individual is only allowed to purchase one housing unit (in practice, one title certificate represents one unit of housing) for their own use, subject to the requirement of residing or studying in China for more than one year; and
- a branch or representative office of an offshore entity in China is allowed to purchase non-residential real estate for its office use in the city where such branch or representative office is registered.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

If commercial real estate is acquired by an onshore entity (including a foreign-invested enterprise), generally the onshore entity may seek financing from banks within the PRC, subject to certain restrictions required by the China Banking Regulatory Commission. If the onshore entity intends to arrange loans from offshore bank(s) or offshore entities, including shareholder(s), to acquire a commercial real estate, it must meet the requirements and restraints in relation to foreign debt under the PRC laws. Currently, no real estate companies are allowed to arrange loans from offshore, except for foreign-invested real estate companies incorporated prior to 1 June 2007.

Offshore Acquisition and Onshore Fixed-Asset Loans

Where a foreign investor acquires commercial real estate through an equity deal (by acquiring equity interest in the onshore company holding the real estate), the most common financing

structure is an offshore acquisition loan accompanied by an onshore fixed-asset loan in renminbi. The offshore acquisition loan is extended by an offshore bank to the offshore buyer to pay for the equity/share purchase price in the same currency as that of the equity/share purchase price, secured by a pledge over the equity interest in the onshore target company acquired by the buyer. The onshore fixed-asset loan is generally extended to the onshore target company by an onshore subsidiary of the offshore bank, secured by a mortgage over the real estate owned by the onshore target company.

3.2 Typical Security Created by Commercial Investors

Where a commercial real estate investor that intends to acquire or develop real estate, acquires a loan from a lender, it will usually be required to provide the following forms of security:

- the mortgage over the real estate;
- the pledge of the equity interest of the target or project company by such investor;
- the guarantee made by the investor;
- the pledge of the account receivables, which are usually the rental proceeds generated from the real estate; and
- the agreement for the transfer of interests in material contracts, which generally include material lease contracts, the property management contract, asset management contract and insurance policies in relation to the real estate.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Although the PRC laws do not prohibit an offshore lender from being the mortgagee of real estate collateral, in practice, certain local real estate registration centres, which serve as the competent authority in charge of real estate mortgage registration, such as in Xiamen, refuse to register an offshore entity (including offshore banks) as the mortgagee. Therefore, in terms of practicality, it may not be possible to register a mortgage in favour of offshore lenders in certain localities, resulting in a failure to create an effective mortgage.

A borrower is generally able to make repayments to its offshore lender without further restrictions, provided that they have completed the relevant foreign exchange regulatory formalities for the cross-border loan (including, but not limited to, the registration of such cross-border loan) in accordance with the PRC laws.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

If a mortgage is created over real estate, both the mortgagor and the mortgagee are obliged to pay stamp duty for the mortgage contract at a tax rate of 0.05% each of the secured debt. A minimal registration fee for a real estate mortgage (CNY80 for residential property and CNY550 for non-residential property, per registration) is charged by the registration authority and often borne by the mortgagee.

Furthermore, if the mortgagor and mortgagee agree in the mortgage contract to an enforcement notarisation, a fee for enforcement notarisation may be incurred, which is usually borne by the mortgagor. Such fee is charged by the notary public office at a rate equal to an agreed percentage of the amount of the secured debt, which may vary at different localities.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under PRC laws, certain real estate may not be used as collateral to secure a debt, such as land

ownership (other than land use rights that can be a valid collateral), land use right to certain collectively-owned land such as farmers' homestead land (other than collectively-owned construction land), educational, medical and other public welfare facilities owned by non-profit schools, nurseries and/or medical institutions, real estate subject to title dispute or without clear title, real estate under attachment, detainment or custody orders.

3.6 Formalities When a Borrower Is in Default

When a lender enforces its security over real estate against a defaulting borrower, if the lender and the mortgagor have explicitly agreed in the mortgage contract to apply the enforcement notarisation approach, the lender may directly apply to the competent court for enforcement by presenting the duly notarised mortgage contract and the enforcement certificate issued by the notary public's office. If the lender and the mortgagor have not explicitly agreed in the mortgage contract to apply the enforcement notarisation approach, the lender may, by agreement with the mortgagor, dispose of the collateral by negotiating a purchase price, by auction or sale of the collateral, and the lender may claim its senior debt against the proceeds from such a negotiated purchase price for auction or sale of the collateral. Failing an agreement between the mortgagor and the mortgagee on the means of disposal of the collateral, the lender may apply to the local court to auction or sell the collateral. In either case, the sale or negotiated purchase price of the collateral shall be based upon market price.

The timeframe required for the aforesaid enforcement varies, and typically ranges from six to 12 months.

Lenders tend to be prudent in exercising their foreclosure rights in the current market, except where the borrower is in fundamental breach or becomes insolvent.

3.7 Subordinating Existing Debt to Newly Created Debt

An existing mortgage debt may become subordinated to a newly created mortgage debt, the mortgage interest of which has been duly registered, only if the mortgage over such existing debt has not been duly registered. But if the mortgage over the newly created debt has also not been duly registered, the existing debt will rank pari passu with the newly created debt.

3.8 Lenders' Liability Under Environmental Laws

The lender, being the mortgagee of the real estate, will not generally be held liable. However, if the lender becomes the land use right owner in respect of such real estate as a result of foreclosure (or enforcement) of the mortgage, the lender may be held liable for such non-compliance if the party that caused the pollution cannot be identified.

3.9 Effects of a Borrower Becoming Insolvent

The security interests created by a borrower in favour of a lender will not be made void if the borrower becomes insolvent, and the lender may continue to claim its senior debt against the collateral, although this will be subordinated to the contractor's lien. In the event of restructuring during the bankruptcy proceedings, the lender will have to temporarily suspend its enforcement of the mortgage (unless damage to the collateral or a situation is likely to decrease the value of the collateral and might endanger the mortgagee's interests). If the borrower enters into reconcilia-

tion or a liquidation procedure, the lender may continue to enforce the mortgage.

3.10 Taxes on Loans

There are no existing, pending, or proposed mortgage recording or similar taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The PRC laws applicable to strategic planning and zoning at state level mainly include the Land Administration Law, and the Urban and Rural Planning Law.

Local governments shall, in accordance with these laws, prepare the urban planning and zoning, and reasonably determine the development scale, steps and construction standards of the urban locality.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

In addition to the relevant laws and regulations, such as the Construction Law and Regulation on the Quality Management of Construction Projects, the design, appearance and method of construction are governed by the national standards promulgated by the relevant authorities of the state council, such as:

- the General Standard for Civil Building;
- the Unified Standard for Energy-Saving Design of Industrial Buildings;
- the Code for Fire-Protection Design of Buildings; and
- the General Standard of Quality Control in the Construction of Buildings and Municipal Projects.

Generally, these regulations and rules apply to both the construction of a new building and the refurbishment of an existing building. Local governments may promulgate detailed implementing rules according to the relevant national regulations and policies.

4.3 Regulatory Authorities

The development and designated use of real estate are generally governed by the competent authorities of the state and local governments, such as:

- the competent development and reform commission (DRC) for the approval or filing of the project initiation;
- the PNRC for planning and zoning approval, grant of land use right and issuance of land use right certificate; and
- the housing and urban-rural development authority (HUDA) for preliminary design approval, issuance of the construction works construction permit (建筑工程施工许可证) and filing for completion acceptance.

4.4 Obtaining Entitlements to Develop a New Project

The approval process for development of a new building and/or infrastructure project can be divided into four phases:

- phase 1 for project initiation and land-planning permission, which includes approval or filing of the project, and issuance of the construction land planning permit (建设用地规划许可证);
- phase 2 for engineering and project permission, which includes project design examina-

tion, and issuance of the construction works planning permit (建设工程规划许可证);
- phase 3 for construction permission, which includes design confirmation of fire-protection and civil air defence, and issuance of the construction works construction permit (建筑工程施工许可证); and
- phase 4 for completion acceptance, which includes completion acceptance of zoning, land, fire protection, civil air defence and other relevant matters, and the completion acceptance filing.

Refurbishment and expansion of an existing building also require the relevant approval and permits, which generally include the construction works planning permit (建设工程规划许可证), the construction works construction permit (建筑工程施工许可证), and the completion acceptance filing. Local authorities may also issue detailed implementation orders.

In addition, for any modification to urban and rural zoning, the relevant authorities that prepared such urban and rural zoning shall solicit public opinion by holding hearings or using other methods. In the event of any modification to the approved detailed construction plan or master plan of a project design, the relevant zoning authorities shall solicit the interested parties' opinions by holding hearings or using other methods. Also, any entity or individual is entitled to report any zoning non-compliance to the competent zoning or other relevant authorities.

4.5 Right of Appeal Against an Authority's Decision

If a real estate developer objects to the approval decision of the competent authority, generally such developer may submit applications for administrative review to the local government or the administrative department at the higher level. If such developer further objects to the administrative review decision, it may file an administrative lawsuit to the court, unless such administrative review decision is, as provided by law, a final decision.

4.6 Agreements With Local or Governmental Authorities

A developer or investor may enter into an investment or joint development agreement with the competent subdivision of the local government, specifying, among other things, local regulatory requirements upon construction, progress and the investment intensity, and the fiscal preferential treatment offered by the local government. The specific contents of such agreement vary from project to project and are subject to local policies and negotiations.

4.7 Enforcement of Restrictions on Development and Designated Use

The regulatory authorities may enforce restrictions on the development and designated use of a piece of land in various ways.

- If any entity occupies land without due approval or with approval obtained by deception, such entity shall be ordered to return the land, and any building and other structures newly constructed on the land may be ordered to be confiscated or dismantled. In addition, a fine may be imposed concurrently, and the relevant persons responsible for the illegitimate occupation may also be subject to criminal liability.
- In the event of any illegitimate land transfer, the income gained by the transferor from such transfer shall be confiscated, and the newly constructed buildings on the land may be ordered to be confiscated or dismantled.
- If construction work is carried out without a permit or the approval of the competent

authorities (including failure to obtain permission or failure to carry out construction in compliance with the construction works planning permit), the project owner or developer may be ordered to correct the violation and dismantle the building or structures, they may be liable to pay a fine and the illegitimate properties may also be confiscated.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Under the Company Law, the types of companies include limited liability companies (有限责任公司) and limited companies by shares (股份有限公司). The liability of each shareholder of either a limited liability company or a limited company by shares is limited to its respective subscribed capital contribution to the company. Limited liability companies are the most common choice for acquiring real estate assets among both domestic and offshore investors.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Both limited liability companies and limited companies by shares are formed and governed by their articles of association (章程), which also govern their shareholders, directors, supervisors and officers, in addition to the companies themselves. These provide for, among other things, capital contributions, shareholding percentage, governance rights, distribution rights, dissolution and liquidation matters.

Both limited liability companies and limited companies by shares that hold real estate are subject to property tax and urban land use tax, as mentioned in **8.3 Municipal Taxes**, and have access to tax benefits as mentioned in **8.5 Tax Benefits**. There is no substantial difference in terms of tax costs, as mentioned in **2.10 Taxes Applicable to a Transaction**, incurred as a result of purchase of real estate to limited liability companies and limited companies by shares.

5.3 REITs

China officially launched a pilot scheme on public REITs in the infrastructure field in 2020, which was further broadened on a pilot basis, to include department stores, shopping malls, and marketplace for agricultural products. Foreign investors can initiate these vehicles subject to satisfaction of "commercial presence" requirement and other qualification requirements, such as sound creditworthiness, robust internal control system, consistent business operations, and material legal compliance in past three years. Using a REIT can improve cash flow and asset-liability ratio, and increase asset turnover ratio of an enterprise. Recently, Shanghai and Shenzhen Stock Exchanges are, at the same time, exploring the introduction of private REITs to supplement public REITs and the first private REIT product is under way.

5.4 Minimum Capital Requirement

The minimum capital for companies engaging in real estate development may not be less than CNY1 million.

5.5 Applicable Governance Requirements

A Limited Liability Company

Pursuant to the Company Law (as amended in 2023, and coming into force on 1 July 2024), a limited liability company shall have:

- less than 50 shareholders and a shareholders' assembly consisting of all the shareholders (or sole shareholder), which is the highest authority of the company;

- a board of directors consisting of three or more directors (or one director in lieu of a board of directors if there is a limited number of shareholders or the company is small), which reports to the shareholders' assembly (or shareholder); and
- a board of supervisors of no less than three supervisors (or one supervisor in lieu of a board of supervisors, or zero supervisor upon unanimous consent by all the shareholders, if there is a limited number of shareholders or the company is small), or an audit committee composed of board directors to serve as the board of supervisors or the supervisor above.

Board directors are appointed by the shareholders' assembly (or shareholder). A limited liability company may have a general manager, who reports to the board, to be appointed or dismissed by decision of the board.

A Limited Company by Shares

A limited company by shares is incorporated by one to 200 sponsors, with at least half of them having residence in the PRC, and has:

- a shareholders' assembly consisting of all shareholders, which is the highest authority of the company;
- a board of directors consisting of three or more directors (or one director in lieu of a board of directors if there is a limited number of shareholders or the company is small), which reports to the shareholders' assembly (or shareholder);
- a board of supervisors of no less than three supervisors (or one supervisor in lieu of a board of supervisors if there is a limited number of shareholders or the company is small), or an audit committee composed of board directors to serve as the board of supervisors or the supervisor above; and
- a general manager.

As in the limited liability company, board directors are appointed by the shareholders' assembly (or shareholder), and the general manager is appointed or dismissed by decision of the board of directors.

5.6 Annual Entity Maintenance and Accounting Compliance

A company must submit the annual report for the preceding year to the administration for market regulation through the corporate credit information disclosure system between 1 January and 30 June each year. No fees are required for the submission of such report.

Companies are also required to prepare financial accounting reports at the end of each fiscal year, which are audited by an accounting firm. In addition to such accounting expenses, additional fees may be incurred for other financial matters as agreed in a company's articles of association. Such fees vary depending on the location of the accounting firm and the company's assets and financial condition.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Leasing is the most common method to obtain the right to occupy and use any or all of a building for a limited period of time. In addition, the habitation right, if duly registered, is another method to occupy and use another person's dwellings, generally free of charge unless otherwise agreed. The habitation right is a newly created right under the Civil Code.

Methods to obtain the use right to a piece of land vary depending on the type of land. Land is classified into farmland, construction land and unused land:

- farmland means land that is directly used for agricultural production, including cultivated land, forest land, grassland, etc;
- construction land mainly includes land zoned for the construction of buildings and other structures; and
- unused land refers to land other than farmland and construction land.

The use right to farmland may be obtained through a contracting arrangement, whereby contractors may enter into an agreement with a landowner or other entities with delegated authority to engage in agricultural production such as planting, forestry, animal husbandry, and fishery on the land, and benefit from such production.

The use right to construction land may be obtained by entering into a land grant contract (with land premiums to be paid) or a land allocation contract (no land premiums to be paid) with the competent local land authorities if it is stated-owned or the relevant collective if it is collectively owned.

In addition, real estate owners are entitled to use the land or buildings adjacent to their own real estate for the purpose of obtaining and draining water, passage, ventilation and lighting, etc that are necessary for their life or production. Such neighbouring right is mandatory and no agreement between the parties is required. Parties may also create easement through execution of agreements to obtain the right to use another party's real estate.

6.2 Types of Commercial Leases

In practice, commercial leases may be divided into the following categories depending on the different rent payment methods:

- lease with a fixed rent, often seen in office leases, under which the rent is a fixed amount as agreed by the parties;
- lease with a turnover rent, under which the rent is calculated at an agreed percentage of the tenant's gross turnover generated from the leased property; or
- lease under which the rent is the higher of a fixed base rent or a turnover rent.

6.3 Regulation of Rents or Lease Terms

PRC laws stipulate that the term in a lease agreement cannot exceed 20 years. If the term exceeds 20 years, the excess period will be invalid. When the lease term expires, the parties may renew the lease agreement for up to 20 years from the date of renewal of the lease agreement. Lease agreements with a term longer than the remaining term of the land use right to the land located beneath the property may be at risk because it is uncertain whether the landlord will still have the right to use the land after the land use term expires.

The rent for a commercial lease is generally negotiable and subject to agreement between tenant and landlord. However, rent for affordable housing such as public rental housing (公共租赁住房) and low-rent housing (廉租房) may not exceed the guiding rental rate promulgated by the local government.

6.4 Typical Terms of a Lease

Generally, the length of a lease term is subject to the agreement between the landlord and the tenant but shall not exceed 20 years (see **6.3 Regulation of Rents or Lease Terms**). The land-

lord and tenant may agree in the lease whether the term may be renewed and, if so, how the lease may be renewed.

PRC law provides that the landlord shall be responsible for the maintenance and repair of the leased premises, unless otherwise agreed by the parties. The tenant has the right to require the landlord to maintain and repair the leased premises within a reasonable time limit when necessary. Where maintenance and repair affect the use of the leased premises, the rent may be reduced, or the lease term extended accordingly.

The frequency of rent payment is, subject to the agreement between the landlord and the tenant, generally on a monthly, quarterly or yearly basis.

6.5 Rent Variation

The tenant shall pay rent in the amount and manner as agreed in the lease agreement. If agreed in the lease, the rental rate may be adjusted based on the agreed adjustment mechanism. Parties are not allowed to unilaterally change rent payments, unless otherwise agreed by the parties or provided for by PRC laws, such as the occurrence of a force majeure, or an unforeseeable material change (other than commercial risks and force majeure) of circumstance.

6.6 Determination of New Rent

When deciding the price adjustment mechanism, a fixed yearly increase rate, the consumer price index or fair market prices are often taken into consideration.

6.7 Payment of VAT

The landlord is responsible for the payment of VAT on the rent income generated from leasing real estate.

6.8 Costs Payable by a Tenant at the Start of a Lease

Generally, in addition to rent, a refundable security deposit, equal to rent plus a management fee of three to six months in most cases for commercial leases (or one to three months for residential leases), is required to be paid to the landlord at the start of a lease. If the tenant wishes to improve or fit out the property, the tenant may be required to pay a security deposit for the fitting-out or improvements, refundable after the completion of the work.

6.9 Payment of Maintenance and Repair

Unless otherwise agreed by the parties, the landlord is responsible for the maintenance and repair of the leased premises. In practice, small maintenance and repairs of common areas and shared equipment, machinery and facilities are generally conducted by the property manager engaged by the landlord, and covered by the management fees, which are payable to the property manager by either the landlord or the tenant, subject to the lease agreement.

6.10 Payment of Utilities and Telecommunications

In practice, the tenant pays their own utilities and telecommunications fees incurred in respect of, or consumed at, the leased premises. Utilities and telecommunications fees incurred in respect of common areas, and public equipment, machinery and facilities are often shared and charged to the end user (ie, the tenant in most cases, or the landlord if otherwise agreed in the lease, or if the premises are vacant) in proportion to the floor area of the leased premises.

6.11 Insurance Issues

The landlord will usually take out and maintain, at their own cost, property all risks insurance for the leased premises, which covers physical

loss of or damage to the insured property arising from any natural hazards or accident. Damages caused or expenses incurred by intentional acts or gross negligence, confiscation, requisition, destruction or damage by any action or order of any government or public authority, war, coup d'état, or strike are generally excluded. On the other hand, the tenant is usually requested by the landlord to take out and maintain through the lease term construction/installation works all risks insurance for the tenant's fitting-out or improvement works, and public liability insurance for the tenant's business operations in the leased premises.

Business interruption insurance, an insurance ancillary to the property all risks insurance, generally only covers losses incurred by business interruption resulting from property damage.

6.12 Restrictions on the Use of Real Estate

In practice, the landlord commonly imposes various restrictions in the lease agreement on how a tenant shall use the leased property, including but not limited to restrictions on the permitted use, subleasing, assignment, and fitting-out of the leased premises. Applicable PRC laws also require that use of the leased premises shall be in accordance with the zoned usage, and the tenant shall not change the load-bearing structure or demolish indoor facilities without the landlord's approval.

6.13 Tenant's Ability to Alter and Improve Real Estate

Typically, the tenant must obtain the landlord's prior consent if the tenant intends to improve or fit out the leased premises. A fitting-out plan is typically required in order to obtain the landlord's written consent. To ensure the safety of the leased premises, the landlord usually requires that the tenant takes out insurance for such improvement or fitting-out works and engages qualified contractors. As discussed in **6.12 Restrictions on the Use of Real Estate**, the tenant may not change the load-bearing structure or other main structure of the leased premises without approval. Furthermore, it is common practice for the landlord to require the tenant to complete all the approval, filing and recording procedures required by the competent authorities (including but not limited to the planning, construction and fire-protection approvals and completion acceptance) for such improvement or fitting-out at the tenant's own cost.

6.14 Specific Regulations

Leasing of various types of real estate are mainly governed by:

- the Civil Code of the PRC;
- the Administrative Measures for Commodity Real Estate Leasing; and
- the Interpretation of the Supreme People's Court on Certain Issues Concerning Specific Application of Law in the Trial of Contractual Disputes over the Leasing of Urban Housing 2009 (as amended in 2020).

6.15 Effect of the Tenant's Insolvency

It is common practice to specify in the lease that the landlord is entitled to terminate the lease should the tenant become insolvent. Failing explicit agreement, the Enterprise Bankruptcy Law of the PRC shall govern. If the court accepts the tenant's application for bankruptcy, the tenant's bankruptcy administrator decides whether to rescind or continue to perform the lease agreement. Failure by the bankruptcy administrator to notify the landlord of its decision within two months from the date when the bankruptcy application was accepted, or to reply to the landlord within 30 days after receiving the landlord's

exhortation, will result in the rescindment of the lease agreement.

Where the lease agreement is so rescinded, the tenant shall reinstate and return the leased premises, and the landlord is entitled to declare its claims to the court, in accordance with the bankruptcy proceedings, for the damages incurred thereunder. Where the administrator decides to continue the performance of the lease agreement, the landlord must comply. However, the landlord has the right to request the administrator to provide security. The lease agreement will then be deemed rescinded if the administrator fails to provide security.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A refundable security deposit is commonly seen in leases to secure the tenant's performance of the lease. Security deposit is generally in the form of cash or bank guarantee.

6.17 Right to Occupy After Termination or Expiry of a Lease

After the expiry or termination of a lease, the tenant generally has no right to continue occupying the leased premises. However, if the tenant continues to use the premises after the expiry of the lease without any objection from the landlord, the original lease shall be deemed as remaining in force but without a fixed term. Under such circumstances, either party can terminate the lease at any time, provided that the landlord gives the tenant reasonable prior notice of such termination. In addition, if the landlord intends to lease the premises after the expiry of the lease, the tenant shall have a right of first refusal under the same terms and conditions.

6.18 Right to Assign a Leasehold Interest

A tenant may sublease part or all of the leased premises to a third party with the prior consent of the landlord. The sublease term should not be longer than the residual lease term of the original lease agreement. The tenant is liable for any damages caused by such third parties to the leased premises.

6.19 Right to Terminate a Lease

The following circumstances are often seen in a lease as causes for termination by the tenant:

- damage to the leased premises preventing the tenant from using the leased premises;
- insolvency of the landlord; and/or
- frequent interrupted supply of water, electricity, air conditioning or elevators.

The PRC laws also give the tenant the right to terminate the lease in the event of:

- the leased premises endangering the safety or health of the tenant;
- the occurrence of any of the following circumstances for reasons not attributable to the tenant, thus rendering the tenant unable to use the leased premises:
  - (a) the leased premises being attached by judicial or administrative organs;
  - (b) title claim to the leased premises; or
  - (c) violation of the mandatory provisions of laws and administrative regulations in respect of the requirements on the use of the leased premises.

The following circumstances are often seen in a lease as causes for termination by the landlord:

- failure by the tenant to pay the rent, management fee, deposit or other amounts due, and

the outstanding amounts remain unpaid for a reasonable period after receipt of notice from the landlord;
- insolvency of the tenant;
- unauthorised suspension or close of business operations; and/or
- damage to the main structure or unauthorised fitting-out or improvement of the leased premises by the tenant.

The PRC laws also give the landlord the right to terminate the lease should the tenant sublease the leased premises without the landlord's consent.

6.20 Registration Requirements

A lease agreement shall, within 30 days of its execution, be filed with the competent real estate authority of the city where the real estate is located, otherwise the parties to the lease will be ordered to comply. Should the parties fail to comply within the prescribed time period, the parties shall be subject to a fine of CNY1,000 (in the case of an individual) or CNY1,000 to CNY10,000 (in the case of a legal entity).

The lease of real estate is not usually reflected in the Land Record.

6.21 Forced Eviction

If the lease is terminated as a result of the tenant's default, the tenant must reinstate and return the leased premises in a timely manner. Should the tenant fail to do so, after the lease has been duly terminated, the landlord may cut off the water or electricity supply to force the eviction of the tenant.

The landlord may file a lawsuit to the court with competent jurisdiction for its confirmation that the lease is duly terminated. If the tenant still occupies the leased premises after the court has found that the lease has been terminated, the landlord may apply for an enforced eviction based on a valid judgment. In practice, the period required for a court to make a judgment and complete the enforcement procedure varies in different localities but is usually longer than a year.

6.22 Termination by a Third Party

A third party who is not a party to the lease cannot generally terminate the lease because it is not a party to the lease. However, under certain circumstances, third parties may make it impossible for the lease to be performed or fulfilled, resulting in early termination of the lease.

6.23 Remedies/Damages for Breach

In addition to the collection from the tenant of outstanding rent and tenant eviction, the parties may agree, in the lease, upon the amount of liquidated damages in the event of a tenant breach and termination of a lease. However, if the amount of the liquidated damages agreed on by the parties exceeds 130% of the losses sustained, the party concerned may apply to the court or arbitration tribunal for an appropriate reduction in liquidated damages. Remaining rent is not generally supported unless it falls within the cap of 130% of the total losses incurred by the landlord, same as the security deposits, whether in the form of cash or bank guarantee, held by the landlord.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common pricing structures for construction include:

- fixed quota pricing (工程定额计价);

- bill of quantities pricing (工程量清单计价);
- fixed lump-sum price (固定总价);
- fixed unit price (固定单价);
- cost plus fee (成本加酬金); and
- adjustable price (可调价).

These are not mutually exclusive and sometimes, multiple pricing structures might be included in the same contract.

Fixed Quota Pricing

Fixed quota pricing means that the construction price, in accordance with the bidding documents, is a total of:

- the direct construction cost calculated based on the unit labour price, material price, equipment price and other information formulated by the relevant administrative authorities and the market price for the same during the same period;
- the indirect construction cost (including management salaries, office expenses, employees' insurance);
- profit; and
- taxes.

Bill of Quantities Pricing

Bill of quantities pricing means that the aggregate of the price for each component of the construction work, which is calculated based on the integrated unit price and quantity of such component, is determined based on the construction drawing and construction management and engineering skills.

Fixed Lump-Sum Price

With a fixed lump-sum price, the total construction price is a fixed amount which is not adjustable within the agreed work scope and conditions.

Fixed Unit Price

This means that the unit price is a fixed amount, which is not adjustable in response to any change in conditions or quantities, and the total construction price is the product of the weighted summation of the fixed unit price multiplied by the quantity required.

Cost Plus Fee

Cost plus fee means that the contractor is paid a fee in the amount agreed between the parties, in addition to reimbursement of the actual construction cost.

Adjustable Price

With an adjustable price, the contract price is adjustable subject to agreed conditions, such as an increase in labour or material costs due to inflation or market change, a change in the order, a change of quantities or other geotechnical conditions.

7.2 Assigning Responsibility for the Design and Construction of a Project

An owner may either enter into an EPC Contract with a general contractor, or separately enter into a design contract and a construction contract with a local design institute and construction contractor, respectively.

EPC Contracts include the following according to market practices:

- an Engineering-Procurement-Construction (EPC) arrangement, under which the contractor is responsible for the engineering, procurement and construction of the project, and is fully accountable for aspects such as quality, safety, schedule and price;
- a Design-Build (DB) arrangement, under which the contractor is responsible for the engineering and construction of the project,

and is fully accountable for aspects such as quality, safety, schedule and price;
- an Engineering-Procurement (EP) arrangement, under which the contractor is only responsible for the engineering and procurement of the project, and not the construction thereof;
- a Procurement-Construction (PC) arrangement, under which the contractor is only responsible for the procurement and construction of the project, and not the engineering thereof; and
- a Lump-Sum Turn-Key (LSTK) arrangement, under which the contractor is responsible for the engineering, procurement, construction and installation, commissioning service, and delivery of the project qualified for use.

7.3 Management of Construction Risk

Construction risks may be allocated between the parties to a contract, considering factors such as bargaining power, fairness and justice. For instance, the owner may transfer the risk of price increase to the contractor by adopting the fixed lump-sum price contract, or the contractor may agree to indemnify the owner only to the extent of the total contract price. Generally, risk allocation arrangements are valid and recognised by the courts, provided they are not in violation of the mandatory provisions of PRC laws and administrative regulations.

Furthermore, a project owner may require a contractor to take out and maintain project-related insurance (such as contractor's all risks and third-party liability insurance) in favour of the owner.

7.4 Management of Schedule-Related Risk

The owner and contractor generally specify a duration for work, including milestone and completion dates in the contract, and manage the work progress through the following contractual arrangements:

- the contractor is required to make and update the work schedule, report in a timely manner any risks of extension of work duration, take all actions necessary to keep to the agreed schedule and pay the delay damages;
- the owner has the right to terminate the contract in case of severe delay of the schedule; and
- the circumstances under which the owner must agree to extend the duration of the contract must be specified.

Monetary compensation may be claimed by an owner in accordance with the contract or by law, if certain milestone and completion dates are not achieved.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

In practice, the following forms of security are generally requested by the owner:

- a performance bond, in the form of a bank guarantee or third-party guarantee, which is issued to the owner by the guarantor for the purpose of securing the performance of the contract by the contractor;
- a payment guarantee in the form of a bank guarantee or third-party guarantee, which is issued to the subcontractors, suppliers or construction workers by the guarantor, for the purpose of securing the payment obligations of the contractor under the relevant contract(s); and
- retention money is an amount retained from each progress payment, which is generally released to the contractor after the contractor has fully performed its contract obligations,

usually after the expiry of the defect liability period.

7.6 Liens or Encumbrances in the Event of Non-payment

The contractor for construction work has the right of contractor's lien over the construction in the event of non-payment by the owner, which is senior to a mortgage or other debts. Such contractor's lien is valid for up to 18 months, commencing from the date the construction payment becomes due. The contractor's lien may be removed if the overdue payments are made in full by the owner by voluntary payment or offset against the negotiated sale price (between owner and contractor) of the construction, or the proceeds from the auction of the construction, ordered by a competent court.

7.7 Requirements Before Use or Inhabitation

The PRC laws explicitly stipulate that no construction shall be delivered for use unless it passes completion acceptance. The owner must organise the geological survey contractor (勘察), designer, contractor and jianli (监理) (professional supervision engineer mainly responsible for the supervision and management of the construction quality and schedule) to attend the completion acceptance inspection; and, after completion acceptance is passed, the owner must go through specific completion acceptance filing formalities at the relevant government authorities, and obtain the Completion Verification and Acceptance Filing Certificate for the Construction Project (建设工程竣工验收备案证书), which may be replaced by an electronic notice from HUDA declaring that the completion acceptance has been passed, for certain small-scale non-residential construction works in some localities.

In addition, in the case of a residential housing project, the PRC laws also require the Residential Housing Quality Warranty and Residential Housing Use Manual to be provided by the real estate developer when delivering such housing, and certain localities, such as Shanghai, Shandong province and Tianjin, further require a certificate of delivery and occupancy issued by the local HUDA, to be obtained by the real estate developer before occupation of the newly built residential housing.

8. Tax

8.1 VAT and Sales Tax

PRC companies are subject to payment of VAT for the sale of real estate, and the seller is the obliged taxpayer. The taxes payable are equal to the sale price multiplied by the applicable tax rate. Two methods are applied to calculate the sale price:

- under the simplified method, the sale price includes all the costs received by the seller plus the out-of-price expenses; and
- under the general method, the sale price equals the balance of the total amount of the costs received by the seller and the out-of-price expenses after deduction of the expenses incurred during the sale of the real estate.

For a general taxpayer, if the seller acquires the real estate before 30 April 2016, it may choose the simplified method (at an applicable rate of 5%) or the general method (at an applicable rate of 9%). If the real estate is acquired after 1 May 2016, only the general method may be applied (at an applicable rate of 9%).

For a small-scale taxpayer (ie, whose VAT-taxable sales are no more than CNY5 million per year), the simplified method at an applicable rate of 5% will be applied. If VAT-taxable sales are no more than CNY100,000 per month, such taxpayer is exempt from the payment of VAT.

8.2 Mitigation of Tax Liability

An equity deal is often chosen by companies over an asset deal as a way to mitigate tax liabilities. However, the State Administration of Taxation has issued certain official replies on a case-by-case basis to collect land appreciation tax from the seller in equity transfer transactions where the main asset of the target company acquired was the real estate. As a result, there might be potential exposure to land appreciation tax liability in similar equity deals.

8.3 Municipal Taxes

Property tax and urban land use tax are the main municipal taxes paid on the occupation and usage of real estate:

- for property tax, the applicable rate is 1.2% if it is calculated based on the residual value of the real estate (ie, the original price of the real estate reduced by 10% to 30%), and 12% if the tax is calculated based on the rental income from the real estate; and
- the applicable rate of urban land use tax varies from CNY0.6 per square metre to CNY30 per square metre, depending on where the real estate is located.

8.4 Income Tax Withholding for Foreign Investors

In the case of an offshore entity holding an onshore project company, which, in turn, holds real estate in the PRC, such offshore entity is subject to:

- withholding income tax at an applicable rate of 10% on any dividends received from the onshore project company; and
- withholding income tax at an applicable rate of 10% on the net income generated from the transfer of equity in such onshore project company, if under each circumstance such offshore entity has no establishment in the PRC or such income has no actual connection with such establishment, unless otherwise provided in a more preferential bilateral tax treaty.

In the case of an offshore entity directly holding real estate in the PRC, which existed before July 2006, such foreign investor, if it has no establishment in the PRC or the income generated in the PRC has no actual connection with such establishment, is subject to:

- withholding income tax on the net income generated from the transfer of the real estate at a rate of 10%; and
- withholding income tax at a rate of 10% on the rental proceeds generated by the real estate.

8.5 Tax Benefits

According to the PRC Enterprise Income Tax Law, real estate held by a company is typically treated as fixed assets, which may be depreciated, and the relevant depreciation amounts are allowed to be deducted from taxable income. The land use right held by companies is usually treated as a non-tangible asset, which may be amortised, and the relevant amortised amount may be deducted from taxable income.

Trends and Developments

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Merits & Tree Law Offices

Merits & Tree Law Offices was founded in 2006 and is now a comprehensive law firm with nine offices across China. Its real estate and infrastructure team is led by four key partners and over ten supporting partners, in addition to over 20 lawyers. The team provides contentious and non-contentious legal services in this sector, including construction and engineering of buildings and infrastructure, real estate development and sales, land acquisition, project mergers and acquisitions, urban renewal, property management and operation, project investment and financing, project tax planning and asset-backed securitisation. The lawyers advise local giant real estate developers as well as various construction companies in China, such as Vanke, Longfor and Greentown. The team specialises in construction and provides strategic and professional solutions to clients on contract negotiation, bidding and tendering, construction claims and disputes, and on-demand guarantee-related matters.

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Overview

In 2023, China's real estate market remained in a complicated situation. Following the passing of the COVID-19 pandemic, demand has been reactivated to some extent, while the supply-demand relationship has changed significantly due to the negative growth of the population in the last few years. Moreover, a number of leading real estate developers have recently run into trouble. In 2023, their situation did not materially improve. Many developers are still looking for financing and restructuring opportunities amid the debt crisis. The positive side is that the central and local governments promulgated a series of policies in 2023 aiming at stabilising the market, including active policies targeting both demand and supply. However, considering the uncertainty of the overall economic environment of the world at the present time, as well as the fact that China's domestic real estate market has remained depressed for a long time, the real estate industry is still moving forward and continuously seeking new opportunities to improve the situation.

Central Government Setting the Tone for the Real Estate Industry

Faced with the complex domestic macro-economic environment, China's central and local governments have issued successive policies in the past year in order to stabilise the real estate market. It is generally considered that 2023 may be the year in which most impactful policies were issued for China's real estate industry.

In April, during the annual session of the National People's Congress, the then premier Mr Li Keqiang set the tone for real estate policy. In summary, he mentioned four objectives, including:

- responding to the reasonable housing demand;
- effectively preventing and resolving the risks of leading real estate companies;
- improving the balance sheet and preventing disorderly expansion of real estate companies; and
- promoting the steady development of the real estate industry.

It seems that the fourth point should be set as the ultimate goal, while the other three points propose solutions from both the demand and supply side.

Policies in Relation to Demand Aiming to Stimulate Consumption

Policies with regard to demand were concentrated in the second half of the year.

On 18 August 2023, the Ministry of Housing and Urban-Rural Development, the People's Bank of China, and the National Financial Regulatory Administration jointly issued the Notice on Optimising the Standards for Identifying of the Number of Housing Units in relation to Individual Housing Loans, according to which, when a family applies for a loan to purchase a residence, so long as the family members do not hold a residence in their names, the loan rate for the first residence should apply, regardless of whether they have borrowed loans in the past.

On 31 August 2023, the People's Bank of China and the National Financial Regulatory Administration issued the Notice on Matters related to Reducing the Interest Rates of Existing Individual Housing Loans for the Purchase of First Housing Units, according to which, if the residence to be purchased by a specific loan borrower is deemed to be their first residence in the city according to the new policy, the borrower may

apply to the bank for a new loan at a lower interest rate to replace the existing loan or directly reduce the interest rate by amending the loan contract through negotiation with the bank.

In addition, on 20 February 2024, the People's Bank of China announced they would further lower the Loan Market Prime Rate (LPR). The LPR for a term of five years or more dropped significantly by 25 basis points to 3.95%, making the loan rate close to record lows.

The issuance of the aforesaid regulations is just an example of the various initiatives to stimulate the demand and increase the buyer's willingness to purchase. Under the new policies, buyers are offered less total cost and lower monthly payments thanks to the favourable interest rate. On the other hand, as more people are able to meet the requirements to purchase a residential property, the potential buyer market is hopefully expanding.

In addition to the national policies, local governments have also issued relevant policies and regulations. Since September and October, many cities have announced the cancellation of purchase restrictions, no longer setting qualifications for residential buyers. By January 2024, 20 core cities including Nanjing, Hefei, Jinan, Qingdao, Wuhan, Wuxi, Ningbo had completely cancelled the purchase restrictions for urban residences. These new policies will lead to the further expansion of the buyer's market.

Overall, it is hoped that the policies will boost the real estate market and increase the transaction volume in the short term, but the long-term effect still needs to be observed, taking into account the changes in the market supply and demand as well as the sustainability of the policies.

Combination of Policies Concerning Supply

While optimising demand-related policies, the central and local governments were also working on improving the environment for supply.

On one hand, the traditional mode of real estate development is changing. From a regulatory perspective, the central government has repeatedly emphasised the construction of "three major projects" in 2023, which include:

- the construction of affordable housing;
- the renovation of urban villages; and
- the construction of "dual-use" public infrastructures.

Among the above three projects, the construction of affordable housing may provide the middle- and low-income class with appropriate living conditions; the renovation of urban villages can improve the environment and enhance the overall appearance of the city; and the "dual-use" public infrastructure may be used for medical treatment, tourism and public services, etc, while in emergencies, it can be immediately converted into emergency facilities.

It seems that the said policy is adjusting the old business mode of "land acquisition-development-sales" from the past. Nevertheless, since the three projects are complicated and systematic, it may need quite a long time to come to fruition.

On the other hand, the government is looking for ways to resolve the risks of real estate developers. At the end of October 2023, the Central Financial Work Conference stressed that "the reasonable financing needs of real estate enterprises of different ownership should be met equally". Under this policy, the central bank as

well as commercial banks have introduced several corresponding measures.

In addition, debt restructuring of real estate developers is also under way. According to media statistics, since the second half of 2021, more than 50 listed real estate developers have started debt restructuring processes, many of which are giants and industry leaders. A relatively positive signal is that some companies have completed or partially completed debt restructuring, laying the foundations for dealing with troublesome debts.

Nevertheless, Chinese real estate developers are still facing a very difficult situation. For instance, China Evergrande Group was ordered to wind up operations in early 2024. Therefore, the rescue of real estate enterprises still has a long way to go. Since the real estate developer plays a significant role in the industry, a stable and predictable market may not exist without the participation of healthy developers. In this regard, it is of great importance to support developers out the debt crisis.

Winding-Up of China Evergrande Group

At the beginning of 2024, a piece of big news spread through China's real estate market. On 29 January 2024, China Evergrande Group (HK.03333, "Evergrande" or the "Company") was ordered to wind up. Given that a number of China's leading real estate developers have fallen into the debt crisis in recent years, the winding-up of Evergrande may give us an example from which to observe the current situation of China's real estate developers.

China Evergrande Group is one of the largest real estate companies in China. Mr Xu Jiayin (also known as Mr Hui Ka Yan) founded Evergrande Real Estate Group Limited ("Evergrande Real Estate") and a group of companies (together the "Group") in 1996 in Guangzhou. The Company has been listed on the Main Board of the Stock Exchange of Hong Kong Limited since 2013.

According to the announcement by Evergrande on Hong Kong Exchanges and Clearing Limited, on 24 June 2022, Top Shine Global Limited filed a winding-up petition against the Company to the High Court of the Hong Kong Special Administrative Region (the "High Court") regarding Evergrande's debt in amount of HKG862.5 million.

On 29 January 2024, Ms Linda Chan, the judge of the High Court, made a winding-up order against the Company pursuant to the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO) based on the facts that the restructuring plan had no progressed and the Company was insolvent.

Evergrande's Case Provided the Market with Directions and Solutions

Overall, Evergrande's debt crisis is a complex and wide-ranging event in relation to China's real estate market, financial system and even the macro economy.

The winding-up of Evergrande is an unprecedented case in China's real estate industry. It has a systematic and profound impact on various aspects, including:

- the mutual recognition and enforcement of bankruptcy-related court decisions between Hong Kong SAR and the Mainland;
- the determination of the scope of bankruptcy estate;
- the settlement of claims of creditors in Hong Kong and the Mainland; and

- the Group's "commitment to timely deliveries of pre-sold properties" policies under the government's direct guidance.

In addition, the winding-up of Evergrande also has a wide impact on numerous market participants such as the purchasers of pre-sold properties, financial investors, banks and so on. Therefore, due to the specificity and complexity of this case, it brings uncertainty to each entity that has a relationship with Evergrande.

The failure of Evergrande is an epitome of many Chinese real estate companies that are struggling with the debt crisis. In addition to Evergrande, a winding-up petition dated 27 February 2024 was filed by Ever Credit Limited at the High Court against the Country Garden Holdings Company Limited (HK.02007). Furthermore, Moody's, an international credit rating agency, has downgraded Vanke, one of the largest Mainland real estate developers' credit rating to a non-investment grade.

It is apparent that many Chinese real estate companies are still facing high levels of debt that need to be mitigated. In this regard, the liquidation of Evergrande and its follow-up actions may provide other Mainland real estate companies that are facing the debt crisis with guidance and a point of reference.

Disposal of Assets: A Common Concern of Cross-Border Listing Developers

As a number of domestic developers are listed on an overseas stock exchange, like Evergrande is, the winding-up case raises the question of whether the winding-up order issued in other jurisdictions can affect the developer's assets in Mainland China.

Pursuant to Part 3 of Schedule 25 of CWUMPO, the liquidator has the power to dispose of the Company's assets. Therefore, the compulsory winding-up order against the Company may have direct legal effect on its assets located in Hong Kong. However, from a legal perspective, whether the order is also binding on Evergrande's main assets located in Mainland China will depend on whether the order can be recognised and enforced by the courts in Mainland China.

On 11 May 2021, the Supreme People's Court of China issued the Opinions on Launching the Pilot Programme of Recognition of and Assistance to Bankruptcy Proceedings in the Hong Kong Special Administrative Region ("Opinions"), which specifies the scope, jurisdiction, acceptance requirements as well as the rules for distribution and settlement of bankruptcy estates in relation to the recognition and assistance procedure by the Mainland court. Therefore, in the authors' opinion, the said Opinions should apply to the Evergrande liquidation case.

Nevertheless, the authors are of the view that the liquidation of the Company may not directly and inevitably lead to the disposal of the assets of the Company's subsidiaries such as Evergrande Real Estate registered in Shenzhen, China.

According to the applicable law, the equity held by the Company in its subsidiaries should be a bankruptcy estate. However, the assets of the subsidiaries of the Company should not be included in the bankruptcy estate since the relevant subsidiaries have independent legal personality at law. Therefore, even if the Mainland court recognises the winding-up order against the Company, the administrator in the Mainland bankruptcy procedure (if any) has no right to directly identify the assets of the relevant sub-

sidiaries (including Evergrande Real Estate) as bankruptcy estate, nor should it dispose of the subsidiaries' assets which are only indirectly held by the Company.

If the administrator in the Mainland bankruptcy procedure (if any) intends to dispose of the assets of Evergrande Real Estate and its relevant project companies, it may liquidate the project companies respectively by resolutions of the shareholders' meeting based on the shareholding relationship. In addition, if the Company is the creditor of any project company, it may apply for the bankruptcy and liquidation of the relevant project company according to the relevant provisions of the Enterprise Bankruptcy Law of China, so as to dispose of the assets of the project company.

However, considering that the aforesaid Mainland bankruptcy procedure may take quite a long time and may bear pressures from the government, other shareholders of project companies, creditors, purchasers of pre-sold properties, etc, it may be quite difficult to implement in practice.

Given the significance of the Evergrande winding-up case, it is important that the market keeps an eye on the liquidator's follow-up moves, restructuring information (if any), and the comments of the relevant Mainland courts.

CYPRUS



Trends and Developments

Contributed by:
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George K. Konstantinou Law Firm is a leading, independent provider of in-depth legal advice with a reputation for impeccable ethics, dedication and professionalism. Founded in 1983, the firm advises on various issues, including real estate, corporate registration, due diligence and governance, family law and investment migration. The litigation group undertakes a range of cases, sometimes of considerable complexity, to help clients respond to challenges and satisfactorily resolve controversies, questions and disputes. The real estate team handles development and construction, property acquisition, financing, leasing, zoning, planning and environmental law. The firm's clients know they will benefit from the group's extensive knowledge, experience and individualised focus on clients' needs. The George K. Konstantinou firm began as a family office with clear principles and has been expanding since. It widely invests in specialised personnel and research to continue to grow and provide the practical and astute legal services it is recognised for.

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Introduction

In Cyprus, real estate trends and developments are closely linked to developments in the wider economy and legal reforms. The economy drives supply and demand and underlies Cyprus's position as an international business hub, while the government regulates and monitors activity through legal and fiscal measures.

Recently, the Cyprus economy faced several challenges, such as rising prices, inflation and cost of living increases. Nevertheless, the forecast is optimistic. The European Commission (latest available data 15 February 2024) expects GDP to grow from 2.4% in 2023 to 2.8% in 2024 and 3% in 2025. Meanwhile, it projects inflation to fall from 3.9% in 2023 to 2.4% in 2024 and 2.1% in 2025. This will have a positive effect on real incomes.

The Commission also notes robust private consumption, rising incomes, and available employment possibilities. Regarding real estate, the Recovery and Resilience Facility of the EU partly supports large investment projects that, in turn, positively impact growth. A January 2024 study from the University of Cyprus Economics Research Centre notes a significant budget surplus for 2023 and solid economic growth during the last quarter of the year.

The Real Estate Market: Challenges and Optimism

The above-mentioned University of Cyprus study examined, inter alia, the real estate industry. Usefully, it has identified a positive contribution made by construction investment to GDP growth. Although business confidence in sectors inclosing services, retail and manufacturing has decreased, confidence in construction remains strong and has reached its highest level since 2019. The real estate sector in Cyprus remained largely unaffected by negative global trends. Good performance is set to continue.

Furthermore, the Department of Lands and Surveys (DLS) statistics, the first for 2024, show healthy activity in property transactions, surpassing the EUR110 million mark in Limassol alone.

The trend for foreign nationals purchasing residential property in all areas of Cyprus, but especially on the coast, is set to continue. There have been satisfactory foreign sales in the first trimester of 2024.

It should be noted that EU nationals may purchase realty on the island without restrictions, while third-country nationals (TCNs) need approval from the Council of Ministers. The

approval procedure is a largely technical requirement; all good-faith applications are approved.

Revised Criteria for Permanent Residence by Investment in Real Estate

Cyprus has been administering a permanent residence through investment programme for several years with considerable success. Such programmes exist worldwide and, at their simplest, provide the right to permanent residence in a state based on specific capital investment, income and other criteria.

In Cyprus, two of the investment options involve real estate acquisition. The first option consists of buying residential property, and the second option involves purchasing commercial real estate.

Nevertheless, as the Financial Action Task Force (FATF) and the OECD point out in a 2023 joint report, there are concerns that residence by investment programmes may be misused and exploited to perpetrate financial crime and fraud. To this effect, in May 2023, Cyprus introduced amendments to its Permanent Residence by Investment Programme. The aim is to strengthen internal controls and manage risk.

Under the new regime, the investment and secure annual income amounts are raised while the number of family members who may benefit from the scheme has been reduced. The investment requirement is now EUR300,000, while the annual income is EUR50,000; the additional requirements for spouses and dependants are also higher. The applicant's parents and parents-in-law can no longer be included in the permanent residence permit.

Moreover, a monitoring and verification mechanism has been introduced. To comply with the requirements, the applicant should verify:

- on an annual basis, that they continue to maintain the investment, and they have either registered themselves with the General Health System (the Cyprus National Health Service, abbreviated as Gesy) or hold a health insurance policy; and
- that they and the adult members of their family continue to hold clean criminal records from their country of origin and country of residence, if these are different, every three years.

The relevant evidence and supporting documentation should be submitted to the Civil Registry and Migration Department of the Ministry of the Interior in Nicosia. Applicants who fail to verify will lose their permanent residence rights. The right is also lost if the applicant is absent from Cyprus for over two years.

The programme operates on an accelerated application basis. Applications are examined and determined within a period of two months.

Reduced VAT on Property Purchase

A significant development in 2023–2024 concerned the reduction in the size of property that can be purchased at a reduced VAT rate. Certain real property transactions, including the sale of a primary residence, are subject to a VAT rate of 19%. Under the previous rules, a primary residence's first 200 sq m were subject to a reduced VAT rate of 5%.

On 16 June 2023, the Cyprus House of Representatives amended the VAT Laws of 2000–2022 with Law 42(I)/2023. Correspondingly, the current regime for VAT has been modified to the

effect that the reduced VAT rate of 5% applies as follows:

- the primary residence of 130 sq m and total value of EUR350,000 gets the reduced 5% rate;
- primary homes between 131 and 190 sq m and up to EUR475,000 in value get 5% for the first 130 sq m and 19% for the remainder;
- primary residences over 190 sq m and EUR475,000 in value do not qualify for reduction; and
- persons with disabilities receive the 5% reduced rate on the first 190 sq m of primary residence.

The European Commission approved this scheme in January 2024.

Change of Rules for Buying Without Title Deeds

The purchase of real estate without title deeds has been an ongoing issue for several years. This sometimes happens because the seller has already mortgaged the property and cannot transfer it.

The House of Representatives responded by passing the Sale of Property (Specific Performance) Law of 2011 (81(I)/ 2011). Under this law, the buyer of property without title deeds could be protected by using the remedy of specific performance, whereby the side in default is ordered to carry out its contractual obligations. The buyer could be protected provided they:

- deposited the contract of sale at the Department of Lands and Surveys (DLS) within six months;
- paid the mortgage; and
- sought specific performance against the seller through the court.

This law was amended on 12 December 2023 to strengthen the protection available to buyers. Under the new amended provisions, the deposition of the contract of sale at the DLS must be accompanied by either of two documents:

- a declaration from the mortgage owner(s) and seller that once the buyer has repaid 95% of the mortgage, they will lift the mortgage (once the receipt of payment is also submitted, the DLS will then transfer the property to the buyer); or
- a declaration from the buyer that they do not wish to accompany the contract of sale with the first type of declaration.

Moreover, the seller is obliged to integrate in the contract of sale a search certificate concerning the real property. The search certificate, an official document issued by the DLS showing burdens on the property, must not be older than five working days from the signing of the contract. If there is a mortgage and the seller wishes to repay it (as above), the mortgage owner(s) are obliged to accept payment. Once the buyer has repaid 95% of the mortgage, the DLS will transfer the real property to the buyer.

The amendments to the law concern contracts signed after 12 December 2023. Contracts signed before that date are covered by the previous law.

Mortgage to Rent (MTR) Programme

Due to recent economic considerations, vulnerable real estate owners in Cyprus have been concerned about their ability to repay mortgage loans. On 12 July 2023, the Council of Ministers approved the Mortgage to Rent (MTR) programme, aiming to protect the primary residence of specific vulnerable groups. The programme

started on 4 December 2023 and will remain open until 4 August 2024.

MTR works as follows:

- The government owns the Cooperative Asset Management Company, an asset management company created from the former Cyprus Cooperative Bank. In turn, the Cooperative Asset Management company established a subsidiary named KEDIPES, to manage the non-performing loans (NPLs) that were brought to light during and after the financial meltdown of 2012–13.
- KEDIPES purchases the primary residence of qualifying applicants (the assets and share capital of KEDIPES are pledged to be used for the benefit of the Republic of Cyprus, in line with both entities' co-operative roots).
- The maximum value of a qualifying residence is EUR250,000.
- The government pays rent for the property so the applicant can remain in residence.
- After five years, the applicant may re-purchase the property through a new mortgage.
- Applicants over 65 may remain in residence on rent terms for life.
- Within the programme, an incentive has been announced to create affordable housing for foreign company professionals and employees. The incentive is linked to the Cyprus Business Facilitation Unit (BFU, see below). Foreign company professionals and employees will also benefit from an increase to the allowable building areas of certain residential zones. Both incentives were approved by the Council of Ministers on 20 December 2023.

The programme was launched with success. On 3 April 2024, the government extended the criteria for eligible applicants.

Real Estate Trends

Current real estate trends refer to both the business environment and household life. Specific real estate trends are linked to new government policies on foreign-interest businesses and employee citizenship acquisition.

Business: trends and relocating to Cyprus

Regarding business, the trend is for companies from abroad to buy or rent premises in Cyprus, especially in the coastal cities. Such companies are often, but not always, call centres. Another flourishing business type is setting up and running small hotels within the city rather than large hotels on the coast. Reasonable prices attract tourists since even city centres are never far from the sea in Cyprus.

Several options exist when a foreign business wishes to relocate to Cyprus. These include:

- registering as a foreign company with the BFU, provided specific criteria are met (see below);
- opening a branch of an existing foreign company upon relevant application to the Registrar of Companies;
- registering a new Cyprus company or a European Company (SE) with the Registrar of Companies; or
- performing a cross-border conversion and converting a company registered in the EU to a Cyprus company – the procedure is carried out through the Registrar of Companies.

Cyprus possesses a number of attractions as an international business centre. It is poised in a strategic location between Europe and the Middle East; as an EU member, it offers political and social stability in a financial environment controlled by the European Commission and the European Central Bank.

Recently, the government of Cyprus established the Business Facilitation Unit (BFU), which operates through the Ministry of Finance. The BFU facilitates the registration and running of businesses of foreign interests, issues residence and employment permits to personnel, and allows for tax exemptions. Under family reunification rules, members of the family of such personnel may also come to Cyprus. This justifies the trend for companies to consider Cyprus a prime relocation choice and to acquire real property for entrepreneurship.

In November 2023, Cyprus passed Law 149(I)/ 2023, an amendment to the Civil Registry Law 2002-2021, which creates favourable conditions for highly skilled personnel in companies of foreign interests or foreign companies.

The terms "company of foreign interest" and "foreign company" are used interchangeably in the Ministry of Finance documents and refer to companies where:

- shareholders are TCNs; or
- TCNs hold up to 50% of the shares and have a share capital of at least EUR200,000.

Law 149(I)/ 2023 came into force on 19 December 2023. It allows highly skilled personnel of foreign companies to apply for naturalisation (citizenship) after three or four years of work and residence on the island, depending on knowledge of the Greek language.

Respectively, the certificate of knowledge of the Greek language must be at the A2 or B1 level under the Common European Framework for Languages (CEFR). The applicant must show a twelve-month continuous and lawful residence in the Republic preceding the application (absences of up to 90 days are allowed).

The Ministry of Education conducts language examinations at regular intervals. Highly skilled personnel means personnel with a university degree or equivalent or two years of experience in their field, receiving a monthly salary of at least EUR2,500 gross.

Moreover, in a policy announced on 5 February 2024, the government expressed an intention to allow businesses registered under the BFU to remain in the BFU Registry even if, after shareholders acquire citizenship, they no longer satisfy the foreign participation requirements.

Households: decentralised real estate markets and renting out

Ownership patterns among new households are exhibiting a trend for decentralisation (ie, properties in urban districts or rural areas that are near a larger city). Moreover, renting out is becoming a popular investment strategy. Buying a flat or erecting a cabin-sized house to rent out is increasingly considered a secure source of income.

Forecast and Conclusion

The real estate field in Cyprus is exhibiting resilience and is expected to continue its significant contribution to the economy. Legal measures aim to rectify weaknesses and ensure the system functions smoothly. New areas of opportunity and new fields of regulation for the near future are expected to be the role of AI in real estate and the government's focus on sustainable development and green building.

DOMINICAN REPUBLIC



Law and Practice

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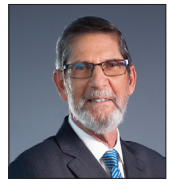
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Guzmán Ariza is a top-ranked Dominican law firm, well known for its real estate and tourism practices. Headed by Fabio Guzmán Ariza and Alfredo Guzmán Saladín, the practice is renowned for its skill, experience, and geographical reach. The real estate team works in synergy with other disciplines – including tax, incentives, permits, financing, environment, and litigation – to ensure that all issues that could impact a transaction are properly and thoroughly addressed. The firm has ten offices, strategically located in the most important tourist and business areas in the country, including the capital city of Santo Domingo, Punta Cana, La Romana, Casa de Campo, Cap Cana, Puerto Plata – Sosúa, Cabrera and Samaná, Las Terrenas and Las Galeras. The firm's knowledge, commitment, and responsiveness to clients, along with its cost-effective strategies, have earned it the reputation in the international business community of being a trusted and respected law firm that delivers results.

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1. General

1.1 Main Sources of Law

For the first 100 years or so following its independence 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 US model, with three branches of government: a strong presidency, a legislature and a judiciary with the power to cancel acts of the other branches found to be unconstitutional.

Since the first half of the 20th century, however, there has been a move away from the French model, with the adoption of many statutes and codes inspired by other legal systems. Examples include:

- 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 US criminal litigation;
- the new arbitration statute of 2008, taken from the model arbitration code prepared by the United Nations; and
- the new bankruptcy and insolvency statute of 2015, influenced greatly by US bankruptcy law.

The Constitution of the Dominican Republic lays out the fundamental framework for the organisation and 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 the courts and is subject to 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.

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

Finally, real estate laws are national in scope and application.

1.2 Main Market Trends and Deals

Market Trends

The main trends in the real estate market in the Dominican Republic continue to be the development of important projects in the tourism sector. Many well-known international developers have created multiple projects, some of which are

already operational, in the areas of Punta Cana, Bani, Miches, Puerta Plata, Santo Domingo and the southwest provinces of Pedernales, Barahona and Peravia.

A growing trend has been the use of public-private partnerships to develop new regions for tourism such as the development of the southwestern area of the country, Cabo Rojo and Bahia de las Aguilas in Pedernales, which are virgin beaches. This will be an eco-friendly development which will include hotels and residential developments.

There has also been Ciudad Juan Bosch, a real estate development of more than 12,000 homes, to which the government contributed land and infrastructure. The private sector is developing low-cost housing for low-income families in the city of Santo Domingo.

Tourism and luxury properties

Recently, local promoters, hotel operators and prominent landowners from the eastern region of the Dominican Republic created the Hotel and Tourism Association of El Seibo and Miches (PROMICHES), with the aim of positioning Miches as an environmentally responsible and inclusive tourist destination. PROMICHES will promote the development and growth of innovative and socially responsible businesses that protect and enhance the environmental and cultural diversity of the area, aimed at diversifying the country's tourism offering. Its 13 members represent projected investments totalling USD1.18 billion, as well as developments that will bring 3,400 new hotel rooms and 1,400 residential rooms to Miches, and the required infrastructure necessary to maintain its operations.

One of the most notable real estate trends in the Dominican Republic is the effect of the booming tourism industry on the market, which is driving demand for both commercial and residential properties, particularly in coastal areas. Another factor is the surge in foreign property investors, which has been pushing demand up. There is also an increasing demand for housing from the local middle class, driven by economic growth and improved access to financing. In terms of real estate as an investment, there is a noticeable trend towards buying properties for rental income, particularly in tourist-heavy areas. Properties such as beach-front villas, apartments in popular tourist destinations, and properties near major attractions are in high demand among investors. Areas with high tourist traffic, like Punta Cana, Puerto Plata, and parts of Santo Domingo, typically see a robust demand for short-term rentals. These regions cater to tourists and seasonal visitors who prefer renting over buying, leading to a vibrant rental market.

Another trend is the increasing popularity of luxury properties. The Dominican Republic has become a hot spot for wealthy individuals looking for high-end vacation homes and investment properties. The volume of luxury property transactions has been rising strongly since the end of the pandemic.

Eco-friendly real estate and government policies

There is also a growing trend for producing eco-friendly real estate. Many developers are now incorporating sustainable design features into their projects, such as solar panels, rainwater harvesting systems, and green roofs, making them more appealing to environmentally conscious buyers.

Regarding government policies in 2024, areas of focus include further development of infrastructure, like road expansions and airport upgrades,

enhancing tourism facilities, and continuing to improve the legal framework for property transactions.

Disruptive Technologies

Disruptive technologies have transformed every step of the real estate value chain, providing massive opportunities for the industry. The technologies with the highest rate of adoption include augmented reality (AR), drones and artificial intelligence (AI), along with instant communication channels and social media, big data and the 5G network.

So far, the fastest adoption has been in AR and drones for surveying properties and neighbourhoods and for providing virtual tours. At the same time, due to the fast-paced nature of the business, instant communication tools and social media have also had a significant impact.

There is still room for improvement in the way big data is being used by the industry, but this will likely change as AI-powered customer relationship management and listings become more prevalent.

There are also high expectations of the 5G network, to which the president has given priority, as this will influence real estate development, from the way existing structures are used, to the way in which new structures will be integrated into the internet of things. Smart buildings have been the standard for new constructions in the country for some time now.

In addition, the expectation is that as blockchain technology becomes more mainstream, it will permeate the industry, having been touted as a far more secure and transparent way to conduct transactions.

1.3 Proposals for Reform

The Dominican Republic has been improving the legal framework to make the buying and selling of property more straightforward and secure. These efforts include streamlining the process for acquiring title insurance and registering property, both crucial for foreign investors; as well as improving transparency.

Regarding government policies in 2024, areas of focus include further development of infrastructure, enhancing tourism facilities and continuing to improve the legal framework for property transactions.

It is expected that this year will bring a fiscal reform as one has been recommended by the IMF.

2. Sale and Purchase

2.1 Categories of Property Rights

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 co-operative ownership arrangements or other occupancy interests.

2.2 Laws Applicable to Transfer of Title

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.

2.3 Effecting Lawful and Proper Transfer of Title

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;
- a receipt attesting to the payment of the real estate transfer taxes (currently 3% of the government-appraised value of the property) – the buyer is exempt from this tax in some cases (eg, first purchases in certain tourism projects and low-cost housing acquired with a bank loan);
- a copy of the identity card or passport of the parties, or tax card if a legal entity – non-resident foreigners need to provide an additional identity card from their country of origin in addition to their passports; and
- a copy of evidence of the purchase price or mortgage payment through a non-cash method, for operations involving more than DOP1 million (about USD18,352).

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2.4 Real Estate Due Diligence

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 whether 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.

Under the Torrens system (used for land registration as noted in **1.1 Main Sources of Law**), there is no need to conduct a chain-of-title search. Title insurance is available but is not used frequently for various reasons – especially limited protection and costs – even though the indemnity fund set forth by the Real Estate Registration Law does not function 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 that 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.

2.5 Typical Representations and Warranties

The Dominican Civil Code establishes that the seller has two main obligations: (i) the delivery of the thing that is the object of the sale; and (ii) guaranteeing the object of the sale.

The first obligation is fairly straightforward, as the seller fulfils its obligation with the delivery of the keys or the delivery of the title that protects the ownership of the real estate property.

As for guaranteeing the object of the sale, this involves (i) the peaceful possession of the object, and (ii) ensuring the absence if redhibitory (ie, hidden) defects. Although there are several statutes of limitation prescribed by law, the parties are also free to determine the period of enforceability of these obligations.

The typical cap is between 60 and 90 days, which gives the buyer enough time to carry out the corresponding procedures to transfer ownership of the property into their name. The sale contract must state the agreed period and the release in favour of the seller upon its expiration.

Warranties typically specify that:

- the property is registered to the seller and is of the dimensions mentioned in the title;
- there are no overlapping parcels;
- there are no liens, mortgages or third-party registered rights;
- the conveyance will not be affected by any tax liabilities;
- the seller will have to provide any documentation and sign any additional sets of documents required for the final conveyance of the title to take place; and
- all liabilities, including utility bills and contractors' fees, will be paid up to the date of closing.

The warranties are provided both in relation to the property and to the shares of the holding entity being purchased, if that is the case.

2.6 Important Areas of Law for Investors

Any investor who wishes to participate in the real estate market of the Dominican Republic should consider the impact on their investments of tax law, real estate law, environmental legislation and administrative law for licences, planning and the registration of the title of ownership before making a purchase.

2.7 Soil Pollution or Environmental Contamination

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.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

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

2.9 Condemnation, Expropriation or Compulsory Purchase

The Constitution and Law 344 of 1943 establish the legal regime for the government's compulsory purchase or condemnation of real estate. The Dominican Constitution states: "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 Defence, compensation may not be paid before the expropriation."

Law 344 establishes the specific procedure that the government must follow in any case of expropriation. Because the provisions of this law are of public order, allocations cannot be modified by contractual arrangements between the parties.

2.10 Taxes Applicable to a Transaction

A conveyance tax must be paid before registering the purchase of real estate. The conveyance tax amounts to 3% of the price of sale or the market value of the property as determined by the tax authorities, whichever is higher.

A 1% annual tax is assessed on real estate 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% is calculated only for values exceeding approximately USD150,000. For unbuilt lots, the 1% tax is calculated on the actual appraised value without the USD150,000 exemption. Individuals pay this tax every year on or before 11 March, or in two equal instalments: 50% on or before 11 March, and the remaining 50% on or before 11 September. This threshold is adjusted annually for inflation.

The following properties are exempt from the property tax:

- built properties valued at USD150,000 or less;
- farms; and
- houses inhabited by owners who are at least 65 years old and have no other property in their name.

Properties held in the name of a corporation or other entity are not, at present, subject to a property tax per se; however, a 1% tax is levied on company assets, including real estate.

There are also different tax treatments with regard to leasing to individuals or to corporate entities. Leases to entities are subject to value-added tax and leases by individual landlords are subject to a 10% withholding tax that is credited towards the landlord's annual income tax.

2.11 Legal Restrictions on Foreign Investors

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 the same as for Dominicans; there are no national defence or security limitations. 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 merely formal requirements that can easily be fulfilled.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

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

Financing sources are mixed, depending on the type of investment. For example, major infrastructure financing is obtained through foreign banks and financial institutions, while real estate developments in the tourism sector have been more dependent on local banks, most of which have entire departments catering to the real estate-tourism industry.

There are major financial institutions, publicly traded funds and private investors with interests in the country, as it is the largest recipient of foreign direct investment (FDI) in the region.

3.2 Typical Security Created by Commercial Investors

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 the event of default through a foreclosure process, not an automatic defeasible conveyance in the event of default.

In both cases (mortgages and privileges), in the event of default, the enforcement is made through a foreclosure process before the competent civil and commercial court of first instance.

Dominican trust law offers the possibility of setting up real estate security trusts.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

A foreign lender does not need specific authorisation to do business in the Dominican Republic. To register a mortgage in its 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% in general, or 10% 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, as follows.

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

The registration of a security interest is perfected by filing the documentation at the Registry of Title in the jurisdiction where the property is located. The documents required for filing a mortgage are:

- a mortgage contract;
- an original of the certificate of title of the borrower;
- a mortgage tax receipt; and

- certification attesting to the payment of property taxes.

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

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The Civil Code states that buyers pay all the fees, expenses and taxes required for conveyances unless agreed otherwise by the parties. Each party covers their own attorney's fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no mandatory legal rules or requirements that must be complied with before an entity can give valid security over its real estate assets, except for those imposed on financial entities by the Financial and Monetary Code.

3.6 Formalities When a Borrower Is in Default

The formalities that need to be complied with before enforcing security over real estate depend on the approach to be taken.

In the case of the execution of a credit through a foreclosure based on an automatically enforceable document such as a promissory note, the process takes approximately 18 months if there are no delays.

However, in the case of an execution based on the breach of a contract, the process can take much longer. This is because, under the Dominican legal system, a judgment rendered by a court of first instance may be appealed to a Court of Appeals and the decision of the Court of Appeals may be further appealed to the Supreme Court. A suit going to the three jurisdictions may take five years or longer to be resolved, depending on the complexity of the matter.

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 notice of payment to the debtor;
- if the notice expires without payment being fulfilled by the debtor, the creditor files an embargo at the Registry of Title to completely block any further registrations on the property; and
- the creditor initiates the court procedure for the foreclosure, which ends in a public auction sale of the foreclosed property.

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 or mortgage act and proved by the creditor.

The usual time taken 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, now available to all types of creditors after a 2017 court ruling.

Aside from the judicial foreclosure process mentioned, there are no other legal avenues available to enforce a loan against a defaulting debtor.

3.7 Subordinating Existing Debt to Newly Created Debt

Banks usually require a first-rank mortgage and will not accept subordination to an existing collateralised debt. Most credit agreements forbid the debtor from entering into additional agreements without express authorisation from the lender; if they do, the new debt will be registered as a second-rank mortgage with second priority after the initial registered lender.

3.8 Lenders' Liability Under Environmental Laws

There is no lender's liability in the Dominican Republic with respect to environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

Under Law 141-15, foreclosure or sequestration processes pursued by creditors affecting more than 50% of a commercial debtor's assets, among other conditions, can trigger a bankruptcy and restructuring process.

Aside from exceptions for certain regulated industries, such as banks and stock exchange-related entities, as well as government-owned entities, the law is applicable to any Dominican or foreign entity or commercial individual person with a permanent establishment in the country.

All of the following processes against the debtor will be deemed as automatically stayed or prohibited once the court approves the bankruptcy petition:

- all legal, administrative, tax or arbitration claims or lawsuits, including foreclosure and sequestration processes;
- computation of liquidated damages clauses and contractual or judicial penalties;
- disposition of a debtor's assets, including the filing of a non-registered deed of sale, unless otherwise authorised by the law; and
- payment against debts originated prior to the restructuring request.

These processes will remain stayed during the restructuring plan's execution, thereby prohibiting any asset seizure actions by the creditors. The stay will be lifted if the restructuring plan fails and the court authorises the debtor's asset liquidation.

During the restructuring's conciliation and negotiation stage, all creditors, including secured ones (registered securities, mortgages and pledges, etc), that wish to have voting rights assigned to them for the execution of the restructuring plan must formally register their credits before the Bankruptcy Court, prior to the court-appointed mediator's submission of the final report to the court.

3.10 Taxes on Loans

When obtaining a mortgage, it is essential to consider the purchase loan government taxes, which are typically charged by legal advisors. These fees amount to 1% of the value of the contract.

Additionally, some lenders may impose other fees or charges related to mortgage processing, and these may vary by institution.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The main law governing zoning in the country is Law 975/44, dated 29 June 1944, regarding urbanisation and public adornment.

Furthermore, Law 64-00, dated 25 July 2000, the General Environmental and Natural Resources Law, also sets forth a series of provisions regarding zoning in determined regions of the national territory, and also includes a series of limitations with regard to the use of lands declared as national parks, as well as protected areas.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

In the Dominican Republic, methods of construction are regulated primarily by the Ministry of Public Works and the Ministry of Environment and Natural Resources, as they must comply with environmental regulations and construction must not harm the environment.

Exceptions apply in some areas designated as protected spaces, such as the Colonial Zone, where design, construction and appearance must be pre- approved by the Ministry of Tourism.

4.3 Regulatory Authorities

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

4.4 Obtaining Entitlements to Develop a New Project

In order to develop a new project, approval and permits must be obtained from the following government agencies:

- City hall – land use clearance is locally processed. At the same time as the plans are submitted to the local city hall for evaluation and clearance, an environmental authorisation is submitted.
- Ministry of Environment and Natural Resources – the environmental impact of the project is evaluated. This process includes a public hearing, allowing for third parties to participate and object to the request.
- Ministry of Tourism – for projects being developed in tourism areas, requests and documentation are submitted to the Ministry's Department of Planning for evaluation.
- National Water System – this is in charge of evaluation and approval of the hydraulic and sanitary design plans.
- Ministry of Public Works – once the plans are approved by the previous entities, the Ministry of Public Works issues a building permit.

4.5 Right of Appeal Against an Authority's Decision

If the application for permission or authorisation has been denied by any of the institutions involved in the process, the applicant has the right to appeal to the same institution where it was denied. If the reconsideration is again denied, an administrative appeal should be submitted to the immediately superior government authority.

The applicant can also have the case evaluated directly by an administrative court judge by submitting its claim to the administrative court, bypassing the hierarchical appeal previously mentioned.

4.6 Agreements With Local or Governmental Authorities

Agreements are usually signed with the corresponding city council so that the taxes collected from the developer are used for social improvement projects.

Optional agreements can also be arranged with the Ministry of Environment and Natural Resources, by signing an environmental management plan, which is compulsory for projects developed in protected areas.

Large developments in the infrastructure industry can now enter into development agreements with the government through the Public-Private Partnerships Law No 47-20.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions are enforced on development and designated use by employing sanctions designated by the state.

These sanctions include fines and penalties, closing of operations, and/or removal of licences and permissions. New regulations on environmental licences and permissions include provisions on prison sentences for violations.

The government also uses tax regulations to enforce restrictions.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Foreign Investors

The most common entity used by foreign investors is a local limited liability company (LLC). Some investors, concerned 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.

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, an entity 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.

Dominican Entities

As for Dominican entities, Dominican company law allows different types of commercial companies (individually owned enterprises and LLCs) and corporations (regular or simplified stock corporations), all of which provide limited liability for their 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 full liability shields to their members and are subject to the same tax treatment as the other entities. In addition, in 2011, Law 189-11 introduced local fiduciary vehicles as a holding option.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

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, although their shareholders or beneficiaries will pay income tax on income received from the funds.

5.3 REITs

Real estate investment trusts (REITs) are securities similar to mutual funds that allow investors of different sizes to take an ownership share in real estate ventures. International investors drawn to the Dominican Republic by its strong growth and investor-friendly political climate are taking advantage of these new securities to transform the real estate market, expanding the stock of rentable commercial and industrial space in Santo Domingo and other growing economic centres.

The rise in REITs can be put down to the Dominican Republic's strong housing sector and the government policy that supports it. REITs are available to both local and foreign investors. In May 2012, the Central Bank of the Dominican Republic (BCRD) enacted a series of measures to boost the availability of credit to the economy. Most significantly, it reduced the reserve requirements for Dominican banks, a move that increased total lending by USD489 million. The BCRD cited the real estate sector as a particular point of emphasis, announcing that 25% of the increase in lending funds was assigned to buyers of affordable housing, with another 5% earmarked for buyers of newly completed housing.

Actions like these have helped the sector remain robust in an uneven economic environment over the past few years, with global interest in the island reaching new highs. The emergence of REITs should have a continued positive impact on the Dominican Republic's resort and commercial housing industries, generating positive economic impacts that should present new opportunities for the market as a whole.

5.4 Minimum Capital Requirement

To form an LLC in the Dominican Republic, the law currently requires, as a minimum, that each shareholder holds a share with a value of no less than DOP100 (USD1.83) each. After the introduction of Law 68-19, there are no established minimum capital amounts required, aside from the one previously stated, but in practice, LLCs are usually formed with a minimum contribution from shareholders of DOP100,000 (approximately USD1,835), paid in full, and divided into shares with a par value of at least DOP100 each.

5.5 Applicable Governance Requirements

LLCs are governed by the provisions of their by-laws. The authority over day-to-day activities falls on the managers or board of directors, and shareholders are the maximum authority regarding issues relating to the dissolution process, the modification of by-laws, sales of the company's assets, and transformation of the company, among others.

Corporations incorporated with the purpose of acquiring or acting as holding companies for real estate properties are not required to obtain licences, authorisations or government permits.

5.6 Annual Entity Maintenance and Accounting Compliance

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

The Dominican Tax Code has a general anti-tax avoidance provision (a "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 whether they are local or foreign entities, including those with no income or operations, must file income tax returns with the Dominican Republic's Tax Office every year. Aside from the penalties on overdue taxes, which amount to 11.1% for the first month and 5.1% 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.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Leases are the most common arrangement that Dominican law recognises for a person, company or other organisation to occupy and use real estate for a limited period of time without buying it outright.

6.2 Types of Commercial Leases

Dominican law only considers leases in general terms.

6.3 Regulation of Rents or Lease Terms

Rents or lease terms are freely negotiable for the most part, as general contract law applies to them. Provisions are, however, limited by various statutes that protect 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. Also, evictions cannot occur unless a judicial eviction process is undertaken, regardless of what has been contractually agreed.

Key lease provisions include:

- a lease term;
- tacit renewal clauses;
- ownership of betterments (improvements) made by the tenant during the lease;
- default clauses and waiver of certain tenant-friendly statutory provisions that are not a matter of public order;
- a clear distinction between minor and major repairs and which party will be responsible for covering these; and
- specific use of the property during the lease term (type of business or family residency).

6.4 Typical Terms of a Lease

There is no typical lease term or restrictions on such a term. Tenants of business premises do not have security of occupation or rights to renew the lease.

The law clearly assigns minor maintenance repairs to tenants, while major structural repairs are covered by landlords; all of which can be modified contractually between the parties. The rent is commonly paid monthly; however, the parties are free to agree otherwise.

6.5 Rent Variation
Leases commonly provide for periodic rent increases.

6.6 Determination of New Rent
There is no legal rent level protection. Rent can be increased as long as it has been agreed contractually, otherwise it is not permitted.

6.7 Payment of VAT
Rent payments to individuals, but not to companies, are subject to a 10% withholding at source. All rents are subject to 18% VAT.

6.8 Costs Payable by a Tenant at the Start of a Lease
At the start of the lease agreement, the tenant pays a security deposit, usually equivalent to two months' rent, to guarantee the fulfilment of its obligations. This amount is to be returned by the landlord once the property is received at the end or termination of the lease.

The landlord has the obligation to deposit this money, with a copy of the lease agreement and other documentation, at the Agricultural Bank. Legal fees and other applicable fees are usually paid by each party.

6.9 Payment of Maintenance and Repair
The expenses of maintenance and repairs of common areas, especially in commercial buildings and shopping centres, are paid by each of the tenants and are usually established as part of the agreed rent.

For residential spaces, the costs arising from maintenance of common areas are covered by each tenant, by payment of a maintenance fee, usually on a monthly basis, either to the building administrator or to the landlord, if agreed as part of the rent.

6.10 Payment of Utilities and Telecommunications
Utilities such as electricity, cable TV, water and telecommunications are solely covered by the tenant. Expenses related to common areas of a condominium are usually covered proportionally and distributed between tenants as part of the monthly maintenance fee.

6.11 Insurance Issues
There is no legal obligation to obtain insurance for real estate subject to lease; this will depend on the terms and conditions agreed between the parties. Rental insurance is not commonly used.

6.12 Restrictions on the Use of Real Estate
The parties can agree on the uses of the rented property. There is no regulation and/or law that imposes further restrictions. On occasions, municipal regulations can restrict the use of real estate property for exclusively housing purposes, depending on the zone in which the property is located.

6.13 Tenant's Ability to Alter and Improve Real Estate
Lease contracts usually include provisions allowing tenants to waive their rights to claim any ownership to property betterments and that they will all remain attached to the property and their ownership transferred to the landlord on termination of the lease.

6.14 Specific Regulations
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.

Leases to entities are subject to value-added tax and leases for residential purposes are subject to a 10% withholding tax that is credited towards the landlord's annual income tax.

6.15 Effect of the Tenant's Insolvency

Insolvency can be included as a default clause allowing the landlord to terminate the lease. This said, under Law 141-15, if the tenants initiate an insolvency process, they cannot be evicted from the property during the process, nor can the property be seized. The owner is then assigned by a judge a position in the range of creditors.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The most common form of security the landlord holds against the tenant in the event of failure to meet its obligations is the deposit made by the tenant in advance of the commencement of the lease. The provision of a third-party guarantor can also be agreed between the parties and/or that failure to comply with any of the obligations agreed upon shall result in the termination of the agreement.

6.17 Right to Occupy After Termination or Expiry of a Lease

Upon termination of the lease agreement, the tenant should leave the property and return it to the landlord in the same condition as it was originally received. If the tenant does not vacate the property upon expiry, and the landlord does not object to the tenant's occupancy and continues to receive the rent payment without complaint, the lease agreement is considered effectively renewed but as an oral lease, not a written one, to which different rules apply in terms of eviction prior notice.

6.18 Right to Assign a Leasehold Interest

Most leases provide that any subletting or assignment is subject to obtaining the landlord's prior consent. Landlords do not have to provide a reason for an assignment or a sublease. Where there is a legal reorganisation or transfer/sale of the tenant, there are no effects as long as the tenant remains the same legal entity.

6.19 Right to Terminate a Lease

The circumstances in which leases are usually terminated by the landlord and/or the tenant are:

- reaching of the term of the agreement without renewal;
- by the initiation of an eviction proceeding by the landlord in the event that the tenant fails to comply with payment obligations;
- mutual consent among the parties;
- the destruction of the leased property;
- in the event the tenant uses the property for a different function than agreed upon in the lease agreement, and only in the event that such situation negatively affects the landlord;
- in the event that the tenant subleases the property in whole or part if the lease agreement expressly prohibits subleasing; and
- if the tenant performs modifications to the property.

Usually, termination terms provide that the non-compliant party is forced to pay a penalty for the early termination. Furthermore, compensation for termination must be contractually agreed by the parties.

6.20 Registration Requirements

At the start of the lease agreement, the tenant pays a security deposit, usually equivalent to two months' rent, to guarantee the fulfilment of its obligations. This amount is to be returned by

the landlord once the property is received at the end or termination of the lease.

The landlord has the obligation to deposit this money, with a copy of the lease agreement and other documentation, at the Agricultural Bank. Legal fees and other applicable fees are usually paid by each party.

6.21 Forced Eviction

Tenants can sue landlords for the specific performance of any obligation assumed by the landlord in the lease, plus damages. The landlord, likewise, can sue for specific performance and damages, as well as for eviction; remedies available to landlords do not differ depending on whether the nature of the lease is commercial or residential.

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; evictions cannot be enforced while appeals are pending.

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 a lease, the landlord cannot raise it unilaterally without undertaking a lengthy administrative procedure.

6.22 Termination by a Third Party

No third parties are allowed to initiate the termination process of a lease agreement. However, the government can initiate an expropriation process against the property, by following the due process.

6.23 Remedies/Damages for Breach

The most common form of security the landlord holds against the tenant in the event of failure to meet its obligations is the deposit made by the tenant in advance of the commencement of the lease. The provision of a third-party guarantor can also be agreed between the parties, and/or that failure to comply with any of the obligations agreed upon shall result in the termination of the agreement.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most commonly used structures are:

- the fixed price system, which gives the owner of the project a comprehensive idea of the final cost of the project, establishing a fixed fee for the construction process; and
- the construction management system, in which the project owner only pays the contractor a construction fee and the owner covers the cost of construction materials and labour.

7.2 Assigning Responsibility for the Design and Construction of a Project

The parties are free to establish the conditions that govern their relationship, allowing any scheme to be developed for assigning responsibility for the design and construction of a project,

but with the caveat that plans must be executed by a licensed architect or engineer.

7.3 Management of Construction Risk

Construction risk is usually managed contractually through provisions and the establishment of penalties (agreed in the event of delays), performance bonds and insurance cover, among other things.

The Dominican Civil Code establishes a warranty on structural and hidden damages in a property, enforceable against architects and contractors for up to ten years. In practice, this timeframe is usually limited by the parties.

7.4 Management of Schedule-Related Risk

These types of risks are managed contractually through provisions and the establishment of penalties in the event of delays; it is also common to ask for a performance bond from the contractor issued in favour of the owner and/or developer.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Owners or developers often require the contractor performing the work to provide security in the form of monetary compensation through available financial tools, should they be unable to deliver the work on time or meet the quality standards for which they have been paid.

These risks are usually managed contractually by means of warranties, indemnity provisions, retention provisions, penalties agreed in the event of delays, performance bonds and insurance cover, among other things.

In addition, the Dominican Civil Code establishes a warranty covering structural and hidden damages in a property that is enforceable against architects and contractors for a period of up to ten years. In practice, this timeframe is usually limited by the parties.

7.6 Liens or Encumbrances in the Event of Non-payment

According to Article 2103 of the Dominican Civil Code, architects and builders are able to register court-ordered liens in the event of non-payment after the construction in question has been delivered to the owner. Additionally, under Dominican law, contractors and/or designers are not permitted to register any liens or encumbrances in property from non-payment, but can sue the owner for breach of contract, and if the debt is recognised by the court, then they may proceed to register the lien or encumbrance in the property. For an owner to remove the lien or encumbrance, they must provide evidence of successful completion of the obligation to the land registry.

7.7 Requirements Before Use or Inhabitation

In the Dominican Republic, a site certificate issued by the parties or by an independent engineer is usually required, certifying that the project has been finished and is ready to be delivered and inhabited.

8. Tax

8.1 VAT and Sales Tax

There is no VAT or equivalent tax liability applicable to the sale or purchase of real estate.

8.2 Mitigation of Tax Liability

Other than the exemptions mentioned above and the option of purchasing the shares of the holding company, there is no way of avoiding the

payment of the 3% title transfer tax. Large institutional holders are advised to seek the advice of expert real estate law and tax professionals to mitigate other tax liabilities.

8.3 Municipal Taxes

There are no municipal occupation taxes. All planning and land use matters are, however, handled by the municipalities, and a land use tax is levied on developers or owners planning new construction projects.

8.4 Income Tax Withholding for Foreign Investors

The basic tax withholdings in the Dominican Republic are as follows:

- withholding for interest paid abroad – 10%;
- withholding for payments abroad – 27%; and
- dividends – 10%.

8.5 Tax Benefits

There are no tax benefits from owning real estate in the Dominican Republic. Corporations may be compensated on the property's depreciation in accordance with the Dominican Tax Code and exemptions may apply depending on the type of real estate, the activities developed at the property and its location, among other things.

FRANCE



Law and Practice

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1. General

1.1 Main Sources of Law

The sources of real estate law are spread over various codes, including:

- the Civil Code for property titles, transfers of ownership and civil leases;
- the Commercial Code for commercial leases and administrative authorisations;
- the Construction Code for the construction or repurposing of buildings; and
- the Planning Code for planning and local planning regulations.

1.2 Main Market Trends and Deals

The relatively unstable macroeconomic climate of the past 12 months (armed conflicts, major elections to come, instability of the interest rates, rise of inflation) has certainly resulted in a year of contrasts for the French real estate market.

In 2023, the overall volume of real estate transactions was circa EUR15 billion, a significant decline of about 53% compared to 2022 – and to the yearly average volume of investment over the past ten years. France is not an isolated case, with the European market also falling 53%.

Large-scale transactions have been relatively scarce, with fewer than 25 deals individually worth more than EUR100 million recorded, accounting for just a third of the volumes invested.

The breakdown of overall investment volume by class of assets was broadly in line with the past few years, with a steady predominance of offices (44%) followed by warehouses (21%), retail (21%) and hotels (14%).

Value-add strategies have been a significant trend over recent months, and increased approximately 30% in 2023. Real estate operators were also fairly active in the year, with a 122% increase in sale and lease-back transactions compared to 2022.

Foreign investors have been less active this year, their investments representing just 27% of investment volume in 2023 (compared with 40% over the past few years).

The market has shown quite encouraging indicators in recent months as interest rates have stabilised and even fallen. Inflation is also steadier. Potential investors are therefore gaining much more visibility.

1.3 Proposals for Reform

Environmental factors have an increasing impact on the obligations borne by all French real estate market participants. Recent meaningful examples of this trend include:

- the law relating to the acceleration of the production of renewable energies (loi relative à l'accélération de la production d'énergies renouvelables) of 10 March 2023, which aims to develop renewable energies, in particular solar energy by requiring installation of solar panels on half the surface area of parking lots larger than 1,500 square metres from July 2026 or July 2028 depending on the type of management and surface area; further, among other obligations, certain buildings must also be equipped with renewable energy production systems or by vegetation systems with progressively increasing minimum coverage (however, the law provides for specific exceptions to be specified by decree);
- the "Net Zero Artificialisation" (Zéro Artificialisation Nette, ZAN) law of 20 July 2023 to

facilitate the implementation of objectives to combat land artificialisation and strengthen support for local elected officials to progressively achieve net zero artificialisation of land by 2050;
- the "Green Industry" law of 23 October 2023 to finance green industry, accelerate industrial start-ups, rehabilitate brownfield sites and in favour of green public procurement; this law covers innovations, such as the creation of major urban planning operations in which (i) pre-emption rights may be included when implemented in areas of economic activity; (ii) there may be an exemption from the requirement to obtain a business license for consolidations of stores; and (iii) derogations to the applicable urban planning documentation are possible; and
- the decree of 23 July 2019 (often referred to as the "décret tertiaire") according to which all existing buildings for tertiary use with a floor area exceeding 1,000 square metres must implement measures to achieve a level of energy consumption reduced by 40% in 2030, 50% in 2040 and 60% in 2050; such rules and objectives have a direct impact on the negotiation of commercial lease agreements since the landlords and their tenants must implement relevant measures enabling the leased premises to achieve the aforesaid energy consumption objectives.

2. Sale and Purchase

2.1 Categories of Property Rights

In addition to exclusive ownership and time-share arrangements, ownership can be divided between the right of usufruct (the right to receive the income and produce from real estate without outright ownership) and bare ownership (ownership without the right to use and derive profit from the property).

2.2 Laws Applicable to Transfer of Title

Varying legal regimes apply to transfers of title in different kinds of real estate, and there are a number of different tax regimes. There are no specific provisions linked to the industrial, office or retail sectors.

2.3 Effecting Lawful and Proper Transfer of Title

Ownership of real estate must be recorded at the locally competent mortgage office registry. Institutional non-domestic investors have shown a growing appetite for title insurance policies, although their use remains essentially limited to specific identified risks.

2.4 Real Estate Due Diligence

Lawyers and notaries share the responsibility for conducting due diligence investigations, with the former handling tax, social, leasing and insurance matters, and the latter title, zoning, construction and commercial status.

2.5 Typical Representations and Warranties

French law imposes the following obligations and warranties on the seller:

- an obligation to transfer the property in accordance with the specifications set out in the deed of sale;
- a guarantee of eviction: the seller must ensure that the buyer does not suffer any nuisance from the seller or third parties in relation to rights such as easements or leases relating to the property;
- a guarantee against hidden defects (*vices cachés*), which may affect the normal use of the property; and

- an obligation to deliver technical information on the property; the obligations are stricter when the buyer is not a real estate professional.

The buyer's remedies in relation to misrepresentations by the seller are limited to a claim for financial compensation or, in some cases, the annulment of the sale.

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- a guarantee against hidden defects (*vices cachés*), which may affect the normal use of the property; and
- an obligation to deliver technical information on the property. The obligations are stricter when the buyer is not a real estate professional.

The buyer's remedies in relation to misrepresentations by the seller are limited to a claim for financial compensation or, in some cases, the annulment of the sale.

As a general rule, the buyer has a period of five years from the date of the sale to file a claim, with the exception of, notably: (i) the action for hidden defects (*vices cachés*), which is limited to a period of two years from the discovery of the defect; and (ii) the action for a guarantee of eviction, which can be subject to no prescription at all.

Warranty and indemnity insurance policies (often tailored to and/or supplemented by title insurance policies in order to capture specific identified risks possibly affecting, inter alia, the validity of the property title) are now implemented in the vast majority of complex real estate (share deal) transactions. The insurer's (and the seller's) liability with respect to representations and warranties are typically limited to two to five years. In the case of implementation of a warranty and indemnity insurance, the seller's liability is often capped at EUR1 (except, sometimes, for "fundamental warranties" – ie, relating to the title over the asset and/or over the target entity's shares).

2.6 Important Areas of Law for Investors

An investor should have a clear understanding of the commercial lease regime as set out in the French Commercial Code, which has been significantly modified following Law No 2014-626 (the "Pinel law") dated 18 June 2014.

Over recent years, US and English compliance rules have had a major impact on French real estate acquisition practice, with increased integration of some of the provisions of the United States Foreign Corrupt Practices Act 1977 and the UK Bribery Act of 2010 concerning anti-corruption, sanctions and anti-money laundering compliance into the obligations carried out by the parties. The equivalent French legal provision would be Law No 2016-1691 of 9 December 2016 on transparency, the fight against corruption and the modernisation of economic life *(Loi no 2016-1691 du 9 Décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique, known as "Sapin II").*

2.7 Soil Pollution or Environmental Contamination

In accordance with the "polluter pays" principle, a landowner cannot be held responsible for historic contamination of the soil/groundwater. However, if it is established that the landowner has been negligent or has not been a "knowing permitter" in the polluting process, then it is assumed that the landowner could incur liability, although the concept of a "knowing permitter" has not been defined in legislation.

When investing in a site that has pollution problems, it is assumed that an investor can take over the obligation to restore the site after it has been polluted, and therefore becomes liable if the site is not properly restored. However, the initial polluter will be liable again if the investor becomes insolvent.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The zoning and planning laws and regulations for each local region are available to the public and must be checked before applying for a building permit. Copies of the regulations and local decisions can be obtained for a nominal cost.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation processes are used to facilitate major public or semi-public development projects. They assess what is in the public interest and the amount that should be paid for expropriated properties.

2.10 Taxes Applicable to a Transaction

Transfer taxes usually apply at the rate of 5.09% to 5.8% on the purchase and sale of a real estate asset that is not "new" (ie, that has been built for more than five years), subject to various conditions:

- transactions involving "new" buildings, or transactions whereby the buyer commits to re-selling the property within a five-year period, are subject to a 0.715% transfer tax;
- if the buyer commits to erect a building within a four-year period and complies with this undertaking, a fixed registration duty of EUR125 applies;
- a specific 0.1% contribution applies to the sale of property/asset deal (*contribution de sécurité immobilière*);
- for the disposal of office premises, retail premises and storage premises in Île-de-France, the Paris region, an additional tax of 0.6% of the sale price applies if the disposal is not subject to VAT.

Indirect transfers of real estate through the transfer of a company holding real estate assets are subject to transfer tax at the rate of 5% of the price paid for the shares. Transfer tax applies to all companies, irrespective of their legal form, where the market value of the real estate accounts for more than 50% of the total value of the company's assets.

Transfer taxes are typically paid by the buyer, although the buyer and seller remain jointly liable for their payment to the French Treasury.

2.11 Legal Restrictions on Foreign Investors

There are no restrictions on foreigners investing in property located in France, except for agricultural properties that must be authorised by the local prefect, and sensitive activities that must be authorised by the Ministry of Economics. Since 12 May 2017, the sale or purchase of property located in France by non-residents, for an amount exceeding EUR15 million, must be reported to the *Banque de France*, for statistics purposes only.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate in France are commonly financed through a combination of equity and quasi-equity, and senior debt in the form of a loan or sometimes bonds, which may be completed with junior (subordinated) debt depending on the risk profile of the transaction, the size of the portfolio and the required loan-to-value ratio.

Financial leasing (*crédit-bail*) is another common type of debt financing for commercial real estate, where the creditor acquires the real estate asset from either a third party or the debtor and leases it back to the debtor in return for payment of rent. The debtor has the option to acquire ownership of the real estate asset at the end of the term of the financial lease agreement.

3.2 Typical Security Created by Commercial Investors

Investor and/or Bank Guarantees

Lenders generally accept non-recourse financing for the acquisition of commercial real estate assets, whereas investor and/or bank guarantees will usually be required in addition to the standard security package for development projects.

Contractual Mortgage or Lender's Lien

Typically, the lenders will require security that may take the form of a contractual mortgage *(hypothèque*) or a lender's lien (*privilège de prêteur de derniers*) over the real estate asset and/or a pledge over the shares of the entity holding such asset, which also ensures that no change to the shareholding of the borrower will occur during the period of financing without the consent of the creditors.

Assignment of Receivables

The security package will also include security interest over cash flow related to the real estate asset (eg, receivables from rent), as well as cash flow resulting from the financing transaction (intragroup loans, hedging, etc), usually in the form of an assignment of receivables by way of security ("Dailly assignment"), a delegation or a pledge over receivables.

Possible Changes to French Security Law

Note that a reform of the French security law is under discussion containing several proposals which, if implemented, could have an impact on the security package described above (among others, modifications regarding personal guarantees and mortgage security are being considered, as well as a new civil assignment of receivables by way of security, as an alternative to the Dailly assignment by way of security).

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

In principle, French banking monopoly rules prohibit institutions other than licensed credit institutions or licensed financial institutions from carrying out banking operations in France on a customary basis and for valuable consideration. However, there are certain exceptions to this general rule, particularly for European long-term investment funds and certain alternative investment funds.

Generally, with the exception of a Dailly assignment, there are no restrictions on granting security to foreign lenders and on payments made to foreign lenders under a security document or loan agreement.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Fees paid on the granting of security over real estate assets are proportional to the amount of the secured debt at the time of creation, and depend on the type of security granted (mortgage or lender's lien) as follows:

- For publicity tax, the mortgage is 0.715% of the secured amount and the lender's lien is between EUR0 and EUR25.
- For the notary's emoluments, both the mortgage and the lender's lien are EUR18.87 of the loan amount, plus VAT.
- For real estate security contributions, both the mortgage and the lender's lien are 0.05% of the secured amount.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under French law, a French entity granting any type of security must ensure that it complies, where relevant, with the following rules.

Financial Assistance Rules

A French entity is prohibited from providing assistance (whether by way of a loan, a guarantee or security) in financing the acquisition of its own shares by a third party.

Corporate Benefit Requirement

Managers of a French entity must ensure that acts and decisions taken on the entity's behalf fall within the entity's corporate benefit (*intérêt social*), which is distinct from that of its shareholders and other entities.

Corporate Purpose Requirement

As a principle, any act or decision made on behalf of a French entity must be included in its corporate purpose, as stated in its by-laws.

Consultation of the Works Council

French labour law obliges French entities for which the existence of a works council is mandatory (ie, entities with more than 50 employees) to inform and, in some cases, consult the works council in respect of decisions that may have significant consequences for the company's future.

3.6 Formalities When a Borrower Is in Default

The principal risk for a creditor if a debtor defaults depends on whether that debtor opens insolvency proceedings, as creditors may not enforce their security interest for the duration of such proceedings.

In the absence of insolvency proceedings of the French debtor, and provided that all the formalities regarding the mortgage or the lender's lien have been correctly accomplished, the creditors will effectively have priority over the real estate asset. The secured creditors can enforce the mortgage or the lender's lien in the following ways:

- by way of application to the court for an order to seize the property (*commandement aux fins de saisie*); following the proceedings, the property will be sold by way of a public auction at a hearing before a civil court (Tribunal Judiciaire);
- by way of application to the court for the attribution by court order of the property to the beneficiary of the mortgage or the lender's lien; or
- if so provided in the security deed, by way of appropriation (*pacte commissoire*), in which case the creditor becomes the owner of the real estate asset and the value of the real estate asset will be determined on the day of the transfer by an expert designated by the

parties, or judicially, if no agreement can be reached.

If the loan agreement has not been contracted in the form of a notarial deed, or if the obligation to pay under such loan agreement has not been reiterated in the mortgage deed, the mortgage will not constitute an enforceable title. This implies that, prior to the enforcement of the mortgage, the secured creditors will have to obtain a court judgment stating that their receivable is certain, of a fixed amount, and payable.

3.7 Subordinating Existing Debt to Newly Created Debt

A creditor may agree to contractually subordinate the existing secured debt to newly created debt by entering into a subordination or intercreditor agreement.

In addition, in the event of insolvency proceedings of the debtor, the existing secured debt will be legally subordinated to super-privileged debts and privileged debts, ie, new debts qualified as "useful" (contracted for the purpose of the running of the insolvency proceedings or the observation period, or as consideration for services provided to the debtor in relation to its business activity) and contracted regularly after the opening of the insolvency proceedings.

3.8 Lenders' Liability Under Environmental Laws

A lender holding security over a real estate asset will not be liable for environmental damage, provided it does not itself cause, or knowingly permit, damage to the environment.

In the event of enforcement of the security over a real estate asset by way of appropriation, the lenders may incur a risk of liability under environmental laws since, in some circumstances, owners of a real estate asset can be liable for environmental damage of such asset or an emanation from it, even if they did not cause the damage.

3.9 Effects of a Borrower Becoming Insolvent

In principle, a validly granted and perfected security interest may not be made void if the borrower becomes insolvent.

However, if insolvency proceedings are opened against a debtor, most of the security interests will be inefficient for the duration of such insolvency proceedings, and creditors whose receivables are not privileged by way of law will be prohibited from commencing or continuing any individual legal actions against the debtor.

Moreover, any new security granted by a debtor during the "hardening period" (*période suspecte*) – a maximum of 18 months from the date determined by the court as being the date of suspension of payments (*date de cessation des paiements*) and ending on the date of the opening of the insolvency proceedings – to secure pre-existing debts is deemed null and void.

3.10 Taxes on Loans

See **3.4 Taxes or Fees to the Granting and enforcement of Security**

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Most national regulations regarding zoning and planning are contained in the French Planning Code (Code de l'urbanisme) and local regulations are usually prescribed by the relevant

municipality and are covered in local development plans (Plans Locaux d'Urbanisme). Typical restrictions include those on height, location, parking spaces, exterior aspects, green areas, etc.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Public law controls whether a landowner may construct a new building or refurbish an existing building by means of prior planning authorisation, usually a building permit.

Other types of authorisation (eg, declaration of works, authorisation to create commercial space, authorisation for high-rise buildings) may be required, depending on factors such as the location of the building, its future intended use and the extent of any contemplated works.

4.3 Regulatory Authorities

Overall, responsibility for regulating the development and designated use of the land lies largely with local authorities, as the mayor of the municipality is almost always responsible for issuing building permits (except in certain areas or projects where the person responsible for issuing building permits is the prefect).

4.4 Obtaining Entitlements to Develop a New Project

The process for obtaining an authorisation involves filing a building permit or declaration of works application with the municipality where the building is located.

The time period for the instruction of the application file will depend on the characteristics of the project and its location. The usual time period is one month for the declaration of works, and three months for the building permit (such time period can be up to 12 months).

For major projects, a public consultation may have to be carried out to obtain the opinion of the public.

Building permits are valid for a period of three years, during which time the works must have started (although extensions of time may be granted by the authorities). Furthermore, once started, the works must not cease for any period longer than one year.

4.5 Right of Appeal Against an Authority's Decision

Once granted, the building permit or the declaration of works can, for a limited period of time, be withdrawn by the municipality, or be challenged by either the prefect or third parties (such as neighbours), provided they can evidence an interest to act.

This challenge can take place in front of the administrative authority that issued the decision (*recours gracieux*) or the administrative courts (*tribunaux administratifs*).

4.6 Agreements With Local or Governmental Authorities

Several agreements may be necessary, depending on the nature and location of the project. For instance, for construction projects located in a Zone d'Aménagement Concertée, it is often necessary to purchase construction rights in addition to the land.

The owner (*maître d'ouvrage*) may have to make a financial contribution to the infrastructure in order to support new development.

4.7 Enforcement of Restrictions on Development and Designated Use

See **4.3 Regulatory Authorities** and **4.5 Right of Appeal against an Authority's Decision.**

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The types of corporate vehicle are as follows:

- SCI (*société civile immobilière*) – real estate civil company;
- SNC (*société en nom collectif*) – partnership;
- SARL (*société à responsabilité limitée*) – limited liability company;
- SA (*société anonyme*) – stock corporation;
- SAS (*société par action simplifiée*) – simplified stock corporation;
- SCPI (*société civile de placement immobilier*) – real estate civil investment company; and
- SIIC (*société d'investissement immobilier cotée*) – listed real estate investment company.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

SCI

An SCI is a real estate civil company. Its shareholders are liable indefinitely for the debts of the company in proportion to the shares they hold in its share capital.

SNC

This is a commercial partnership whose partners are deemed to be businesspersons *(commerçants*) who are jointly and severally liable for any debts.

SARL

A SARL is a limited liability company in which shareholder liability is limited to the amount of their investment.

SA

An SA is a stock corporation in which the capital is divided into stocks, and the shareholder liability is limited to the amount of their investment.

SAS

An SAS is a simplified stock corporation and may be formed by a private individual or a corporation as a sole shareholder. As with an SA, shareholder liability is limited to the amount of their investment.

SCPI

An SCPI is a real estate civil investment company, the purpose of which is to acquire and hold rental property. These companies are entitled to sell their shares to the public as soon as the total value of the shares held by the founding shareholders is at least equal to the minimum share capital amount, and if they provide evidence that a bank guarantee is in place, as approved by the French stock market regulator (*Autorité des Marchés Financiers*). At least 15% of the share capital must have been issued to the public within one year of the initial public offering.

SIIC

An SIIC is a listed real estate investment company that allows for special tax exemption arrangements – the main purpose of which is to acquire or build property for rental purposes – or directly or indirectly owns stakes in legal entities with identical corporate purposes legally classified as partnerships or subject to corporate income tax.

5.3 REITs

Listed real estate companies (sociétés d'investissement immobiliers côtées) are listed companies that benefit from a favourable tax regime. A company can become a SIIC if it complies with certain conditions, including:

- a minimum share capital of EUR15 million; and
- a principal corporate purpose relating to the acquisition or construction of buildings with a view to renting them, or the holding, directly or indirectly, of interests in entities with the same corporate purpose, the share capital or voting rights of which are not held to the extent of 60% or more by one or more persons acting in concert, and the share capital and voting rights of which are held, at the time of incorporation, to the extent of at least 15% by persons holding less than 2% of the share capital and voting rights each.

SIICs are available to non-French investors.

The SIIC and its nominated subsidiaries (which must have the same business purpose and be at least 95% owned, directly or indirectly) are exempt, upon SIIC election, from tax on renting or subletting of real estate under finance lease agreements, on capital gains arising from the disposal of real estate assets and on dividends received from SIIC subsidiaries, subject to distribution (ie, 95% of the rental income, 100% of the dividends received from nominated subsidiaries, and 70% of gains arising from the sale of real estate or shares in a SIIC subsidiary).

5.4 Minimum Capital Requirement

The minimum capital required to set up each type of entity is as follows:

- SCI – EUR1;
- SNC – EUR1;
- SARL – EUR1;
- SA – EUR37,000;
- SAS – EUR1;
- SCPI – EUR760,000 (each share must have a minimum face value of EUR150); and
- SIIC – EUR15 million.

5.5 Applicable Governance Requirements

The applicable governance requirements for these entities are as follows.

SCI

The company must be managed by at least one general manager, who may be an individual or a legal entity appointed in the by-laws (a statutory manager) or by the shareholders.

SNC

The partnership must be managed by at least one general manager, who may be an individual or a legal entity appointed in the by-laws (a statutory manager) or by the shareholders.

SARL

The company must be managed by at least one individual general manager, who may be named in the by-laws (a statutory manager) or properly appointed subsequently. Additional general managers can also be named in the by-laws (statutory managers) or appointed by a decision of the shareholders. Only an individual is likely to be appointed as a manager.

For the SCI, the SNC or the SARL, the general manager can be a shareholder or a third party.

SA

There are two possible structures for an SA.

Société anonyme with a board of directors

The board of directors must be composed of between three and 18 members appointed through the by-laws when the company is set up, and subsequently by the shareholders. The chairman of the board of directors is appointed by the board, from among its members. The board must also appoint a chief executive to lead the management of the company.

Société anonyme with an executive board and a supervisory board

The executive board typically has between two and a maximum of five members, all individuals. If the company is listed on a French stock market, this number may be increased to seven.

If the share capital of the company is less than EUR150,000, the executive board can be replaced by a single chief executive. Members of the executive board are not required to be shareholders of the company. The executive board manages the company.

The supervisory board must contain at least three, but no more than 18, members.

SAS

By-laws can grant considerable flexibility on corporate governance. The company is typically managed by a president, who can be either an individual or a legal entity. The by-laws can provide for the president to be assisted by one or more executives, or by one or more deputy executives, and can also provide for the appointment of a joint management body.

SCPI

An SCPI is managed by a management company, which must be either a stock corporation with a minimum share capital of EUR125,000 or a partnership, of which at least one partner is a stock corporation with at least this amount of share capital.

The management company must:

- be approved by the French Securities and Exchange Commission (Autorité des Marchés Financiers);
- present sufficient guarantees regarding its organisation, its technical and financial strength, and the suitability and experience of its managers;
- take steps to secure the transactions it enters into; and
- have sufficient financial means to conduct its business and meet its liabilities.

The management company is assisted by a supervisory board comprising at least seven shareholders, who are appointed at a shareholders' meeting.

SIIC

An SIIC is managed by a management company, which must be either a stock corporation with a minimum share capital of at least EUR125,000 or a partnership, of which at least one member is a stock corporation with at least this amount of share capital.

The management company must:

- be approved by the French Securities and Exchange Commission (Autorité des Marchés Financiers);
- present sufficient guarantees regarding its organisation, its technical and financial strength, and the suitability and experience of its managers;
- take steps to secure the transactions it enters into; and

- have sufficient financial means to conduct its business and meet its liabilities.

The management company is assisted by a supervisory board comprising at least seven shareholders, who are appointed at a shareholders' meeting.

5.6 Annual Entity Maintenance and Accounting Compliance

Costs

The annual entity maintenance and accounting compliance costs for each entity are as follows:

- SCI: EUR12,000 plus the cost of statutory auditors (EUR10,000 to EUR20,000), if applicable; the appointment of an auditor is mandatory for an SCI of a certain size that has an economic activity, when two of the following three thresholds relating to capital, turnover and the number of employees are exceeded:
  (a) the total value of the assets on the balance sheet is EUR1,550 million or more;
  (b) the turnover (exclusive of tax) is EUR3,100 million or more; and/or
  (c) the average number of employees is 50 or more;
- SNC: EUR12,000 plus the cost of statutory auditors (EUR10,000 to EUR20,000), if applicable;
- SARL: EUR12,000 plus the cost of statutory auditors (EUR10,000 to EUR20,000), if applicable;
- SA: EUR20,000 plus the cost of statutory auditors (EUR20,000 to EUR25,000), if applicable;
- SAS: EUR20,000 plus the cost of statutory auditors (EUR20,000 to EUR25,000), if applicable;
- SCPI: EUR12,000 plus the cost of internal auditors (EUR10,000 to EUR20,000); and
- SIIC: EUR20,000 plus the cost of statutory auditors (EUR20,000 to EUR25,000).

Mandatory Appointment of an Auditor

For the SNC, SARL, SA and SAS, the appointment of an auditor is mandatory when two of the following three thresholds relating to capital, turnover and the number of employees are exceeded:

- the total value of the assets on the balance sheet is EUR4 million or more;
- the turnover (exclusive of tax) is EUR8 million or more; and/or
- the average number of employees is 50 or more.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Commercial Leases

Commercial leases are granted for a minimum term of nine years and are subject to the mandatory legal regime laid down in the French Commercial Code. Subject to specific conditions, a tenant has the right to terminate the lease at the end of each three-year period and also has the right to renew the lease.

Overriding Leases

Overriding leases (or short-term leases) have a duration of up to three years. The tenant gives up the protection of the mandatory regime applicable to commercial leases. Any renewal of the lease must be on the terms of a normal commercial lease.

Professional Leases

Professional leases have a minimum duration of six years and are for professional activities only (to the exclusion of commercial, craft, industrial and agricultural activities). The lease can be terminated by the tenant at any time, by giving six months' notice.

6.2 Types of Commercial Leases

Regular commercial leases are historically tailored for the purpose of merchant activity, but are also regularly used for office or warehouse premises, for instance.

In any event, the applicable rules of the French Commercial Code are mainly designed to protect the tenant vis-à-vis the landlord.

Short-term leases can be seen as a first step on the path to the granting of a commercial lease. Under such an agreement, the tenant is able to start its business operation for a limited period of time (less than three years), while the landlord is not bound for more than such duration.

6.3 Regulation of Rents or Lease Terms

The statute governing commercial leases is mostly designed to protect the tenant's interests.

Even though many items are freely negotiable, important terms and conditions are subject to regulation, and any derogation from said regulation is forbidden, or at least limited.

The most common relevant items are as follows:

- the duration of a regular commercial lease will be at least nine years;
- allocation of charges – the landlord will provide the tenant with a limited list of repayable service charges;
- allocation of works – certain types of work, such as structural work, may not be charged to tenants;
- the assignment of the lease by the tenant may be prohibited unless the lease is assigned to the purchaser of the tenant's business;
- subletting is prohibited, unless otherwise provided;
- the tenant is entitled to renew its lease, which the landlord cannot deny unless the landlord pays an eviction indemnity (most of the time assessed by an expert before the court); and
- termination clause – its triggering is subject to a specific process.

6.4 Typical Terms of a Lease

The minimum term for a commercial lease is nine years (leases are rarely granted for more than 12 years due to tax implications – see **6.20 Registration Requirements**). Unless stipulated otherwise, the tenant has the right to terminate the lease at the end of each three-year period.

Under the French Civil Code, expenses relating to the maintenance of the premises and major repairs are payable by the landlord if they relate to structural works listed under Article 606 of the French Civil Code (ie, those pertaining to load-bearing walls, vaults, entire roofs and beams).

An extensive and precise list of works completed during the last three years and those to be completed during the next three years must be drawn up and communicated to the tenant by the landlord upon signing the lease and thereafter updated every three years.

6.5 Rent Variation

Rent can be revised every three years at the request of either party, even if a formal rent review is not provided for in the lease.

Parties may also agree on an automatic yearly rent revision. The index chosen by the parties must have some connection with the activity carried out by one of the parties or with the purpose of the lease.

Variable rents, although permitted by law, are not common in leases for offices, but are a common feature of hotel and retail leases.

6.6 Determination of New Rent

The parties may freely determine the rent of a renewed lease. The landlord will typically aim to fix the new rent of the lease at the then-applicable rental value of the premises (such rental value may be capped in certain specific cases). If the parties disagree on the rent of the renewed lease, whether or not the rent cap is excluded, either party may apply to the French court so as to have the current rental value of the rented premises assessed.

In most cases, the judge appoints a judicial expert with the duty to assess the then-current rental value of the rented premises and, as the case may be, to determine whether rent capping is applicable.

6.7 Payment of VAT

The landlord can elect to subject the rent to VAT (at 20%) under certain conditions. VAT can be recovered (totally or partially) by the tenant if it uses the building for the purposes of a VAT-able business.

If VAT does not apply to the rent, then CRL (*Contribution sur les Revenus Locatifs* – contribution from rental revenues) does, at a rate of 2.5%. CRL is not recoverable but is a tax-deductible expense.

6.8 Costs Payable by a Tenant at the Start of a Lease

There are no specific costs to be paid by the tenant at the start of a lease, although the tenant will often transfer the amount of the rental deposit, if any, on the execution date of the lease.

6.9 Payment of Maintenance and Repair

If there is more than one tenant, the expenses are shared according to the terms of the relevant leases and on a pro rata basis.

6.10 Payment of Utilities and Telecommunications

See **6.9 Payment of Maintenance and Repair.**

6.11 Insurance Issues

The landlord must take out an insurance policy to cover the risks associated with the premises occupied under a commercial lease, while the tenant must insure the risks associated with its own activities on the premises.

The insurance policy usually covers the risk of fire, explosion and theft. However, it is common to include an express clause in the lease agreement whereby the tenant reimburses the owner for the cost of insuring the premises as part of the service charges.

6.12 Restrictions on the Use of Real Estate

Leases usually specify the permitted use, which is narrowly defined, and any changes require the landlord's consent and/or administrative permissions.

6.13 Tenant's Ability to Alter and Improve Real Estate

Any works must have the prior consent of the landlord if they will have an impact on the structure of the property (walls, floors and roof) or if

they will alter the premises' character or legally permitted use.

6.14 Specific Regulations

There is a specific law governing residential leases, which are normally granted for terms of three years and require a cash deposit corresponding to one month's rent.

Offices, retail spaces and hotels are usually let under commercial leases, with the level of rent determined with reference to the market value of similar premises.

Professional premises are usually let under professional leases with a duration of six years.

6.15 Effect of the Tenant's Insolvency

Under an insolvency proceeding, the administrator appointed by the court can decide whether to terminate or continue the lease. This option is a public policy rule, and the lease cannot provide for an automatic termination when the tenant is subject to an insolvency proceeding.

In the continuation of the lease, rents due for the period after the opening of the insolvency proceeding are to be paid on time, failing which the landlord can ask for the termination of the lease, as usual.

The opening of an insolvency proceeding freezes the triggering of the termination clause based on unpaid rent and charges, as long as a court has not acknowledged the effect of the termination clause.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A security deposit usually equals one rent instalment excluding VAT, but can bear interest to the benefit of the lessee for sums exceeding two rent terms, pursuant to Article L 145-40 of the French Civil Code.

Cash security deposits are increasingly being replaced by bank guarantees and/or corporate guarantees (which overall guaranteed amount is not framed by the aforementioned Article L 145-40 of the French Civil Code).

6.17 Right to Occupy After Termination or Expiry of a Lease

Subject to certain exceptions, a tenant under a commercial lease has a right to renew the lease for a nine-year term and the landlord must pay compensation (*indemnité d'éviction*) to the tenant for a refusal to renew, unless the refusal is due to serious and legitimate reasons, or in certain other circumstances provided for by law.

6.18 Right to Assign a Leasehold Interest

The assignment of the leasehold right may be framed and/or prohibited by the lease's stipulations and the assignment of the business which includes the leasehold right may not be contractually prohibited (it may only be framed under certain specific conditions).

Article L 145-31 of the French Commercial Code states that, unless the lease provides to the contrary, any subletting, whether of the whole or a part of the leased premises, is prohibited. Subletting authorisation is, however, typically granted to parent companies and/or third-party companies of equivalent financial health.

6.19 Right to Terminate a Lease

The landlord under commercial leases may terminate the lease at the end of each three-year period based on certain limited grounds, such as:

- to build or rebuild the existing building;
- to reassign the ancillary dwelling to this use; or
- to carry out works imposed or authorised for a property restoration operation.

In principle, the landlord should pay an eviction indemnity to the tenant (see **6.21 Forced Eviction**).

In addition, commercial leases usually provide for an automatic termination clause in favour of the landlord in the event of the tenant breaching its obligations under the lease.

The tenant is in principle entitled to break options at the end of each three-year period, and the parties may agree on additional break options in favour of the tenant.

6.20 Registration Requirements

Although it is not mandatory to register commercial leases in the Trade and Companies Register, all leases with a term exceeding 12 years must be executed in a notarised form and published at the French land registry. Such publication is required for the rights under the lease to be enforceable against third parties. This gives rise to the payment of notary fees and the land registry tax, to be borne by the tenant (it being specified that the lessor is, however, jointly liable for the payment of such tax), equal to approximately 0.715% of the total amount of the rent and service charges due over the whole duration of the lease (within the limit of 20 years).

6.21 Forced Eviction

In some cases, the landlord may force a tenant to leave at the end of the three-year period, but will have to pay compensation (*indemnité d'éviction*) unless the refusal to renew is due to circumstances provided for by law.

If the tenant defaults on the rent, the landlord can force the tenant to vacate the building. Associated legal proceedings can take around six months or more.

In addition, if the lease contains a termination clause, the landlord may terminate it prior to the date agreed if the tenant fails to comply with the terms and conditions of the lease. The implementation of the automatic termination clause requires a formal notice to address the breach to be served to the tenant by a bailiff. Should the tenant fail to address the breach within one month, the landlord is entitled to initiate proceedings to obtain acknowledgement by the court of the termination of the lease.

6.22 Termination by a Third Party

Where a compulsory purchase order takes effect, the lease is automatically terminated and the tenant is paid compensation by the purchaser.

6.23 Remedies/Damages for Breach

In the event of a tenant breach and termination of a lease, there are no legal or contractual limits concerning damages that a landlord may collect.

Landlords typically hold a security deposit, which is often equal to three months of rent (one instalment) in order to avoid the application of interest at the legal rate of 6.75% which is applicable if the landlord holds more than two instalments of rent. Furthermore, this could be completed or replaced by a first demand bank or corporate guarantee, the amount of which is not limited by law.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are two main types of construction contract under French law:

- fixed-price construction contracts (*marché à prix forfaitaire*), where the contractor carries out construction works (as detailed in documents attached to the agreement) for a fixed price agreed prior to the execution of the works; and
- quantity construction contracts (*marché aumétré*), where the contractor carries out construction works for a price based on the quantities used for the works.

7.2 Assigning Responsibility for the Design and Construction of a Project

The owner can enter into:

- separate contracts with the design team and the contractor(s), whereby responsibility for the design studies will mostly be placed on the design team, while the contractor(s) will be liable for the works;
- a single "design and build" contract (*contrat de contractant général*) with a contractor who will also take responsibility for the design; and
- a real estate development agreement (*contrat de promotion immobilière*), whereby a developer – as agent – will appoint the design team and the contractors on behalf of the owner and be liable for both the design and the construction works.

7.3 Management of Construction Risk

The following contractual devices are commonly used to manage construction risks.

Retention Provisions

The owner is entitled to retain an amount not exceeding 5% of the entire price of the contractor agreement in order to guarantee the remediation of any defects arising on the date of acceptance of the works. The contractor has the right to replace this retainer with a bank suretyship (cautionnement bancaire).

Indemnity Provisions

Although such provisions are enforceable in principle, a court may revise the amount of the indemnity if it is deemed to be obviously excessive or insufficient.

Contract Provisions Regarding Penalties for Delay

Delay penalties are calculated by multiplying the contract price by the rate of delay. The damages are payable, unless the delay was due to force majeure/unforeseen event, or was the fault of the owner.

Mandatory Set of Warranties Covering Damages to the Construction

These include:

- a one-year warranty from the date of acceptance of the works (*garantie de parfait achèvement*), whereby the owner can claim for the repair of all defects that were not apparent at the date of acceptance of the works;
- or two years after acceptance of the works, the owner can claim for the repair of damages to equipment of the buildings (*garantie biennale*); and
- for ten years after acceptance of the works, the owner can claim for the repair of structural damage caused to the building or where the ability to use the building is jeopardised (*garantie décennale*).

Construction risks are also covered through specific/mandatory insurance.

7.4 Management of Schedule-Related Risk

Construction contracts provide for damages for delay.

An owner is entitled to monetary compensation for delays in achieving milestones and completion dates, through delay penalties. Parties may even provide for termination of the contract by the owner for material delay.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Additional forms of security are often requested by owners in major projects, such as performance bonds issued by banks or a contractor's parent company. If an advance payment is made to the contractor, owners also often request a corporate or bank guarantee to secure the repayment of such advance payment in case of termination of the contract.

7.6 Liens or Encumbrances in the Event of Non-payment

In most contractor agreements, the owner will either provide for a direct payment by the bank to the contractor in the event a loan was secured by the owner to finance the construction works, or provide the contractor with a joint bank guarantee (or any other type of agreed guarantee) equal to the entire price of the contract.

These provisions are mandatory, otherwise the contractor – if unpaid – can legally suspend the construction works.

Architects and contractors benefit from a legal lien (*privilège*) over the building.

7.7 Requirements Before Use or Inhabitation

A building is deemed to be completed once the works and associated essential equipment can be operated in compliance with the agreed use. Parties are free to provide for any other definition of completion, except for residential buildings subject to mandatory requirements.

From a town planning perspective, the owner has the obligation to file a declaration of completion and compliance of the works. Upon receiving this declaration, the administrative authorities have from three to five months to verify that the works are compliant with the administrative authorisation obtained. Thereafter, the owner can request a certificate of non-opposition to the compliance of the works.

Specific administrative authorisations may be necessary in order to be able to use/operate the building in some limited cases (eg, high-rise buildings and premises to be opened to the public).

8. Tax

8.1 VAT and Sales Tax

Some of the rules applicable to VAT are described below:

- Transactions involving non-developable land (*terrain non-constructible*) are exempt from VAT (unless an election for VAT to be payable is filed, in which case the VAT is due on the total purchase price).
- Transactions involving developable land (*terrain à bâtir*) are subject to VAT:
  (a) on the total purchase price if the VAT incurred by the seller on the initial acquisition was deducted; or

(b) on the margin if the VAT incurred by the seller on the initial acquisition was not deducted.

- Transactions involving new buildings (ie, acquired less than five years after completion from a VAT-liable entity acting as such, and also renovation works completed during the last five years on properties built more than five years ago) are subject to VAT on the total purchase price;
- Transactions involving other properties are exempt from VAT (unless an election for VAT to be payable is filed).

If the seller is not registered for French VAT, the transaction is not subject to VAT.

8.2 Mitigation of Tax Liability

The sale of shares in a company owning real estate assets (where the value of the real estate represents more than 50% of the company's assets) is subject to a transfer tax of 5% on the price paid for the shares.

If the price of the shares reflects the fair market value of the real estate assets minus the liabilities of the company, the transfer taxes are, in principle, lower than those due on the sale of the real estate assets.

8.3 Municipal Taxes

Property Tax

Property tax (*taxe foncière*) is payable for the whole calendar year by the owner of a property asset as of 1 January of each calendar year. The amount of property tax is calculated by applying the rate of the tax set by each local authority to the cadastral income obtained by applying a reduction of 50% (20% for non-developable lands) to the local rental value (*valeur locative cadastrale*).

Housing Tax

Housing tax (*taxe d'habitation*) is due for secondary dwellings by the occupier of the property as of 1 January.

Office Tax

This is payable yearly by the owner (as of 1 January) for premises used as offices or for commercial or storage purposes, located in the Ile-de-France and the PACA (Provence-Alpes-Côte d'Azur) region.

Office Development Tax

Office development tax (*taxe pour la création de bureaux*) is payable by the owner of office premises in the Paris area, with the rates varying from EUR0 to EUR455.75 per square metre depending on the district in which the office is located.

Tax on Unoccupied Premises

Tax on unoccupied premises, located in certain areas, is due, at the rate of 17% in the first year and 34% thereafter, by the owner of any premises that have been unoccupied for at least one year (as of 1 January).

Local Development Tax

This is payable in relation to building, rebuilding or extension projects for all types of premises.

3% Tax

A 3% tax applies to the market value of real estate properties and rights owned in France, directly or indirectly, by any French or foreign legal entity (with exception for some categories of investors).

8.4 Income Tax Withholding for Foreign Investors

Rental Income

Ownership of a property in France does not itself make it a permanent establishment.

If a permanent establishment is deemed to exist, current income is fully taxable in France at the rate of 25% (increased by additional contributions) in 2024.

Foreign owners are generally subject to French tax on rental income either under the individual income tax regime at a progressive rate ranging up to 45% (increased by additional contributions), or under the corporate income tax regime at the standard rate of 25% (increased by additional contributions).

Deductions

Several limitations on interest deductibility may apply, including a general limitation regarding the net financial charges, which may be deducted up to the higher of the following two amounts:

- EUR3 million; or
- 30% of the adjusted taxable income, before offsetting of tax losses; lower thresholds may apply when a company is thinly capitalised.

No withholding tax on interest expenses applies in France except when these are paid in a non-co-operative state, in which case a 75% withholding tax is triggered.

Finally, the Finance Act for 2020 transposed into French law the provisions regarding hybrid mismatches of Directive (EU) 2017/952 of 29 May 2017 (ATAD II). These provisions aim to neutralise the tax effects of hybrid mismatch arrangements which exploit differences in the tax treatment of an entity or instrument under the laws of two or more EU member states.

Dividends

Resident individuals

A flat tax, or PFU (prélèvement forfaitaire unique), is set at 30% (12.8% of individual income tax and 17.2% of social contributions) and applies to dividends distributed from 1 January 2018.

Under certain conditions, individual taxpayers may still elect for dividends to be taxed at the progressive income tax rate if lower than the PFU.

Non-resident individuals

Withholding tax rates depend on the applicable tax treaties. The French standard withholding tax rate on dividend distributions to non-resident individuals is aligned with the PFU rate (12.8%). The withholding tax rate is 75% for dividends paid on a bank account located in a non-co-operative state within the meaning of the French tax code, or paid or accrued to persons established or domiciled in such a non-co-operative state.

Resident companies

Unless the participation exemption on dividends applies, dividends arising in France paid to corporate shareholders are included in taxable income for corporate income tax purposes.

Under the French participation exemption regime, 95% (99% in certain circumstances) of the dividend is tax-exempt.

Non-resident companies

Dividends arising in France distributed to non-resident shareholders are subject to a final withholding tax at a rate of 25%, subject to the provisions of applicable tax treaties.

Subject to certain conditions, the withholding tax is reduced to nil for dividends paid by a French resident company to a qualifying EU parent company if the parent company holds at least a 10% shareholding in a French subsidiary for at least two years (or 5% when the EU par-

ent company cannot offset the withholding tax in its country of residency). The rate is 75% for dividends paid on a bank account located in a non-co-operative state, or paid or accrued to persons established or domiciled in such a non-co-operative state.

Capital Gains

Other than usual profits derived by asset dealers, profits on the sale of a French property by a non-resident company are subject to a 25% tax in France (the effective rate is 25.83% for corporate taxpayers with a turnover in excess of EUR7,630,000), although certain treaty exemptions may apply.

Profits on the sale of a property by an individual – resident or non-resident – are subject to a 19% tax, plus 17.2% in social contributions, subject to the provisions of tax treaties as regards non-resident individuals.

Furthermore, a progressive 2% to 6% tax applies on real estate capital gains on sales of property. This tax applies both to real estate rights and assets, other than building lands.

Allowances increasing with the holding period can be deducted from the taxable gain, leading to a full exemption of individual income tax after 22 years of holding and a full exemption of social contributions after 30 years of holding.

Real Estate Wealth Tax (Impôt sur la Fortune Immobilière, IFI)

IFI is assessed on the real estate owned directly or indirectly by the taxpayer via companies or collective investment vehicles when it is not allocated to the business of the relevant entities to the extent that the value of the taxpayer's real estate net assets exceeds EUR1.3 million.

A limited number of exemptions apply.

Subject to tax treaties, non-residents holding corporate securities will henceforth be liable for IFI for the part of the value of such shares corresponding to real estate.

8.5 Tax Benefits

Depreciation

If the owner of the property is a company subject to French corporate income tax, depreciation is allowed (on a straight-line basis) on the acquisition value of the buildings, but not the land (generally, at rates between 2% and 5% per year for commercial buildings).

GERMANY



Law and Practice

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Linklaters

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Linklaters is a full-service provider offering international advice on legal and tax issues in the real estate industry, which gives it a leading edge in meeting client requirements and demands. The cross-practice team includes real estate experts and specialists in corporate, tax, finance, investment, competition and regulatory law. With more than 50 real estate lawyers in the Frankfurt, Munich and Berlin offices and over 350 real estate lawyers globally, the firm's real estate team is chosen by leading global investors, developers, occupiers and financial institutions to advise on their largest and most complex or multi-jurisdictional real estate transactions and disputes. The practice, inter alia, advises private equity clients (eg, Blackstone, BlackRock, Cerberus), funds and institutional investors (eg, BNP Paribas REIM, CBRE Investment Management, GARBE, DWS), as well as a number of Asian clients (eg, Hanwha, Frasers, Huazhu Group, Samsung, CapitaLand).

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1. General

1.1 Main Sources of Law

The main source of real estate law is the Civil Code (*Bürgerliches Gesetzbuch*).

Of further relevance are:

- the Land Registration Act (*Grundbuchordnung*);
- the General Terms and Conditions for Building Contracts (VOB/B);
- the Mandatory Fee Structure Regulation for Architects and Engineers (HOAI);
- the Federal Building Code (*Baugesetzbuch*);
- the Federal Land Use Ordinance (*Baunutzungsverordnung*);
- the 16 states' individual building regulations (*Landesbauordnungen*);
- the Notarisation Act (*Beurkundungsgesetz*);
- the Heritable Building Right Act (*Erbbaurechtsgesetz*); and
- the Condominium Act (*Wohnungseigentumsgesetz*).

1.2 Main Market Trends and Deals

Although sustainability has become more and more important and also impacted real estate financing, it has been overshadowed by the interest rate turnaround (*Zinswende*) in 2023. According to surveys, mainly (commercial) residential and logistic properties are in demand, data centres and care homes are also trending upwards. Transaction volume increased only very slightly compared to previous years. The most popular investment cities remain the top seven centres: Berlin, Hamburg, Munich, Frankfurt, Düsseldorf, Cologne and Stuttgart.

Some of the most significant deals in Germany in 2023 were the takeover of X+Bricks supermarkets by Slate and the sale of two residential portfolios by Vonovia to CBRE Investment Management.

Neither blockchain concerning real estate transactions, nor creation of new opportunities regarding capital investments in the form of tokenisation of real estate assets have gained broad acceptance so far. Use of artificial intelligence becomes more important in the areas of accounting, property administration, valuation, due diligence and ESG monitoring.

A federal government funding programme for 2024 and 2025 with a volume of EUR480 million aims at the conversion of commercial real estate into climate-friendly residential properties. Owners and investors should benefit from advantageous loans.

In light of the increased interest rates and inflation, more and more restructurings can be seen, including some insolvencies, while foreclosures do not (yet) take place in large scale. Loan on loan lending (net asset values lent against loan portfolios) is an increasing form of financing.

1.3 Proposals for Reform

Federal Building Code (Baugesetzbuch)

The German Federal Building Code dating back to the year 1986 shall receive an overall reconsideration in the year 2024. While several smaller changes concerning single issues were made in the last couple of years, those amendment shall now be incorporated into an overall concept. The code's instruments shall become more effective and less complicated. In particular in relation to climate protection, strengthening the focus on public welfare, further inner-city development and mobilising additional building land, the planning and approval procedure phase shall be accelerated.

Future Financing Act (Zukunftsfinanzierungsgesetz–ZuFinG)

The German Future Financing Act passed in the end of 2023 creates decisive scope for the property industry to significantly boost investments by property funds in photovoltaic systems through regulatory adjustments. The ZuFinG amends, inter alia, the German Capital Investment Code (KAGB) and enables property funds to invest also in ground-mounted systems on undeveloped land. In this respect, the draft law aims at creating a framework for sustainable investments in line with the sustainable finance strategy pursued by the German government. Open-ended mutual property funds (Section 230 et seq. KAGB) will also be allowed to acquire undeveloped land in the future, if the land is intended and suitable for the construction of facilities for generation, transport or storage of electricity, gas or heat from renewable energies.

Energy Price Cap (Energiepreisbremse)

The energy price cap which was introduced in the year 2023 in order to support end consumers with significantly increased gas and electricity prices will expire in April 2024, which is why VAT on gas will return to the original percentage rate of 19% and therefore lead to increased costs.

2. Sale and Purchase

2.1 Categories of Property Rights

Generally, there are freehold titles granting full and absolute ownership, and heritable building rights (*Erbbaurechte*) giving the right to lease the land for a certain amount of time (30–99 years) and to erect buildings on it. Both categories can be split into condominium shares accompanied by special rights of use for a designated area of the property.

Properties can be encumbered with various rights in rem, such as easements (*Dienstbarkeiten*), land charges (*Grundschulden*) and mortgages (*Hypotheken*).

2.2 Laws Applicable to Transfer of Title

The Civil Code and the Land Registration Act apply to every transfer of title. In addition, permits under other laws, in particular, the Federal Building Code for properties located in special areas and the Real Properties Transfer Act (*Grundstücksverkehrsordnung*) for first-time sales in eastern Germany after 28 September 1990, might be necessary. Local authorities might have statutory pre-emption rights in certain designated areas.

The laws applicable to transfer of title do not distinguish between the types of use of the property.

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title requires a deed notarised by a notary containing an agreement on the sale (*Kaufvertrag*) and an agreement on the transfer (*Auflassung*). The notary applies for the permits necessary for the sale and waiver of pre-emption rights, which are a prerequisite for transfer of title and usually also for the payment of the purchase price. The notary also informs the tax authorities about the conclusion of the sale and purchase agreement. They will issue a clearance certificate confirming that real estate transfer tax has been paid, which is necessary for the registration of transfer of title in the land register (*Grundbuch*). The acquisition process has not been changed or simplified due to the COVID-19 pandemic.

While economic transfer of title (transfer of possession, use and burdens) is usually agreed for the day following the payment of the purchase

price, the actual legal change of ownership only takes place upon registration in the land register.

Title insurance is not relevant due to the title guarantee resulting from the so-called "public belief" in the land register. Its accuracy is protected by law and, therefore, a buyer can acquire ownership in good faith (bona fide) even if the property is purchased from an unauthorised person registered in the land register.

2.4 Real Estate Due Diligence

Legal and technical due diligence is usually performed on documents provided by the seller. Technical advisers often carry out site visits. Some information can be obtained from authorities with power of attorney from the seller and public registers. In some cases, separate environmental due diligence is performed.

The typical legal report contains information about title and encumbrances, leases, public building and zoning issues and other permits (if required), environmental information and, if relevant, acquisition documents, service agreements and litigation. In a forward transaction where the building is still to be developed, the report also covers development, project management, construction, architectural and other agreements relating to the development.

2.5 Typical Representations and Warranties

The extent of representations or warranties agreed depends on the market climate. Germany is currently a seller's market, giving sellers enough leverage to avoid granting the buyer large-scale representation or warranties. Instead of objective guarantees, guarantees to the seller's best knowledge are often given. No significant additional representations and warranties have developed due to experiences in the COVID-19 pandemic.

Remedies

The parties can agree on the type of remedies – either compensation in cash or actual repair of the damages. The parties often agree on a cap of the overall maximum amount of compensation. This agreement is regularly accompanied by both a de minimis method, granting damages only if the claim exceeds a certain amount, and a basket method, granting compensation only if the sum of all claims exceeds a certain threshold, resulting in the seller having to cover the total amount of the claims rather than just the difference between the total and the threshold.

The buyer carries the risk of the seller's insolvency often without being especially secure. Possible security would be paying a certain amount into an escrow account, holding back on a certain amount of the payment, or simply lowering the purchase price. In some cases, a joint liability of or comfort letter by a parent company can be agreed with the seller. Less often a W&I insurance is contracted as security for the given seller guarantees.

Limitation of Liability

The statutory period for expiration of claims of approximately three years is often contractually limited to 12 or 18 months. Depending on the seller's negotiation skills, a cap, de minimis amount and basket can be agreed to limit liability. The liability is often limited to approximately 5–10% of the purchase price (cap); claims can only be raised if the individual claim reaches at least 0.1–1% of the purchase price (de minimis) and exceeds 0.5–1.5% of the purchase price (however, approximately EUR500,000 maximum) either by itself or together with other claims (basket). It remains to be seen how the

changed market environment influences these values in favour of purchasers.

2.6 Important Areas of Law for Investors

In addition to the civil and public law provisions mentioned in **1.1 Main Sources of Law**, the provisions contained in the Anti-money Laundering Law (*Geldwäschegesetz*) are particularly important for investors and the required know-your-customer checks sometimes create unexpected bureaucratic hurdles. Company register excerpts, passport copies, etc, must be provided to those who are obliged to carry out the checks. Corporations, partnerships and foundations operating on the financial market and/or buying real estate in Germany have to report their beneficial owners to the register of ultimate beneficial ownership (*Transparenzregister*). Checks and notifications not only have to be carried out by providers of financial services, but also to a certain extent by brokers, law firms and notaries.

2.7 Soil Pollution or Environmental Contamination

Under the Federal Soil Protection Act (*Bundesbodenschutzgesetz*), the polluter, all current and former users, and all current and former owners of a property can be held liable for environmental laws irrespective of whether they are aware of the contamination or if it was caused by them. When requesting remediation measures, the authorities act solely on the basis of the principle of effectiveness and will usually charge the most financially sound party, which is often the owner. However, the owner may take redress from the actual polluter if their actions or fault can be proved.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A property owner has a right to a building permit if the proposed building complies with public building law. The issued building permit will ensure the legality of the building and its permitted use.

Local Authorities

In many areas, the general public building law is substantiated in local development plans (*Bebauungspläne*) issued by the local authorities that make provisions for the permitted use and size of the property. If there is no development plan, the permitted use can be determined by the Federal Building Code and the Federal Land Use Ordinance. If no local development plan exists or significant amendments are required for a development to be permitted, the owner might enter into an urban development agreement (*städtebaulicher Vertrag*) with the local authorities with the aim of establishing/amending the project-related development plan to secure the building project.

2.9 Condemnation, Expropriation or Compulsory Purchase

The fundamental right to property is protected by the German constitution, which only allows the government to expropriate for public interest, if authorised by German law, for appropriate cause and against compensation. There are federal and federal state laws enabling expropriation. The procedure varies, depending on the law it is based on. Compensation is based on the market value of the property at the time of expropriation.

Municipalities also have the right to expropriate, as a last resort, to fulfil their goals under the Federal Building Code, especially if the real estate is

located in a development area (*Entwicklungsgebiet*).

2.10 Taxes Applicable to a Transaction

Asset deals are subject to RETT, with the rate varying between 3.5% and 6.5% depending on the federal state in which the asset is located. VAT is in principle not applicable to the sale of real estate. If the property is sold B2B, the seller can waive the VAT exemption, thus VAT at 19% applies. The buyer has to pay this VAT to the tax authorities (reverse charge). If the buyer intends to use the real estate to render non-VAT-exempt supplies, the VAT triggered may be reclaimed as input VAT; hence no VAT would actually be payable.

RETT-neutral share deals were significantly impeded by the recent RETT reform. Share deals trigger RETT if at least 90% of the partnership interest/shares of a partnership/corporation holding German real estate is transferred within ten years to new partners/shareholders.

In addition, RETT is triggered if at least 90% the shares in a corporation or partnership holding German real estate are directly or indirectly unified in one hand or the hands of affiliated entities.

2.11 Legal Restrictions on Foreign Investors

Generally, there are no legal restrictions on foreign investors acquiring real estate in Germany.

However, a notary may only notarise a real estate sale and purchase agreement with a foreign entity as the buyer and, therefore, a foreign entity can only acquire real estate in Germany if the entity is registered in the German ultimate beneficial owner register (*Transparenzregister*). Due to the European single market, registrations in an equivalent register of an EU member state are also sufficient.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Generally, acquisitions are financed by both debt and equity, with the ratio between the two depending on the market. Equity is often provided downstream in the form of shareholder loans that are expected to be subordinated to the debt financing. If insufficient equity is available in the company's group, additional funds may need to be obtained from mezzanine lenders. For mezzanine loans, there will typically be an increased margin, giving the lender a way to participate in the profit and/or the possibility to transform the loan into an equity participation ("equity kicker").

Portfolios are often financed by syndicated loans involving different lenders, and secured debt is traded between the lenders. For refinancing, the so-called Pfandbrief (covered bond) is often used. In this case, the loan and granted security must comply with a strict standard.

Furthermore, sale-and-leaseback transactions can be seen as a different form of financing, as the former owner/now tenant of the property activates new liquidity.

3.2 Typical Security Created by Commercial Investors

The most important security granted over real estate is the land charge (*Grundschuld*) or mortgage (*Hypothek*). While the more often-used land charge is non-accessory in nature and connected to the secured claim via a security purpose agreement, the mortgage is accessory in nature and attached to the underlying claim. Both are

registered as rights in rem in the land register, as encumbrances over the freehold property or a hereditary building right.

In addition, the typical security package includes the assignment of rental income, claims under the acquisition agreement, the property management agreement, insurances and contractor agreements. Bank accounts and shares or interest are pledged to the financing bank. The property/asset manager is expected to conclude a duty of care agreement.

If developments are financed additionally, cost overrun and/or finance costs shortfall guarantees are commonly granted by the sponsor.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders and no restrictions on repayments made to a foreign lender under a security document or loan agreement.

However, the payment of interest to foreign lenders can be restricted. Under German tax law, banks and other financial services providers must withhold taxes on interest payments made to foreign lenders that do not themselves qualify as a bank or financial services provider.

If a foreign lender has a permanent establishment in Germany and the loan is attributable to this establishment, the foreign lender is subject to German taxation on the profit resulting from the loan. Depending on the applicable double-taxation treaty, the interest will generally either be tax-exempt in the foreign jurisdiction or the German tax will be credited against the tax liability arising in this jurisdiction.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Land charges/mortgages as well as share pledges require notarisation which triggers mandatory statutory notarial fees. Furthermore, the mandatory registration of land charges/mortgages on the land register triggers registration fees. If the land charge/mortgage is granted by a foreign entity, the land registry often requests a cost advance before registration.

Enforcement of security is done via court proceedings for which court fees are payable. The court will only initiate the proceedings once the secured creditor applying for the proceedings has paid a cost advance.

No taxes apply to the granting and enforcing of security. However, if a land charge/mortgage is enforced by way of public auction, RETT of between 3.5% and 6.5% (depending on the German federal state in which the property is located) is payable, for which the successful bidder and the property owner are jointly liable.

Additionally, interest on loans granted by a foreign lender and secured by German real estate would trigger German domestic income for the lender; ie, interest would in principle be subject to German income tax if no double tax treaty excludes the German right to tax this income.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Depending on the security-granting entity, financial assistance and corporate benefit rules must be complied with.

The prohibition on financial assistance only applies to German stock companies (*Aktiengesellschaften*). If there is a control agreement or a profit transfer agreement (*Beherrschungs- oder*

Gewinnabführungsvertrag) in place between the stock company and the financially assisted company, the prohibition on financial assistance does not apply. On the other hand, a transaction carried out in violation of the financial assistance rules is void.

As a corporate benefit rule, managing directors are legally obliged to act as prudent business people vis-à-vis their company. In upstream or cross-stream loans within a group, there is an obligation on the lending entity to take security if there is a credit risk in relation to the borrowing entity. Furthermore, the German Code of Corporate Governance applies to members of the managing board and the supervisory board of German listed stock companies. An infringement of corporate benefit rules does not lead to the invalidity of a transaction, but to the possible liability of the directors, managing board, and/or supervisory board.

In addition, other rules deriving from corporate and insolvency law apply, including rules relating to capital maintenance, restrictions on transactions between a company and its affiliates other than its own subsidiaries, and provisions relating to transactions that disadvantage creditors and have been entered into within a certain period before the commencement of insolvency proceedings.

3.6 Formalities When a Borrower Is in Default

In addition to contractually agreed prerequisites for the enforcement of security, such as serving an enforcement notice to the security grantor and the borrower, and giving the chance of healing the default, additional statutory requirements apply to the enforcement of a land charge/mortgage. It must be terminated with a mandatory six months' notice period and the enforceable copy of the land charge/mortgage deed must be officially served to the property owner. Only once this has been done can enforcement proceedings via forced administration and/or forced auction commence. A forced auction procedure takes a minimum of several months; in some cases it can take more than one year.

Additional steps to give priority to a lender's security interest are not required.

No new restrictions on a lender's ability to enforce security have been implemented as a response to the COVID-19 pandemic.

Although the percentage of non-performing loans has multiplied within the last year, and preparations for enforcement of real estate securities are underway in some cases, a significant number of actual enforcements has not been initiated. Lenders largely still tend to agree on a standstill and issue waivers or reservation of rights letters.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt can be subordinated both by agreement and by law.

A creditor can agree to subordinate its existing debt to that of another creditor by means of a subordination agreement or an intercreditor agreement. If the existing debt is secured by a land charge/mortgage and such land charge/mortgage will be subordinated to a newly created land charge/mortgage, registration of such subordination is required in the land registry in order for it to become effective.

Shareholder loans and other arrangements equivalent to shareholder loans are subordinated to the claims of all other creditors by law, except:

- when the relevant shareholder is not a director of the company and does not hold more than 10% of the registered share capital in the company (minority shareholding privilege – *Kleinbeteiligungsprivileg*); or
- when the shareholder has acquired shares with the intention of rescuing the company from insolvency (restructuring privilege – *Sanierungsprivileg*).

In addition, newly created debt is subordinated by law to outstanding debt to public authorities.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over real estate cannot be held liable under environmental laws due to its position as lender/security beneficiary.

Under the Federal Soil Protection Act, the polluter, all current and former users, and all current and former owners of a property can be held liable for contamination. The lender can, therefore, be held liable in the unlikely circumstances that they were in possession of the property or that they are themselves the polluter.

3.9 Effects of a Borrower Becoming Insolvent

In certain circumstances, a borrower's insolvency administrator may challenge agreements entered into by the borrower between one month and ten years prior to the filing for the opening of insolvency proceedings. The following are valid reasons for challenging security interests granted by the borrower:

- the creditor had knowledge of the borrower's illiquidity, or the borrower had already applied for the opening of insolvency proceedings, or the creditor was aware of circumstances leading directly to the conclusion that the borrower was illiquid or had applied for insolvency proceedings;
- the creditor is a shareholder of the borrower;
- the borrower provided the security intending to discriminate against the rights of other creditors and the creditor was aware of this intention;
- the creditor did not have a valid right to obtain the security that he or she was not due to receive, or was not yet due to receive, or was due to receive in a manner that was otherwise inconsistent with the original agreement between the borrower and the creditor;
- the interests of other creditors were directly prejudiced at the time the security was granted (it not being sufficient that they might have been prejudiced as a result of granting the security); or
- the security interest was granted gratuitously.

If immediate and adequate consideration was received by the borrower for the transaction for which the security was granted, it can only be challenged by the insolvency administrator if the transaction was undertaken willfully to discriminate against other creditors' rights.

If a transaction is successfully challenged, the secured creditor must repay any amounts already received or release the respective security interest.

3.10 Taxes on Loans

There are currently no taxes or levies in connection with real estate secured mortgage loans or mezzanine loans in Germany nor are there any proposals to impose those. Statutory notarial and land registry fees apply to any recordings in the land register, relevant for mortgages (see **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**).

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

In Germany, strategic planning and zoning are governed by federal statutory law and the relevant statutory law of each of the 16 German states, as well as regional and local development plans (*Flächennutzungspläne, Bebauungspläne*). Particularly important codes are the Federal Planning Act (*Raumordnungsgesetz*), the Zoning Codes of the German states (*Landesplanungsgesetz*), the Federal Building Code and the Federal Land Use Ordinance.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design, appearance and method of construction of new buildings or refurbishment of existing buildings are governed by legislation, specifically the Federal Building Code and the Federal Land Use Ordinance. Regarding the safety of buildings (fire safety, layout and structural safety), the building codes of the respective federal states apply.

4.3 Regulatory Authorities

Municipalities are responsible for the regulation of the development and use of individual parcels of land. The federal government of Germany lays down "leading concepts" (*Leitbilder*), such as the guarantee of equal living conditions within Germany, the protection of the natural environment, and the necessity of correcting structural imbalances between former East and West Germany.

The federal states establish comprehensive plans (*Raumordnungspläne*) covering the entire state. These plans and their objectives are binding on all subordinate planning authorities. They mostly cover the requirements for the desired structure of settlements, the need for areas to remain undeveloped, and infrastructure locations and routes.

The municipalities' planning functions are carried out at two levels:

- the development plan for the entire territory of the municipality (*Flächennutzungsplan*), which lays down the main features of the various types of land use that will be permitted on the basis of intended urban development and the anticipated needs of the municipality, eg, areas earmarked for development, transport, public infrastructure, green spaces, etc; and
- a detailed plan for individual areas within the municipality (*Bebauungsplan*), which designates the permitted land use and usually refers to the Federal Land Use Ordinance, giving a detailed description of the building areas (eg, residential, industrial, retail or business) and restrictions on the size, height and floor area of permissible buildings.

4.4 Obtaining Entitlements to Develop a New Project

In order to obtain entitlements to develop a new project or complete a major refurbishment, an application specifying the planned construction work and the use of the land must be submitted. The responsible authorities will then forward the application to any other authority with potential interest in the planned project.

The responsible authority itself verifies whether the project complies with planning law. If it does, and if no relevant concerns are raised by the other authorities involved, the responsible authority must grant the building permission.

4.5 Right of Appeal Against an Authority's Decision

Legal action can be taken against the relevant authority's decision to refuse planning permission. Third parties, such as neighbours, can commence proceedings against the issuance of a building permit if they can prove that the decision may unlawfully affect their rights.

4.6 Agreements With Local or Governmental Authorities

Arrangements known as urban development agreements can be entered into between building owners or developers and the relevant municipality. In these contracts, the municipality undertakes to support the building owner/developer, or the building owner/developer undertakes to support the municipality in its planning goals.

4.7 Enforcement of Restrictions on Development and Designated Use

If a building is not built or used in line with the issued building permit the competent authority has the right to prohibit the use or – in a worst-case scenario – request the deconstruction of the building. The authority is obliged to exercise reasonable discretion (ie, it must adhere to the principle of proportionality). This means, if there is any way to grant a building permit to cover the actual building or use, it must be granted (after the usual application process) instead of a deconstruction order.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Generally speaking, any entity, including foreign entities, that has legal capacity can hold real estate in Germany, unless prohibited by law or court or administrative order. Limited liability companies (GmbH) and limited partnerships (KG) are most commonly used to acquire and hold real estate.

German law also recognises real estate investment trusts (REITs), which are listed real estate stock companies. However, there are only five REITs listed in Germany.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Company

A GmbH as limited liability company is a corporation acting fully independently of its shareholders, subject to rights and obligations. Only the company assets of a GmbH serve to discharge the company's obligations vis-à-vis creditors, and any personal liability of the shareholders is excluded if the capital contributions have been fully paid. The applicable legal framework is quite flexible, and the company's articles can be adjusted to specific needs. Its foundation requires a notarial act. The management is vested with one or more managing directors, who are generally bound by the instructions of the shareholders. The company may have a supervisory board (*Aufsichtsrat*). In order to establish a limited liability company, at least half of the mandatory EUR25,000 capital contributions have to be paid. Notarial, company register fees and fees for business registration amount to approximately EUR1,000.

Limited Partnership

The KG is a limited partnership under German law and must have at least two partners. The partnership agreement does not require notarisation, unless it contains obligations requiring the observation of specific form requirements (eg, contribution of real estate). It is characterised by having at least one general partner, per-

sonally liable without limitation, and one or more limited partner(s) only liable to the extent of their liable contribution (*Hafteinlage*) registered in the commercial register. Additional contributions can be agreed. Management is vested with the general partner.

There is no mandatory minimum contribution. Company and business registration fees as foundation costs amount to approximately EUR550.

5.3 REITs

Although German law recognises REITs, they are hardly relevant (see **5.1 Types of Entities Available to Investors to Hold Real Estate Assets**).

German REITs are listed stock companies and cannot be structured in another form. They are tax-exempt on entity level. Distributions are taxed on shareholder level.

In addition to the Commercial Code (*Handelsgesetzbuch*) and the Stock Exchange Act (*Aktiengesetz*), the REIT Act (*REIT-Gesetz*) applies to them. In addition to being listed at the stock exchange, REITs must fulfill certain other criteria, such as a minimum distribution of 90% of annual profit, focus on real property investment (at least 75%), minimum diversification (no shareholder must maintain more than 10%, minimum free flotation of 15%), exclusion of real property trade and a minimum equity ratio of 45%.

5.4 Minimum Capital Requirement

The minimum share capital for a GmbH is EUR25,000. Capital contribution in kind is possible but is subject to further restrictions.

No minimum capital requirements apply for a KG.

5.5 Applicable Governance Requirements

No specific governance requirements apply to real estate investments as such. However, regulatory requirements apply if the investment vehicle qualifies as an investment fund under the German Investment Code (KAGB) – ie, any collective investment undertaking that raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and that is not an operative business outside the financial sector. The German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) supervises German fund managers and investment funds offered by such companies under the provisions of the KAGB.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual entity maintenance and accounting compliance costs depend on the individual circumstances of the entity and the property itself.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

German law differentiates between Pacht, entitling the tenant to use the property and benefit from it, and Miete, which only entitles the tenant to use the property. For example, the leasing of a hotel, including all fixtures and equipment, and the right to operate the hotel is regarded as a Pacht contract.

6.2 Types of Commercial Leases

There are no different types of commercial leases, apart from the general differentiation previously explained.

6.3 Regulation of Rents or Lease Terms

Leases are subject to the Civil Code, which regulates basic contractual matters. Within that scope, contracting parties may freely negotiate the contractual provisions, as long as they do not violate any mandatory law, eg, regulations on the maximum rent payable and its increase for residential leases.

There is no material ongoing regulation of rents or lease terms that resulted from the COVID-19 pandemic. The moratorium on termination of rental and leasehold agreements due to non-payment of rent established by the government expired on 30 June 2022.

6.4 Typical Terms of a Lease

Fixed leases typically run for a period of between five and ten years, and extension options are often agreed. It is possible to negotiate terms of up to 30 years.

The landlord is obliged to maintain the premises in the agreed condition – therefore, the landlord must bear all costs for repairs and decoration. It is market standard for maintenance and repair work to be undertaken by the tenant at its own cost. In most cases, the landlord remains responsible for structural and major repairs, and the tenant carries out internal repairs and maintenance as well as repairs solely for interior decoration.

Case law regards clauses that oblige the tenant to repair the roof and structure of the leased premises, to decorate at fixed intervals, to comply with unlimited renovation obligations at the end of the term, or to pay for renovation irrespective of the premises' actual state at the end of term, to be unfair and invalid.

Triple net leases (in which the tenant agrees to pay all real estate taxes, building insurance and maintenance) are generally not permitted unless individually agreed; eg, in sale-and-leaseback transactions.

Rent is mainly paid on a monthly basis. In rare cases quarterly, six-monthly or yearly rents are agreed.

Newer leases contain specific provisions for a pandemic situation or another force majeure event in relation to delays in the fit-out works and therefore in the handover of the leased premises. In some cases, parties have negotiated material adverse change clauses related to the pandemic.

6.5 Rent Variation

In principle, the parties are free to agree on the amount of the rent and its increase under commercial tenancy law. The parties generally agree on rent adjustment systems, such as indexation rent, graduated rent or turnover-linked rent. For residential leases, strict limitations apply to a possible rent increase.

6.6 Determination of New Rent

It is usual to agree on the rent adjustment system in the lease agreement itself. It is seldom agreed to negotiate a new rental based on the then-applicable average market rent after a certain number of years, or if the tenant has exercised an option right. Generally, commercial rents are adjusted according to changes in the Consumer Price Index (*Verbraucherpreisindex*). A graduated rent will be raised by a specific amount after a certain period. A turnover-linked rent will be adjusted to the change of turnover of the tenant for a certain period; in order to mitigate the risk of falling sales, however, a minimum fixed rent is usually agreed.

6.7 Payment of VAT

In principle, rent is VAT-free, the landlord is hence not entitled to deduct input VAT. However, the landlord may waive the VAT exemption, resulting in its right to deduct input VAT. Such waiver is only effective if the tenant exclusively uses the premises to render supplies which do not exclude the right to deduct input VAT; ie, the landlord's input VAT deduction depends on the tenant's use of the property. Lease agreements therefore normally provide for a compensation claim if the landlord's waiver fails due to the tenant's use.

6.8 Costs Payable by a Tenant at the Start of a Lease

Rent securities, such as deposits or bank guarantees, are often requested before the commencement of a lease, if agreed upon in the lease agreement. In landlord-friendly markets such as Berlin, Frankfurt and Munich, landlords also increasingly demand a lump-sum payment for administrative costs of between 1% and 5% of the annual rent. Such lump-sum payment has to be made irrespective of whether such administrative costs have actually been accrued by the landlord.

6.9 Payment of Maintenance and Repair

Generally, the landlord must pay for the maintenance and repair of commonly used areas, provided no other agreement has been made in the lease. In commercial leases, those costs usually must be borne by the tenants in proportion to their leased area and are normally capped at 5–10% of the annual net rent.

6.10 Payment of Utilities and Telecommunications

The Civil Code provides for two ways of regulating such costs: either the actual costs can be allocated to the tenants on an annual basis, or an annual lump sum can be fixed to cover these costs. It is possible for specific utilities to be allocated to the tenant according to the actual consumption, and a lump sum payment agreed for other utilities. The parties can agree that the tenant will enter into direct contracts with the utility provider for specific utilities. Leases generally provide for a monthly utility cost prepayment together with the rent. The actual costs will be settled regularly within 12 months of the end of each rental year.

6.11 Insurance Issues

It is standard market practice for the landlord to procure an all-risk insurance policy for the building, usually covering the risks of fire, storm, hail, water damage and other natural disasters. The incidental insurance premiums are allocated to the tenant as part of the operating costs. The landlord's insurance policies, however, do not cover any personal property of the tenant; therefore the tenant should cover possible damages with liability insurance. Landlords also often take out loss-of-rent insurance and, depending on the location of the property, terror insurance at their own cost.

Tenants are often obliged to conclude a business interruption insurance. However, according to a decision by the Federal Court of Justice (*Bundesgerichtshof*), such insurance does not cover closures of businesses on the basis of the Infection Protection Act (*Infektionsschutzgesetz*) due to COVID-19 as long as COVID-19 is not explicitly mentioned in the insurance policy as relevant illness.

6.12 Restrictions on the Use of Real Estate

The specific use of the real estate is generally agreed between the parties in the lease agreement. Any change of use is usually subject to

approval by the landlord. Public building law and the respective zoning plan also impose what uses are possible, and the building permit for the property is issued for a specific use based on this. If the tenant intends to deviate from the use granted in the building permit, a change-of-use permit must be obtained from the responsible building authority. Such permit might list additional building requirements to be adhered to. The agreement between the parties who bear the related costs and carry out the necessary measures very much depends on the market situation.

Regarding subletting, the landlord may restrict the use to the extent that it is only permitted with the landlord's consent. Furthermore, the landlord generally lays down house rules – ie, general conditions for the use of the property – to avoid conflict between and with the tenants.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant may not cause any damage to the real estate, which might also – from the landlord's point of view – include any alterations or improvement. It is important for the tenant to clear the conditions the landlord has set in the lease agreement before starting to change anything substantially and irreversibly. Any alterations by the tenant are generally subject to the landlord's prior consent.

6.14 Specific Regulations

Besides the Civil Code, there is no special regulation or law regarding the lease itself. However, operation of the tenant's business on the premises may be subject to particular laws and regulations, which might have an impact on specific provisions in the lease. Furthermore, specific laws and regulations can apply to the rent payable by residential tenants and its increase. Regarding commercial tenants, the Federal Court of Justice (*Bundesgerichtshof*) clarified that a COVID-19 pandemic-induced closure of a retail shop does not constitute a defect in the rental object as such. Rather commercial tenants who are directly affected by the government's protective measures to contain the pandemic may, depending on the individual case, claim a disturbance of the contractual basis (*Wegfall der Geschäftsgrundlage*) allowing for adaptation of the lease agreement to the specific new circumstances. This can lead to a reduced rent being payable for the relevant period; however, aspects of the individual case such as actual economic effects of the closure as well as possible state aid must always be taken into consideration so that there can be no generalised approach.

6.15 Effect of the Tenant's Insolvency

A landlord does not have the right to terminate a lease due to a tenant's insolvency. A termination due to rent arrears is only possible before the opening of insolvency procedures over the tenant's assets.

If an insolvency administrator is appointed for the tenant under insolvency legislation, the administrator has an extraordinary termination right regarding the lease. During the insolvency proceedings, any claims the landlord might make against the tenant must be formally filed with the insolvency administrator.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A rent security is usually agreed between the parties. For residential leases, a cash deposit or pledged account is typical, while various other rent securities can be found in commercial leases, particularly bank guarantees or letters

of comfort (*Patronatserklärungen*). For residential leases, German law prohibits a rent security exceeding three months' net rent.

Additionally, the landlord has a lien (*Vermieterpfandrecht*) over the movable assets of the tenant in the leased premises. This lien has priority over contractual liens.

6.17 Right to Occupy After Termination or Expiry of a Lease

The Civil Code gives the tenant the right to occupy the premises even if the contractually agreed fixed term has ended, if the landlord does not object within two weeks after the official termination date. In this case, the lease will continue, and statutory ordinary termination rights (usually between six and nine months) will apply. Parties regularly exclude this provision in lease agreements. Leases do not typically contain any further stipulations to ensure that the tenant leaves on the termination date, as the tenant is obliged to vacate the premises after the lease has ended under statutory law. Therefore the landlord cannot arrange for timely eviction by the tenant in advance but can claim for damages if the tenant does not vacate the property on time.

6.18 Right to Assign a Leasehold Interest

The right to sublet to third parties is commonly accepted, and in the case of residential leases, it cannot be excluded. Subletting is usually subject to the landlord's prior written consent which can only be withheld for good cause. The main tenant remains fully liable for rent payment and compliance with other obligations under the lease agreement vis-à-vis the landlord. It is sometimes agreed that the surplus rent generated in the sublease, or a certain percentage thereof, has to be paid out to the landlord. If VAT is payable in addition to rent, subletting is often permitted only to parties which must pay VAT as well Non-authorised subletting constitutes a serious offence and justifies extraordinary termination of the lease agreement without notice.

For transfer of the entire lease agreement to a third party, an agreement involving the landlord, the existing tenant and the new tenant is necessary. In commercial leases, a transfer without the landlord's involvement is sometimes permitted for affiliated companies.

6.19 Right to Terminate a Lease

Commercial leases are usually agreed for a fixed term and ordinary termination rights are excluded. Sometimes break options towards a predetermined date are granted to the tenant. The Civil Code grants both landlord and tenant extraordinary termination rights if the other party cannot reasonably be expected to continue the lease, considering all circumstances of the individual case.

The tenant may terminate if:

- the property is not handed over on time;
- the tenant is deprived of its use; or
- the landlord has increased the rent.

The landlord may terminate if:

- the tenant violates the rights of the landlord by substantially endangering the property; or
- if the tenant is in significant rent arrears (for two successive due dates or for payments amounting to at least two months' rent).

The Civil Code also grants both parties the right to terminate the agreement 30 years after the start of the lease, with a statutory notice period of six to nine months.

In addition to this, in commercial leases, parties typically agree on further extraordinary termination rights in favour of the landlord, such as unauthorised subletting. If the property is sold due to foreclosure or the insolvency of the owner, the new owner has an extraordinary termination right.

6.20 Registration Requirements

There are no registration requirements for leases and a lease cannot be recorded in the land register. However, form requirements apply. Leases of a fixed term of more than one year need to be in writing, signed by each party, and contain all terms and conditions. If a lease contains a pre-emption right or is part of a sale-and-leaseback transaction, it needs to be notarised.

Tenant easements (*Mieterdienstbarkeiten*) preventing an early termination in case of the landlord's insolvency or a forced auction over the premises, and permanent right of use (*Dauernutzungsrechte*), to which statutory lease law only applies if expressly agreed, must be registered in the land register.

For such registration, an approval certified by a notary is required. Statutory registration fees are applicable. The parties can freely agree who bears these fees and the costs are usually seen in the context of the entire commercial agreement. No matter what the parties decide, vis-à-vis the land registry, the party that files the registration application will be liable for the fees.

6.21 Forced Eviction

A tenant can be forced to leave after a lease agreement is effectively terminated or has expired. If the tenant will not leave voluntarily, the landlord can file for an action for eviction (*Räumungsklage*). If the tenant does not follow the court's order, the landlord can file for a forced eviction (*Zwangsräumung*) with the local authorities. However, due to various regulations protecting the tenant and the inevitable court proceedings, this can be a long process and an average timeframe cannot, therefore, be given. Forced eviction as such is not affected by any COVID-19 legislation and the moratorium affecting concerning certain termination rights expired in the year 2022.

6.22 Termination by a Third Party

If the leased premises are sold due to the landlord's insolvency or due to foreclosure, the buyer of the leased premises has a statutory extraordinary termination right regarding existing leases. In such instances, the tenant generally cannot claim compensation for lost expenditure but may be able to claim against the buyer for unjustified enrichment if the buyer is able to lease the premises to a third party for a higher rent than the rent agreed with the tenant.

Protection against such extraordinary termination right can be granted in the form of a tenant easement, which gives the tenant a right in rem to continue to occupy and use the premises in accordance with all the conditions set forth in the lease agreement, irrespective of the termination. The tenant easement is an encumbrance that needs to be registered in the land register.

6.23 Remedies/Damages for Breach

In case of an extraordinary termination of a lease agreement due to tenant breach, the landlord is entitled to damages in the amount of outstanding rent and ancillary charges less saved expenses until the date of the next ordinarily possible termination. Additional statutory damage claims are not excluded.

As long as the tenant is not a very strong market player or a part of the public sector, the pro-

vision of a rent security is usually agreed in a lease agreement. Standard is an amount of three monthly net rents, but for commercial tenants up to six monthly net rents can be seen, in the form of a cash deposit, pledged account or bank guarantee and less often collateral promise or a parent guarantee.

7. Construction

7.1 Common Structures Used to Price Construction Projects

For construction agreements, two types of prices are usually agreed on: either a unit price (*Einheitspreis*) for partial services or a fixed price (*Pauschalpreis*) for the completion of the entire project. If the parties choose to agree upon a unit price, all individual services provided to complete construction as a whole are listed separately. In this case, the price is not fixed in the beginning but will be calculated depending on the services and units actually delivered for construction. The construction contract, therefore, includes only a cost estimate, which is not final until the final invoice for the work is rendered.

Hourly rate contracts (*Stundenlohnverträge*), cost-plus contracts (*Selbstkostenerstattungsverträge*) and guaranteed maximum-price (GMP) contracts (*garantierter Maximalpreisverträge*) are relatively rare.

7.2 Assigning Responsibility for the Design and Construction of a Project

Often the responsibility is split between a constructor for construction work and an architect for the planning of the project. In this case, the cost of the architect's remuneration is prescribed by law (HOAI, the official scale of fees for services by architects and engineers); for the constructor it is – as usual in German Civil Law – freely negotiable.

The other possibility is to instruct a general contractor for all construction services, including planning tasks. In this case, the HOAI is not applicable, although architect services are included in the general contractor agreement.

7.3 Management of Construction Risk

To manage construction risks on a project, a constructor's all-risk insurance is a general liability insurance normally used to reduce risk. Additionally, the Civil Code offers a liability system, which usually applies to every construction, architectural and engineering contract. Furthermore, it offers a special liability system including a longer limitation period regarding construction contracts, taking the general terms and conditions for building contracts into account. The liability of a contractor is generally not limited. Some contracts provide limitation of liability in the amount of the insurance coverage or to the extent of purpose or gross negligence.

7.4 Management of Schedule-Related Risk

Under the Civil Code, the contractor is liable for construction delays if they are caused negligently or wilfully.

Furthermore, the parties may agree on contractual damages (*Vertragsstrafe*) for the delay of contractually agreed milestones. In this case, the parties agree on a certain amount the contractor has to pay for each day's delay after the breach of a milestone, with a usual maximum cap of 5% of the overall fee. The parties may agree intermediate milestones or the finalisation date of the construction work, which will be subject to liquidated damages. According to High Court judgments, the maximum amount of damage per

day may be 0.25% of the net purchase order for the finalisation of construction work, and 0.15% of the net purchase order for any agreed intermediate milestones. In any case, the liquidation damages must be deducted from any damages for delay of works under the Civil Code.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

A warranty bond of 10% of the net fee is market standard to secure the performance of the contractor's work until completion.

From completion onwards, a warranty bond of 5% of the amount of the final invoice for malperformance within the liability period is market standard.

Generally, warranty bonds are provided as bank guarantees.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors of a construction project (or parts of such) may acquire a right over the property, comparable to a lien, in the form of granting a mortgage on the property to secure the contractor's remuneration (*Sicherungshypothek des Bauunternehmers*). However, this is only applicable if the buyer is also the owner of the relevant property on which the construction work is performed and the work, the value of which is to be secured, has already been performed. In addition, the contractor may claim a lien (*Werkunternehmerpfandrecht*) on movable items the contractor has been instructed to create or modify for the buyer.

Once the contractor's payment claim has been satisfied, it is obliged to approve the deletion of the encumbrance in the land register and to return the movable item to the buyer.

7.7 Requirements Before Use or Inhabitation

For all building projects, the necessary building permits must be obtained before the start of construction work. This includes the official approval of necessary fire safety standards and other technical certificates by the building authority or the responsible engineer. In some, but not all federal states, the building project is formally accepted by the building authority after completion.

In some instances, if the building is intended for a specific commercial or industrial purpose, a business licence must also be issued.

8. Tax

8.1 VAT and Sales Tax

VAT is in principle not applicable to the sale of German real estate. If the property is sold business to business, the seller may waive the VAT exemption, triggering VAT at a rate of 19%. The buyer owes the VAT triggered to the tax authorities (reverse charge). If the buyer intends to use the real estate to render non-VAT-exempt supplies, the VAT triggered may be reclaimed as input VAT; hence no VAT would be payable.

These principles do not apply for operating facilities (*Betriebsvorrichtungen*), the transfer of which is always subject to VAT. Furthermore, no VAT would be triggered if the real estate is transferred by way of a transfer of a going concern (*Geschäftsveräußerung im Ganzen*) which is not subject to VAT by law. A transfer qualifies as a transfer of a going concern, if the buyer continues the VAT-able business rendered by the seller, which typically applies if the buyer continues the existing lease agreements.

8.2 Mitigation of Tax Liability

German tax law does not provide any commonly used methods to mitigate the RETT burden in asset deals. Since the German legislator tightened the rules with effect as of 1 July 2021 (see **2.10 Taxes Applicable to a Transaction**) RETT neutral share deals are significantly more difficult to realise.

8.3 Municipal Taxes

The municipalities charge property tax which is assessed on a value (*Einheitswert*) currently usually below the market value, with the average tax rate varying between 1.3% and 1.5%, depending on the municipality. A new property tax act will enter into force on 1 January 2025 and significantly alter the determination of the assessment base. The federal states may make use of the opening clause allowing them to adopt their own assessment base for property tax; currently, seven federal states (including Baden-Wuerttemberg, Bavaria, Hesse, Hamburg, Saxony, Lower Saxony and Saarland) intend to make use of such clause.

8.4 Income Tax Withholding for Foreign Investors

The municipalities charge property tax which is assessed on a value (*Einheitswert*) currently usually below the market value, with the average tax rate varying between 1.3% and 1.5%, depending on the municipality. A new property tax act will enter into force on 1 January 2025 and significantly alter the determination of the assessment base. The federal states may make use of the opening clause allowing them to adopt their own assessment base for property tax; currently, seven federal states (including Baden-Wuerttemberg, Bavaria, Hesse, Hamburg, Saxony, Lower Saxony and Saarland) intend to make use of such clause. proportion of the lease income, ie, remain below a certain threshold in relation to the rental income, they are not harmful.

Trade tax is (i) levied by municipalities at rates varying between 7% and 17.15%, and (ii) payable by the corporation or partnership which is not deemed to be tax transparent for the purpose of trade tax. Similar principles apply to profits from the sale of real estate.

The sale of interest in a partnership is treated as a (partial) sale of the assets held by the partnership.

Capital gains from the sale of shares in a corporation holding German real estate are subject to German (corporate) income tax if:

- the company is resident in Germany; or
- more than 50% of the value of the shares in such company is based directly or indirectly on German real estate.

However, if the shares are held by a corporation, the German participation exemption regime providing for an effective tax exemption of 100% or 95% might apply.

8.5 Tax Benefits

Buildings are subject to depreciation at an annual rate of usually 2% or 3% on the acquisition costs. However, the Growth Opportunities Act (*Wachstumschancengesetz*) will provide for a degressive depreciation of 5% for the first six years after acquisition/construction of residential buildings whose construction commenced between 1 October 2023 and 30 September 2029. Land and shares are not depreciable. Taxable rental income will be reduced by the costs incurred for rendering the lease (eg, interest, maintenance).

If an investor maintains a permanent establishment in Germany, profits from the sale of real estate allocable to this permanent establishment can be offset by accounting for a reserve that reduces taxable income, subject to specific conditions. This reserve will reduce the acquisition costs of real estate that are acquired in later years. Thus, the built-in gains of the sold real estate are not realised upon the sale of such real estate; hence, the tax on such built-in gains may economically be suspended by transferring the built-in gains to newly acquired real estate.

Tax benefits have recently been introduced regarding photovoltaic facilities. VAT-zero-rating applies to the supply of small photovoltaic facilities for residential buildings. Income from the operation of small photovoltaic facilities will be exempt from income tax.

Trends and Developments

Contributed by:
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Latham & Watkins

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Introduction

Current market situation

As of January 2024, the European Central Bank (ECB) has maintained its key interest rates unchanged, with the primary refinancing rate (ie, the rate at which commercial banks can borrow money from the ECB) set at 4.5% per annum. This decision comes against the backdrop of a medium-term inflation outlook that, while showing signs of a declining trend in underlying inflation, still faces upward pressures, particularly from energy-related sectors. The ECB's steadfast approach reflects its ongoing efforts to dampen demand through tight financing conditions, thereby aiding in the gradual reduction of inflation towards its 2% target.

Europe's biggest real estate market, Germany, showed very little transactional activity in 2023. Brokers' reports show that the total transaction volume in Germany was down by more than 50% compared to the year before, making 2023 the worst investment year since 2011. Demand for office space is still stalling and the occupancy rates, not only in Germany but throughout Europe, are still substantially lower than the pre-pandemic rate of approximately 70%. While the overall vacancy rate has been rising since 2020, it still remains in the single digits for the major German cities, and many market participants expect the vacancy rate to peak in 2024.

The situation has also worsened as the German real estate sector deals with a rising number of insolvencies. This increase has created a critical challenge for everyone involved, from property owners to investors, as they work to find solutions and keep the market stable. The industry is at a turning point, needing strategic decisions to overcome these challenges. The current period marks a crucial effort to solve problems, and the complex situation will create good opportunities for PE funds and other investors to invest, as prices are at a level that could not have been foreseen even a year ago.

Capitalising on these opportunities, however, comes with its own risks. A sound investment requires considering and analysing the nuances of insolvency law-related issues. This article will explore the most critical issues of insolvency law that investors must address in order to structure investments that are not only robust, but also poised to thrive in the post-crisis real estate landscape.

Factors to consider in distressed real estate transactions

Real estate transactions in a distressed situation typically follow a tight timeline due to the financially tense situation of the target/selling entity. An out-of-court solution may be found only if the management of the selling entity (or the sold

entity) is not required to file for insolvency due to illiquidity or over-indebtedness resulting from lack of a (mid-term) going-concern.

As for the transaction structure, each real estate investor should carefully consider and assess whether an asset deal or a share deal is the more favourable option. In a distressed world in particular, investors must weigh potential claw-back risks, which come into play if the relevant seller needs to file for insolvency following the transaction. Claw-back risks – depending on the jurisdiction in which the seller has its centre of main interest (COMI) – exist especially in relation to legal acts (eg, transfer of ownership, all kinds of payments) in the period after a material insolvency occurs, but prior to formal insolvency proceedings. In this context, cross-border transactions imply an increase of complexity since, in particular, local insolvency law regulations differ significantly in different countries, even within the EU. To assess the overall magnitude of potential risks, the financial situation of the potential selling entity also needs to be considered.

Reasons for Deal Structuring

The following section summarises claw-back rights under German law in an insolvency situation, focusing on the various claw-back rights, the legal consequences of a claw-back and the so-called right of choice of the insolvency administrator.

General introduction to claw-back rights under German law

Insolvency law in Germany is based on the principle of equal treatment of creditors. A key tool used to ensure the application of this principle and establish a level playing field between the various creditors is the claw-back right of the insolvency administrator. The German Insolvency Code (InsO) provides an exhaustive number of claw-back rights (Section 129 et seq, InsO). In practice, insolvency administrators examine claw-back rights thoroughly, given that their remuneration depends on the size of the insolvency estate.

Legal consequences of claw-back

The following section focuses on the legal consequences of a successful claw-back by the insolvency administrator. In general, assets received as a result of a void transaction must be returned to the insolvency estate – ie, retransfer of ownership. Therefore, the transfer of ownership claim revives, but:

- is solely an unsecured insolvency claim;
- can be filed only with the insolvency table; and
- is therefore only satisfied on a pro rata basis, like all other unsecured claims.

If the transfer of ownership claim is to be realised, the purchase price might need to be paid again if the settlement of the initial purchase price payment was clawed back by the insolvency administrator as well.

As for the burden of proof, the insolvency administrator shall specify and prove:

- the existence and scope of claw-back rights – ie, the voidable transfer of asset(s) to the creditor;
- any benefits and surrogates; and
- the specific value of the assets.

Overview: grounds for claw-back

The following section serves as an overview of claw-back under German law in an insolvency situation, discusses the general requirement of a creditor disadvantage and focuses on the different grounds for claw-back.

General requirement of creditor disadvantage (Gläubigerbenachteiligung)

An objective creditor disadvantage is required for all grounds of claw-back (eg, the sale of assets under market value or even the mere impairment of access to the asset).

Whether a direct (ie, immediate) creditor disadvantage is required or an indirect one is sufficient depends on the applicable legal provision for claw-backs. If third-party creditors are paid in full, there is no room for a creditor disadvantage (so-called solvent liquidation, see below).

In addition, creditor disadvantage is unlikely if the asset in question is encumbered to the full value. To answer the latter, the actual amount of the secured claims (not the nominal amount of security, in particular land charges), is decisive. The German Federal Court of Justice (BGH) has ruled that creditor disadvantage is impossible to achieve for a property encumbered with a land charge to the full extent of its value.

Congruent coverage (Section 130, InsO)

The most relevant ground for claw-back is so-called congruent coverage (Section 130, InsO). A claw-back risk exists within up to three months before filing for insolvency if, at the time of the relevant legal transaction (ie, the transfer in ownership), the debtor was unable to pay its debt when it was due and the creditor was aware of it at the relevant time – ie, knowledge of non-payment of claims and financial difficulties as a whole.

By law, having knowledge of the underlying circumstances that compellingly indicate insolvency is deemed equivalent to being aware of illiquidity (Section 130 paragraph 2, InsO). This presumption cannot be refuted. Relevant examples of knowledge of such underlying circumstances include knowledge of instalment and deferral requests, mere partial payments or non-compliance with payment commitments.

The calculation of the three-month period begins with the filing for insolvency. If, for example, the filing occurred on 4 March 2024, any transaction up to and including 4 January 2024 falls within this period if the debtor was unable to pay its debt when it was due at the relevant time.

As for the burden of proof, the insolvency administrator must specify and prove the objective and subjective requirements for a claw-back under Section 130, InsO.

Incongruent coverage (Section 131, InsO)

Another possible ground for claw-back is so-called incongruent coverage (Section 131, InsO). A claw-back risk exists within up to three months before filing for insolvency for any act to which the creditor was (i) not entitled, (ii) not in the manner entitled, or (iii) not at the time entitled to a claim – eg, transfer of ownership before obligation to do so, or payment in kind instead of payment in cash.

The further requirements of this provision depend on when the transaction occurs:

- for the month before filing for insolvency, there are no other requirements; but
- for the second and third month before filing, (i) inability to pay its debt when it was due of the debtor, or (ii) knowledge of creditor disadvantage of the creditor at the relevant time, is required.

As for the burden of proof, the insolvency administrator must specify and prove the objective and subjective requirements for a claw-back under Section 131, InsO.

Further grounds for claw-back (Sections 133 and 134, InsO)

Further, but less relevant, grounds for claw-back are covered in Sections 133 and 134 of InsO.

With respect to Section 133 of InsO, a claw-back risk exists for any transaction intended to intentionally harm creditors within up to ten years before filing for insolvency if the creditor knew about the debtor's intent. In the case of congruency (ie, a transaction is fulfilled as contractually agreed), knowledge is irrefutably presumed if creditor knew that debtor was unable to pay its debt when it was due and that the transaction was detrimental to the (other) creditors.

Still, the German Federal Court of Justice recently tightened the requirements for proving the debtor's intent to disadvantage creditors. In practice, proving the debtor's malicious intent is now significantly harder for the insolvency administrator. As an example, the creditor would have to know that the transaction will lead directly to insolvency and the corresponding debtor's intention, given that the seller lacks sufficient funds to continue its business or to be liquidated.

As for Section 134 of InsO, a claw-back risk exists for any gratuitous performance by the debtor within up to four years before filing for insolvency. No gratuitousness exists if (i) the debtor's performance is counterbalanced by a compensatory consideration, and (ii) performance and consideration are interdependent. The objective comparison of the values exchanged generally determines whether adequate consideration exists. Only sale (far) below market value would constitute gratuitous performance.

Right of choice of the insolvency administrator

This section explains the most important grounds for claw-back and their legal consequences, and the so-called right of choice of the insolvency administrator.

With a mutual contract, the insolvency administrator may choose if it wants to fulfil the contract, if the debtor and the other party have not fulfilled the contract at all or in full at the time of commencement of the insolvency proceedings (Section 103, InsO).

If the insolvency administrator refuses performance, damages for non-performance are only unsecured claims in the insolvency.

An exception applies to real estate: If a priority notice of conveyance (*Auflassungsvormerkung*) is registered with the relevant land register, a creditor may demand satisfaction of its claim from the insolvency estate. In such a case, due to the secured position of the creditor, Section 103 of InsO does not apply (Section 106, InsO). Even so, the claw-back of the secured claim or of the priority notice of conveyance is still possible. Mitigation measures are therefore essential.

Potential Third-Party Claims

Third-party claims in a real estate insolvency scenario would likely stem from Section 826 of the German Civil Code (BGB) – ie, the allegation that creditors have been impaired in an unconscionable manner or contrary to public policy (*sittenwidrig*). The investor or the debtor may be liable under Section 826 of the BGB if the sale of the debtor or assets of the debtor was made in such a manner, thereby impairing other creditors.

As an example: Craftsmen have continued to work for the debtor in the belief that the debtor will continue as a going concern because of the sale; they were not informed that a sell-off cannot avoid insolvency and was only temporarily prolonging the debtor's struggle for survival.

That said, Section 826 of the BGB establishes high requirements for liability, as damage to third-party creditors must at least be tolerated by the investor or the debtor, and the other third-party creditors must prove this circumstance.

Risk Mitigation

As shown above, claw-backs by the insolvency administrator and third-party claims pose especially significant risks to a real estate transaction in a distressed scenario. This section discusses general considerations on risk mitigation, explains key mitigation methods, and focuses on the practically relevant concept of fair market value and the liquidation agreement.

General considerations

Typically, risk mitigation can be achieved more easily in real estate transactions compared to corporate transactions, because third-party creditors and their claims as well as cash demand in general are easier to identify. Further, the number of creditors – at least on the PropCo level – is rather limited.

As a starting point, the risk of potential third-party claims must be analysed. Depending on the potential volume of these claims, the investor should assess, based on the information available, whether these claims may be satisfied in full to avoid claw-back risks. If all third-party creditors' claims are satisfied, the seller may be liquidated as a going concern. As a result, the relevant transaction would not impair such creditors.

The solvency of the affected company must be carefully assessed in both a share and asset deal. With a share deal, the solvency of the shareholding entity is primarily relevant since its potential insolvency administrator could claw-back the share deal. On the contrary, with an asset deal, the solvency of the relevant special purpose vehicle (SPV) is primarily relevant since its potential insolvency administrator could claw back the asset purchases.

In addition, the investor should consider whether an agreement with other existing creditors on the distribution of proceeds should be concluded, in particular considering existing collateral and non-secured creditors.

Key mitigation methods

In general, thoughtful timing of the transaction given the tight financial situation of the target is essential to avoid any obligation to file for insolvency. The mitigation of claw-back risks also includes thorough deal structuring and careful contract drafting.

In particular, the following tools can help, depending on the individual case:

- Comprehensive due diligence before the acquisition that is not only limited to the assets, but also considers the financial situation of the selling entity or the SPV (asset versus share deal, see **General considerations** section above).
- Confirmation of a restructuring expert that the solvent liquidation or going concern of the selling entity is highly likely; in a best-case scenario, the investor enters into a liquidation agreement with the selling entity (for more details, see **Liquidation agreement** section below).

- Payment of purchase price only at the time of transfer of ownership (*Zug-um-Zug*) to avoid the right of choice of a potential insolvency administrator (see **Right of choice of the insolvency administrator** section above).
- Registration of a priority notice of conveyance (*Auflassungsvormerkung*) in the relevant land register as early as possible to avoid the right of choice of a potential insolvency administrator (see **Right of choice of the insolvency administrator** section above).
- No payment of the purchase price by the purchaser during the preliminary insolvency proceedings to avoid claw-back pursuant to Section 130 of InsO (see **Congruent coverage (Section 130, InsO)** section above), yet a specific agreement with the insolvency administrator may be found which would protect the purchaser.
- Consideration of a legal expert opinion to limit claw-back risks and liability issues based on wilful misconduct by the investor.

Fair market value (Bargeschäft)

A practical exemption to the claw-back by the insolvency administrator is the concept of fair market value: Cash transactions (*Bargeschäft*, Section 142, InsO) are exempted for an at arms' length direct exchange of goods or services against payment (unless there is an intention to harm creditors). If the assets are sold significantly below book value, a market valuation should be considered to reduce claw-back risks. In a best-case scenario, an auction process should be held, since it is the most secure option to prove a fair market value. That said, off-market opportunities and the generally tight schedule often do not allow for such measures.

A less time-consuming option may be to seek a third-party opinion on the fair market value or that the seller has no reason to file for insolvency (if applicable, when the purchase price has been received).

Still, the agreement on a purchase price below market value is always possible if the target has a going concern or may be liquidated (by paying off all third-party creditors and covering the costs of the liquidation) after receipt of the purchase price. A fair market value is not decisive if filing for insolvency is avoided or is likely to be avoided.

In light of the current market conditions, which are characterised by an exceptional lack of volatility, investors and sellers must exercise increased diligence in their transactions. Recent insolvencies of major market players highlight how rapidly circumstances can change and emphasise the importance of risk mitigation in any investment strategy. By ensuring that the purchase price reflects the fair market value, most of the claw-back risks can be effectively removed. For that reason, investors and sellers must remain cautious as the market environment can shift swiftly, impacting valuations and the feasibility of a transaction. In this context, the allocation of interest rate risks and the potential for upside value sharing in successful outcomes are critical considerations for both buyers and lenders. Buyers may seek to mitigate interest rate risks by negotiating a discount on the upfront purchase price, while lenders must carefully assess the financing environment to determine the viability of their lending terms.

Liquidation agreement

Besides the issue of fair market value, a liquidation agreement may serve as a practically important tool. The liquidation agreement is executed between the investor, the selling entity and potential third-party creditors, and secures the solvent liquidation process of the selling entity.

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The underlying idea behind the agreement is the following: no claw-back and liability risks exist if an insolvency filing is avoided due to the solvent liquidation. As a result, a liquidation agreement could create a more secure foundation for the transaction with regard to insolvency law-related risks.

The investor should also assess whether remaining third-party claims (which are not part of the agreement, if any) are so marginal that the investor is generally willing to pay them off, if necessary, to avoid a filing for insolvency.

That said, even if a liquidation agreement is concluded, the financial situation of the selling entity must be carefully assessed because the purchase price might be insufficient to avoid an insolvency. As a result, even if the investor enters into a liquidation agreement with the selling entity, the second line of defence against potential claw-back risks should be that the solvent liquidation was highly likely according to a third-party expert.

In general, the liquidation process for a German corporation includes the following steps:

- the majority of third-party creditors are paid off as of closing;
- some payments such as public fees – eg, taxes, may follow;
- after settlement of all third-party claims, the shareholders of the relevant corporation pass a resolution on the dissolution of the entity;
- following the full pay-off of creditors and the relevant resolution by shareholders, a one-year waiting period applies to a German stock company or limited liability company; and
- after the lapse of such waiting period, the entity can be deleted from the relevant public register and the liquidation is fully completed.

Conclusion

While the current state of Germany's real estate market provides attractive investment opportunities, investors must proceed with caution. Paying close attention to any potential insolvency law-related risks is crucial, especially when the selling company seems to be facing financial trouble. A key solution to reducing such risks in this market is through due diligence, including a scrutiny of the selling entity's financial situation, and selecting the most favourable deal structure.

GREECE



Trends and Developments

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Sardelas Petsa Law Firm is one of Greece's leading business law firms and has a strong international dimension. It is well known for its specialised professional service in high-profile, cross-border and domestic transactions and commercial disputes. The firm is recognised by international legal directories, and considered by clients and peers alike as a legal practice with both expertise and experience. The firm has one of the broadest ranges of practices among Greek firms and provides comprehensive advice and support to domestic and international businesses, spanning a variety of legal disciplines, including banking, finance, capital markets, energy, M&A, real estate, privatisations and development of public assets, public procurement and litigation. Sardelas Petsa represents and advises a wide range of foreign and Greek clients covering all key sectors, as well as public sector enterprises and entities.

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Real Estate Law in Greece

Main laws that govern real estate

The right to ownership is recognised by the Hellenic Constitution (Article 17 thereof) and protected by the State. The principal law that governs real estate in Greece is the Hellenic Civil Code, Title 3 thereof in particular, under the title Property Law. Specific real estate matters are also dealt with in the Hellenic Code of Civil Procedure, Laws 2308/1995 and 2664/1998, which govern the procedure before the Cadastre Offices, as well as Law 3741/1929, which governs horizontal ownership. There are specific laws governing real estate owned by the Greek Orthodox Church and Greek Orthodox monasteries in Greece. In addition, Law 3986/2011 re-introduced "right over surface" on public estates, which had been abolished by the Civil Code in 1946.

Apart from the above, established case law of the Supreme Court and civil courts is generally considered as judicial precedent, and is frequently cited by lawyers and judges.

International laws relevant to real estate in Greece

Article 24 (1) of Law 1982/1990 stipulates certain provinces and islands as border regions, in which non-EU or a non-European Free Trade Association citizens/legal entities may not obtain property. Nonetheless, the above-mentioned prohibition may be lifted by application to the relevant regional Decentralised Administration Authority, stating the exact purpose of the real estate acquisition. Furthermore, in accordance with Article 28 paragraph 1 of Law 1982/1990, real estate property on private islands can be obtained following authorisation by the Ministry of Defence.

Real Estate Rights

Types of rights over land

The Hellenic Civil Code recognises a restricted number of types of rights over land (numerus clausus of rights in rem), which are stipulated in Article 973 thereof. These rights are:

- ownership (full ownership, bare ownership and usufruct);
- servitude; and
- mortgage and pre-notice of mortgage.

None of the above-mentioned rights is purely contractual between the parties.

Furthermore, pursuant to Article 18 paragraph 1 of Law 3986/2011, a person or a legal entity may construct a building over a plot of land owned by the State and exercise on this building similar rights as those provided by the right of full ownership, without actually owning the plot of land. This right is recognised as "right over surface", amounting to the right of ownership between private parties and is of limited duration.

System of Registration

Rights in land that are mandatorily registered

In Greece, all land is required to be registered at the competent Land Registry or Cadastre Office. Registration of the title deed, as provided for by the Hellenic Civil Code, is compulsory for the establishment, abolishment or transfer of rights in rem over land. In particular, notarial purchase agreements, donations inter vivos, donatios causa mortis, notarial parental donations, inheritance acceptance deeds, surface rights, court decisions that pronounce right in rem, rural expropriation decisions, implementation acts of a town plan, etc, are mandatorily registered at the competent Land Registry or Cadastre Office.

Therefore, ownership of land is based strictly upon the registration of the respective title deed with the competent Land Registry or Cadastre Office, depending on whichever operates in the area where a plot of land is located.

Furthermore, the earlier of two registrations will always rank prior to the subsequent one (first-come, first-served principle).

Rights in land that are not required to be registered

Registration of contractual rights, such as lease agreements, is not required by Greek law. However, for long-term lease agreements with a minimum durations of nine years, the parties may sign a notarial contract, which is subject to registration at the competent Land Registry or Cadastre Office, to ensure the validity of the agreement and enhance protection vis-à-vis a new owner if the land were to be transferred.

Land Registries that operate in Greece

There are several Land Registries or Cadastre Offices in every region. Upon completion of the cadastral survey of all regions in Greece, the system of "Operative Cadastre" will replace the Land Registries. Despite the large number of Land Registries and Cadastre Offices in Greece, there rules and requirements do not differ between them.

Proof of ownership of registered real estate

Certificates of ownership are issued by the competent Land Registry or Cadastre Office. Registration of real estate deeds is also proven by a certified copy of the title deed by the competent Land Registry or Cadastre Office. Besides these, a lawyer has the competency to certify ownership in the context of due diligence in the Land Registries. This attestation by the lawyer has the status of a certificate.

Electronic registration of ownership rights

Electronic completion of transactions relating to registered real estate has recently been made possible to the Cadastre Offices, but not the Land Registries of each region yet. This development was expedited due to COVID-19, resulting in Cadastre Offices providing both digital access for the issuance of certificates of ownership, and for the registration of titles and deeds. Nonetheless, the electronic completion of transactions is not yet applicable to all Cadastre Offices.

It should also be noted in this context that, since 2018, all public auctions are conducted online.

The documents needed for the registration of an ownership right are the application for the registration, a certified copy of the notarial title deed (also accepted as digitally issued or certified), a certified summary of the notarial title deed (both obtained by the notary) and the tax declaration. If the registration takes place at a Cadastre Office, a cadastral diagram extract must also be provided.

Restrictions on public access to the Land Registry

All public books in the Land Registries and the Cadastre Offices are accessible for due diligence by lawyers and other professionals (notary public, court bailiffs and civil engineers). Moreover, the Land Registries and the Cadastre Offices are obliged to provide certified copies of the registered title deeds and certificates of registrations to all applicants. After the digitalisation of the Cadastre Office system, individuals have restricted electronic access to the registry, using their digital tax credentials, albeit only for property registered as belonging to them. Only professionals registered with the digital Cadastre Office system may obtain information on any

registered property other than their own, such as lawyers and notary publics.

Real Estate Market

Involved parties

The parties involved in a real estate transaction, in addition to the buyer and seller and the buyer's finance provider, are as follows:

- The real estate agent, who introduces the interested parties.
- The lawyers, who assist both the seller and the buyer in the due diligence process, the issuing of the documentation needed for the signing of the title deed and the drafting of the title deed.
- The civil engineer, who provides the seller with energy efficiency certification, as well as certification that the property is free from unauthorised constructions and/or usages.
- The competent tax office, where the buyer pays the transfer tax and is provided with the tax declaration.
- The notary, who executes the notarial title deed and checks the validity of the documentation compiled.
- The competent Land Registry or Cadastre Office, where the registration of the notarial title deed takes place for the establishment of the transaction.

Taxation

Transfer tax

Under Greek law, the transfer of real estate is subject to a transfer tax at a rate of 3.09%, calculated based upon the value of land, taking into consideration the highest value between the fair market value and the objective tax value.

The transfer tax is paid just before the buyer signing the notarial title deed, which is then provided with the tax declaration.

However, for certain categories of natural persons, the law provides a tax exemption, under the condition that the property will be strictly used as a first residence.

VAT

Transfer of real estate, taking place for the first time after its construction, is subject to VAT of 24% upon the price of the sale, if the building permit has been issued from 2006 onwards. Application of VAT, however, has been suspended until 31 December 2024. As things stand, from 2025 the government has the option to reduce VAT on real estate from 24% to 13% and even zero VAT from 2025. Due to the suspension of VAT, the issuance of new private building permits has increased, because the suspension is a very important incentive to the construction industry and investors wishing to invest in the Greek real estate market.

Other taxes

A tax on capital gains is imposed on the sale of property that is being sold within five years from its acquisition. The tax is 15% of the gain produced by the sale (difference between the sale price and acquisition price). Application of this tax has, however, been suspended by law until 31 December 2024.

Further tax issues

Before the completion of the transfer, it is advisable for the buyer to be informed of the amount of the property tax that is paid annually for the real estate.

Leases of Business Premises

Main laws that regulate leases of business premises

The main laws regulating leases of business premises in Greece are the Hellenic Civil Code and Presidential Decree 34/1995, as amended

by Laws 3853/2010 and 4242/2014. Relevant legislation also includes Laws 4013/2011 (Article 15), 4373/2016 (Article 69) and 4335/2015 on procedural rules.

Types of business lease

The principal types of business lease include:

- leases for commercial use (business activities);
- leases for professional use (pertaining to liberal professions such as lawyers, language schools, doctors, accountants, notaries and engineers – explicitly covered by Article 2 of Presidential Decree 34/1995); and
- state/public leases (intended to accommodate public authorities and organisations).

Typical provisions for leases of business premises in Greece

Length of term

After the entry into force of Law 4242/2014, the minimum length of a business lease is three years, even when the lease agreement stipulates a shorter term. The parties may, however, agree on a term exceeding the minimum.

Rent increases

The lease agreement normally lays down the terms of any annual rent increase, typically inflation-index linked. In the absence of an explicit agreement, the landlord may claim adjustments by resorting to the competent court or, under certain conditions, to regional committees for the settlement and readjustment of rent.

Tenant's right to sell or sub-lease

The tenant may not under any circumstances sell the leased property. On the other hand, a sub-lease is allowed, unless explicitly prohibited by the lease agreement.

Insurance

Insurance is not compulsory; however, either party may choose to insure the leased premises on the basis of an entrepreneurial decision.

Change of control of the tenant

Change of control of a corporate entity tenant does not in any way affect the lease, nor confer any rights to the landlord.

Transfer of lease as a result of corporate restructuring (eg, merger)

Where the restructured corporate entity continues to exist and operate, corporate restructuring does not affect the lease. Typically, lease agreements reserve a tenant's right to transfer the lease to a restructured corporate entity, while a restructured corporate entity landlord is deemed a successor of the initial landlord by default. However, in the event of the landlord's bankruptcy, the new owner may evict the tenant within two months from the auction of the property

Repairs

The law stipulates that repair of damages due to typical or agreed usage burdens the tenant. All other damages burden the landlord. The lease agreement may stipulate otherwise.

Taxes payable on rent either by the landlord or tenant of a business lease

Landlords are subject to income tax on leases. Tax brackets are:

- 15% for lease income up to EUR12,000;
- 35% for lease income between EUR12,001 and EUR35,000; and
- 45% for lease income over EUR35,000.

Landlords are also subject to a solidarity levy ranging from 2.2% to 10% (depending on the total income) for annual income exceeding

EUR12,000. Where the landlord is a legal person, lease income is treated as income from a business operation and the related expenses are tax deductible, provided they have been included in the company's commercial books. Unless otherwise agreed, tenants are burdened with stamp duty amounting to 3.6% of the monthly lease.

"Green obligations" commonly found in leases

All leases, whether residential or business, require a Building Energy Performance Certificate in order to be lawfully concluded under Law 4122/2013. The serial number of the Certificate must be electronically filed with the tax office, along with the other lease details, enabling the tax platform to automatically verify its authenticity and validity.

Trends regarding working spaces

In the last few years, along with the "sprouting" of Airbnb short-term residential leases, there has been an increase in shared short-term working spaces, mainly office buildings, equipped with standard or more advanced amenities. On the other hand, shared residential spaces with shared facilities, apart from short-term leases, are not common.

Leases of Residential Premises

Main laws that regulate leases of residential premises

The main laws governing residential leases are the Hellenic Civil Code and Law 1703/1987, as amended by Law 2235/1984. There is no difference in the law applicable to cases of multiple occupiers under the same lease agreement.

Typical provisions for a lease of residential premises

Length of term

Residential leases have a three-year minimum term, even when the lease agreement stipulates a shorter term. The parties may, however, agree on a term exceeding the minimum.

Rent increases/controls

The lease agreement normally lays down the terms of any annual rent increase, typically inflation-index linked. In the absence of an explicit agreement, the landlord may claim adjustments by resorting to the competent court or, under certain conditions, to the regional committees for the settlement and readjustment of rent.

Tenant's rights to remain in the premises at the end of term

The tenant is obliged to give up the leased property at the end of the term, without further notice. If the tenant remains in the premises after expiry, continuing to pay the lease and the landlord accepts such payment, the lease is deemed implicitly renewed for an indefinite length of time and can be terminated by either party or by mutual agreement.

Tenant's contributions to property costs (eg, insurance and repair)

The tenant is burdened with utility costs (electricity, water supply, etc). Insurance is not compulsory for either landlord or tenant. Repair of damages due to typical or agreed usage burdens the tenant. All other damages burden the landlord. The lease agreement may stipulate otherwise.

Termination of a residential lease

The landlord may terminate a residential lease due to non-compliance with the terms of the tenancy agreement on the part of the tenant (eg, non-payment). There are two main options for termination: (i) by lawsuit terminating the lease and seeking eviction, and (ii) by extrajudicial notice demanding compliance. In the event of non-compliance, after a 30-day lapse period, a request for an eviction

order may be filed. In both cases, the execution of the decision or order will be performed by a bailiff.

Public Law Permits and Obligations

Main laws governing zoning/permitting and related matters

The main laws governing zoning/permitting and related matters are:

- Law 4067/2012 – New Construction Law;
- Law 1337/1983 – Expansion of Urban Development Plans, Residential Development and Other Provisions;
- Law 4495/2017 – Audit and Protection of Built Environment and Other Provisions;
- Law 2508/1997 – Sustainable Urban Development;
- Law 2742/1999 – Spatial Planning, Sustainable Development and Other Provisions;
- Law 2971/2001 – Shoreline and Coastline Protection and Other Provisions;
- Law 4819/2021 – Integrated Framework for Managing Waste (including from construction);
- Law 4759/2020 – Modernisation of Land Use and Planning Legislation;
- Law 4685/2020 – Modernisation of Environmental Legislation;
- Law 4447/2016 – Spatial Planning/Sustainable Development;
- Law 4014/2011 – Environmental Licensing of Projects; and
- Law 4030/2011 – Building Permits.

The bodies which control land/building use and/or occupation and environmental regulation are the City Planning Service of each municipality, the Forest Registries and several Departments of the Ministry of Environment and Energy. Buyers are advised to consult a civil engineer on matters concerning the use of real estate and environmental issues.

In addition to the above, Law 3028/2002 provides for the protection of antiquities and cultural heritage in general. Protection is focused on the preservation of historical memory for the sake of current and future generations, and on the improvement of the cultural environment. In such cases, several limitations regarding the change of use, renovation and development of a building may be imposed.

Climate Change

Regulatory measures for reducing carbon dioxide emissions

Following a revision of the EU Emissions Trading System (ETS) Directive in 2009, EU ETS operations were, in 2012, centralised in a single EU Registry operated by the European Commission. The Union Registry covers all countries participating in the EU ETS. The Union Registry is an online database that holds accounts for stationary installations (transferred from the National Registries used before 2012) and for aircraft operators (included in the EU ETS since January 2012). The Greek Greenhouse Gas Registry is part of the Union Registry and is managed by the Ministry of Environment and Energy.

Further regulatory measures

The Ministry of Environment and Energy has been running, since 2018, a project known as *Εξοικονομώ Κατ' Οίκον* (Saving At Home), which aims to motivate individuals to renovate their homes, in order to make them more sustainable. The process of the renovation is co-funded by the EU. An extension of the project to include businesses has been announced and is expected to be put into force soon.

HUNGARY



Law and Practice

Contributed by:
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Lakatos, Köves & Partners is an 11-partner firm based in Budapest, with more than 55 lawyers (including tax advisers) and a predominantly international client base. It was Clifford Chance's office in Budapest for many years, but has been independent since 2009. The firm has a unique position as an independent one-country firm focusing on international clients, often together with international law firms. Work ranges from development projects, portfolio management, new acquisitions and disposals by foreign investors to industrial real estate. The firm's finance and tax practices co-operate closely on real estate project financing and work with the corporate and M&A team on real estate-related asset and share deals. Clients include Al Habtoor, Accenture, Allianz, China Investment Co-operation, the European Parliament, Horizon Development/DVM Construction, GLP, GLL Real Estate, Indotek Group, Mars, Marriott Hotels, Mogotel, Soulbrain, Thermo Fisher Scientific, Vodafone and Wizz Air.

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LAKATOS, KÖVES AND PARTNERS
LAW FIRM

1. General

1.1 Main Sources of Law

The foundations of the general protection of real estate rights are provided by the Fundamental Law of Hungary, according to which every person has the right to property. The main source of Hungarian real estate law is Act V of 2013 on the Civil Code.

Real properties are registered in the centrally organised land registry, which is regulated by Act CXLI of 1997 on Real Estate Registration and FVM Decree 109/1999 (XII. 29) on the Implementation of Act CXLI of 1997 on Real Estate Registration. Other legislation relating to real properties includes laws on agricultural land, leases of residential properties, construction of buildings, monument protection, condominiums and taxation.

1.2 Main Market Trends and Deals

The commercial transactional real estate market slowed substantially after the start of the war in Ukraine in 2022, and activity has not returned since then (similar to other CEE countries). The reasons are multiple (country risk, limited exit possibilities from assets, high interest rates, etc), but the most important is the lack of price adjustment compared to Western European markets. It is difficult to determine yields due to the limited number of transparent transactions.

Construction activity reduced substantially after the start of the war in Ukraine due to high prices for raw material and energy, the lack of new state projects in the absence of EU sources and the uncertainties of the commercial transactional real estate market. The war and the corresponding market changes have had a considerable impact on the supply of raw materials (such as steel or petroleum-based materials), transportation and energy, and significantly increased operational costs for construction companies, which started to revise bids and contracts to include escalation or force majeure clauses in order to address the risk of fuel surcharges, labour impacts and supply chain disruptions.

Greenfield investments in industrial properties/new developments remain active due to the entering of Chinese, Korean and Japanese manufacturers in relation to the EV manufacturing/related battery industry. Substantial state subsidies are available to attract such investments.

The office market is still waiting to see how the home office/physical office balance will end up, but managements of tenants are making efforts to drive back their workforce, and the general expectation is that the home office trend has reached a steady level and will not drastically alter office occupation ratios going forward. Office vacancy rates have been increasing; new office stock has come to the market in 2023/24, but there will be a gap due to the limited number of ongoing constructions. ESG requirements are becoming more important for both investors and tenants. New developments obtain the appropriate green certificates, and it remains to be seen how existing office stock owners will address this.

The logistics market has seen substantial growth during and after the COVID years, but speculative land acquisitions and developments only take place if there are committed new tenants.

Although the ratio of home ownership in Hungary is one of the highest (close to 95%), institutional housing properties might become a new asset class because of the so-called “golden visa” programme (a special investment visa requiring investment into real estate funds that also have

a residential portfolio). Housing property prices have been increasing intensely but the buying power of locals has not kept pace, so a wider spread of renting is expected, thereby raising the opportunity for investors to invest in larger residential projects.

The increase in interest rates made bank financing expensive, but banks have not stopped financing (although they are more cautious) and still face the risk of the devaluation of their financed real estate portfolios. To mitigate risks, banks are turning towards alternative projects, such as mixed-use developments (office, retail, hotel, residential within the same building complex) and renewable energy projects (primarily solar parks).

1.3 Proposals for Reform

The most significant reform for real estate is the ongoing renewal of the land registry system. The framework of legislation has been published, and the preparation of the supporting procedural rules and IT background is at an advanced stage. The new land registry system and procedure is expected to be launched in October 2024. The introduction of the new "E-Land Registry System" is expected to create a safer, more transparent and faster system, which will allow automatic decision-making processes in certain cases.

A new Construction Act will become effective in October 2024.

There is a housing development programme in place to promote the renewal of neglected urban rust areas by encouraging development in these areas. Rust projects are classed as "priority investments in the public interest", which speeds up and simplifies the process of obtaining the necessary permits. The Hungarian government continuously determines rust areas, which are mostly (but not exclusively) located in Budapest. In February 2024, a new change of control rule was introduced. Accordingly, if there is a change in the direct or indirect majority ownership of a real property qualifying as a rust area after it was designated as such, then the property in question shall lose its rust area status, which may result in severe fines for the owners.

The Hungarian act regulating ESG requirements came into force on 1 January 2024, setting out ESG reporting obligations for so-called "public interest entities" and certain large companies registered in Hungary; fines for non-compliance with such obligations shall only be due as of 2026.

The "Golden Visa" will be introduced on 1 July 2024, meaning that non-EU and non-EC citizens and their family members may acquire a "guest investor visa" in Hungary for ten years by investing (among others) in bonds issued by certain real estate funds in the amount of EUR250,000 or purchase residential real property in the amount of at least EUR500,000.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights range from full ownership to contractual usage rights. Most property rights can be registered in the land registry. Some rights, such as ownership, are established by registration, whereas others – such as pre-emption rights or options – are valid irrespective thereof.

2.2 Laws Applicable to Transfer of Title

The rules for the transfer of title are contained in the Hungarian Civil Code, the Act on Real Estate

Registration (Act CXLI of 1997) and the law on the implementation of the Act on Real Estate Registration (Act 109 of 1999). Specific rules exist for the transfer of agricultural and forestry lands (Act CXXII of 2013 and Act CCXII of 2013).

2.3 Effecting Lawful and Proper Transfer of Title

Title may be transferred by virtue of law (eg, inheritance), by an agreement (eg, sale and purchase agreement) or by court judgment (eg, litigation by adverse possession).

Owing to the stability of the Hungarian land registry system and the limited opportunities to challenge ownership, purchasers can effectively rely on publicly available land registry data.

Title insurance and W&I insurance products have been recognised more and more in recent years, and are typically used by institutional investors.

After COVID-19, it has become common to sign sale and purchase agreements (and other transaction documents) in front of lawyers via remote signing (Teams, Zoom, etc), without the physical presence of the contracting parties.

2.4 Real Estate Due Diligence

Real estate due diligence involves inspecting publicly available data (eg, land registry) and requesting additional documents available only to the seller (eg, lease agreements).

Due diligence in an asset deal usually covers the following main areas:

- title (including encumbrances and easements);
- permits;
- zoning;
- leasing and operating agreements;
- environmental and real estate-related litigation.

If the transaction is a share deal or if financing is involved, the areas to be reviewed are more extensive (eg, corporate, employment, financing and tax matters).

2.5 Typical Representations and Warranties

Representations and warranties depend on the business practice and strength of the parties. However, certain warranties are generally found in any contract relating to real estate, such as:

- the performance of the agreement is not restricted;
- the seller is the owner of the property;
- the property is free of encumbrance or litigation;
- there are no environmental issues; and
- there are no hidden defects.

In commercial real estate transactions, it is customary for the seller's representations and warranties to expire after a certain period. Fundamental warranties (eg, relating to ownership title) are granted for at least 60 months, while others are usually limited to 24 to 36 months. Sellers usually provide tax-related warranties up to 84 months, including the reviewed tax year.

It is also customary to limit the seller's maximum exposure to warranty liabilities to the amount of the purchase price for fundamental warranties. For other warranties, a cap of 10–30% of the purchase price is usually applied.

In the case of misrepresentation, the buyer may allege a breach of the contract and the Civil Code, and claim damages. Please see **2.3**

Effecting Lawful and Proper Transfer of Title regarding the use of title and W&I insurance.

2.6 Important Areas of Law for Investors

The most important areas of law for investors are property law, construction law, local zoning laws, tax laws and environmental laws. For restrictions on foreign investors, please see **2.11 Legal Restrictions on Foreign Investors**.

2.7 Soil Pollution or Environmental Contamination

In accordance with the "polluter pays" principle, the person causing the environmental damage is liable for such damage. However, the current owner of the property may also be considered responsible for the environmental damage, alongside the person who actually causes the pollution. The owner may excuse itself by naming the person (eg, previous owner, tenant) who actually caused the pollution, but this is difficult to prove.

In order to avoid difficulties of proof, appropriate warranties are necessary, under which the seller declares that, to its knowledge, there are no toxic materials or environmentally hazardous substances, explosives or similar materials on or under the surface of the property. The buyer of the property typically seeks to exclude its liability for pollution that occurred prior to the acquisition.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Local building regulations, including zoning plans, are publicly available from the ordinances of local municipalities. Potential purchasers are expected to check such databases to ensure compatibility with their development plans.

The law allows investors to enter into a town settlement agreement with municipalities, in which the latter can even undertake to change the local building regulation to fit the needs of the project. Such agreements are considered private law/commercial matters and cannot predetermine public law matters such as the approval of building permits, which must comply with construction norms in all cases.

2.9 Condemnation, Expropriation or Compulsory Purchase

Ownership of real estate may be acquired by the state or the local municipality – or by a third party – if it acts in the public interest for the purposes specified by law in exceptional circumstances for public use, against immediate, full and unconditional compensation.

2.10 Taxes Applicable to a Transaction

Transfer Tax

Generally, the sale and purchase of real estate is subject to transfer tax, payable by the purchaser. The general tax rate is 4% on up to HUF1 billion of the market value of the real estate and 2% on the excess. However, the total payable transfer tax is capped at HUF200 million per real estate.

Similarly, transfer tax should be payable by the purchaser of shares in a real estate holding company if said purchaser's ownership ratio reaches 75% of the company's total shares. This threshold includes the shares of related parties and close relatives. The amount of transfer tax should be calculated separately in relation to each real estate asset held by the company. A "real estate holding company" is a company whose total assets in the balance sheet are made up of 75% or more of Hungarian real estate or an entity that owns more than a 75% participation, directly or indirectly, in a company fulfilling such condition.

The cost related to transfer tax is typically not shared between the purchaser and the seller in a transaction, but it is always considered by the parties when the acquisition structure is being set up.

In addition, the transfer of real estate that has been rezoned as incorporated land and the transfer of the shares of a company holding such land are subject to transfer tax, payable by the seller. The rate of transfer tax is 90%, which is levied on the following:

- the difference between the market value of the real estate being sold, at the time of acquisition by the seller, and the market value established for the time of transfer; or
- in the sale of shares of a company holding real estate that has been rezoned as incorporated land, the difference established according to the foregoing in proportion to the ratio in which the shares are sold compared to all shares.

The transfer tax is applicable if the rezoning took place within ten years of the sale (taking into account the predecessor's period of tenure of ownership in certain cases). However, no transfer tax is payable if the real estate was rezoned in the sixth year after the seller's acquisition, nor if it was acquired by inheritance.

A preferential transfer tax rate (flat rate of 2%) can be applied to acquisitions by real estate funds, credit institutions, real estate traders or REITs. However, the HUF200 million cap cannot be applied in these cases.

In a special procedure, the paid transfer tax can be reclaimed from the tax authority in relation to the renovation of a historical building if the National Trust of Monuments for Hungary certifies that the renovation has begun within one year of filing the notice of the title change with the tax authority that imposed the transfer tax and the renovation is finished within five years.

Various exemptions are also available – for example, subject to further conditions, no transfer tax is payable if the transfer takes place between related parties and in cases of a preferred transformation or exchange of shares or transfer of business.

2.11 Legal Restrictions on Foreign Investors

The acquisition of real estate by foreigners (ie, natural or legal persons outside the EU or the European Economic Area (EEA)) is subject to the approval of the competent government office, which is granted if the acquisition of the real property does not constitute harm to local government or other public interests.

Only natural persons may acquire agricultural land; the acquisition of such land by foreigners (who are not citizens of the EU or the EEA) is excluded.

The New Hungarian FDI Regime was introduced to provide "economic protection to Hungarian companies" in connection with COVID-19, focusing on the origin of the investor and the activities of the Hungarian target companies. Foreign investors are investors that are registered outside the EU, EEA or Switzerland, or that are controlled by an entity registered in a country outside of the EU, EEA or Switzerland.

The Hungarian FDI Regime is drafted in a way that covers as many transactions as it reasonably can. The applicable FDI laws are vague and often confusing, which makes it difficult in certain situations to decide whether a transaction is

subject to the mandatory screening. A new rule was introduced in January 2024, entitling the Hungarian State to exercise pre-emption rights in transactions involving solar power plants.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The acquisition of commercial real estate is financed with both debt and equity. Typical debt financing instruments are bank loans. Portfolios are often financed with syndicated loans or bond issues. Intercompany loans are often provided for equity financing purposes. Usually, intercompany loans are expected to be subordinated to external creditors.

3.2 Typical Security Created by Commercial Investors

The typical security package for commercial real estate consists of:

- a registered charge over the property (prohibition on alienation and encumbrance is also usually registered and, depending on their approach to enforcement, lenders often also request a call option right in respect of the property);
- a charge over ownership rights in the property holding company;
- a charge or security assignment of significant receivables (eg, claims under acquisition agreements, lease agreements, insurance);
- full security over bank accounts (usually a bank account charge combined with a security deposit);
- a charge over assets (over specific assets or all unregistered assets of the property holding company); and
- guarantees by sponsors.

Securities and encumbrances should be registered with the appropriate Hungarian registers (eg, land register, company register or security interest register maintained by the Chamber of Hungarian Public Notaries) in order to be effective against third parties.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Lending (and taking security for loans) is a regulated activity if conducted in a "businesslike manner". Lenders holding a licence elsewhere in the EEA can passport such licence into Hungary. As the financial regulatory authority, the Hungarian National Bank holds a public register of financial institutions licensed in – or passported into – Hungary.

No general restrictions apply for granting security over real estate to foreign entities, nor are there any specific restrictions on debt repayment to foreign lenders. However, limitations and restrictions can apply in:

- charges over certain types of land (eg, agricultural land and forests); or
- mortgages over "indispensable" assets owned by companies that are considered to be "strategic" under applicable Hungarian FDI regulations (in which case, notification to and acknowledgement by the competent minister might be required).

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Notarial fees and registration charges are payable in connection with the notarisation and registration of security documents. Fees and taxes are also payable in connection with enforcement procedures.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The legal requirement to provide valid security must be considered on a case-by-case basis.

Generally, managers of an obligor must act with the diligence of a prudent businessperson and in the obligor's best interests. The obligor's articles of incorporation may specifically require the prior approval of the shareholders and/or directors of the obligor for taking a loan and granting valid security. Hungarian law, however, gives a significant degree of protection to lenders contracting in good faith with an obligor's legitimate representatives.

Financial assistance restrictions are limited mainly to public companies.

Cross-collateralisation is generally permitted; see **3.9 Effects of a Borrower Becoming Insolvent**.

Additional restrictions can apply to obligations undertaken or security interests granted by specific types of obligors – eg, individuals, public entities, regulated entities, real estate funds or their subsidiaries.

3.6 Formalities When a Borrower Is in Default

Sophisticated loan and security documents contain detailed procedures that apply in the event of a default.

Hungarian security can typically be enforced in the following ways.

- Out-of-court enforcement, through an out-of-court sale of the secured assets by the security holder in accordance with the security agreement and the provisions of the Hungarian Civil Code. This method of enforcement is available regardless of whether or not the security document is notarised.
- Judicial enforcement by a judicial officer or bailiff on the basis of a court enforcement order. This method is available regardless of whether or not the security document is notarised.
- Summary or "direct" enforcement by a judicial officer or bailiff on the basis of an enforcement order issued by a notary public following a summary enforcement procedure. This method of enforcement is only available if the documentation relied upon has been notarised.

Traditionally, lenders have requested that security documents be notarised in order to benefit from the direct enforcement mechanism, thereby avoiding the need to go to court but still benefiting from the involvement of a judicial enforcement officer. In theory, the notary should issue the direct enforcement order on the basis of a statement by the secured creditor that an amount has fallen due and that the obligor has been requested to pay such amount and has not done so. The enforcement order can then be enforced by a judicial enforcement officer on the same basis as a court order. In practice, however, notaries can be wary of granting such orders, and judicial enforcement officers can be wary of acting on the basis of a direct enforcement order.

The time needed to successfully enforce and realise on real property security depends on various factors, including the co-operation of the debtor, the marketability of the real property, the form of the underlying documentation, or the enforcement principles initially agreed by the parties under the security documents. Summary or "direct" enforcement may take from six

months to one or two years, whereas judicial enforcement may take one to three years or more. Out-of-court sales by the security holder may take between six and 12 months.

The ranking of mortgages over real estate depends on the time of registration (principle of priority). Additional steps to give priority to a lender's mortgage are not required.

The sale of certain property (eg, listed buildings) may be subject to pre-emption rights, including on enforcement.

A special regime was introduced in Hungary as a response to the COVID-19 pandemic, before being reintroduced as a response to the war in Ukraine. Under this regime, certain restrictions were imposed on a lender's ability to foreclose or realise on collateral in real estate lending, including the following.

- If the lender is considered a "foreign investor" (see **2.11 Legal Restrictions on Foreign Investors**) at the time of a potential future enforcement scenario involving the sale/acquisition of property-holding entities considered "strategic" within the meaning of applicable Hungarian FDI regulations, the sale/acquisition is required to be notified and acknowledged by the competent minister.
- Generally, private real estate may not be repossessed between 15 November and 30 April.

3.7 Subordinating Existing Debt to Newly Created Debt

Generally, existing debt can be subordinated to newly created debt by way of an agreement between the relevant creditors and the obligor. In the case of secured debts, the relevant security register must reflect the subordination, which usually requires the co-operation of the lenders and the obligors.

3.8 Lenders' Liability Under Environmental Laws

Generally, the polluter is liable for contamination. If the polluter cannot be identified, there is a residual liability for the owner of the real estate.

Secured creditors holding or enforcing security over real estate cannot be held liable under environmental laws solely owing to their position as beneficiary of the security. In the unlikely event that the secured creditor caused the pollution or acquires the real estate itself in the course of enforcement proceedings, said creditor may incur liability.

3.9 Effects of a Borrower Becoming Insolvent

The creditor and liquidator of an insolvent company can challenge transactions concluded during "suspect periods" leading to the insolvency on the basis that they are:

- fraudulent transactions concluded fewer than five years before the start of insolvency proceedings;
- transactions at an undervalue concluded fewer than three years before the start of insolvency proceedings;
- transactions preferential to a specific creditor (or group of creditors) concluded fewer than 90 days before the start of insolvency proceedings; or
- transactions benefiting a creditor concluded fewer than three years before the start of insolvency proceedings where that creditor has failed to adequately account for any surplus of proceeds received from collateral provided to that creditor.

The liquidator is entitled to terminate contracts concluded by the insolvent company. In this case, the counterparty has 40 days from the date of such termination to register with the liquidator any claim it has against the insolvent company arising out of the termination.

Obligors can seek time-limited protection from the enforcement of security under Hungarian corporate bankruptcy laws.

With limited exceptions, secured assets remain part of the estate of the Hungarian obligor. Upon the insolvency of the Hungarian obligor, such assets will be liquidated by the liquidator as part of the liquidation proceedings (rather than by the secured creditor pursuant to the security) and the proceeds of such liquidation (minus the liquidator's costs) will be distributed to the secured creditors by the liquidator. Any surplus proceeds will then be distributed to the unsecured creditors of the insolvent company in accordance with statutory rules.

3.10 Taxes on Loans

Hungary has implemented the interest limitation rules introduced by the Anti-Tax Avoidance Directive.

Notarial fees and registration charges are payable in connection with the notarisation and registration of security documents. Fees and taxes are also payable in connection with enforcement procedures.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Strategic planning and zoning are regulated by acts of Parliament, government decrees and ordinances of the local municipalities. Government decrees and acts of Parliament provide a general framework and apply on a nationwide level, whereas local ordinances provide more specific rules that apply only to their administrative areas.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design, appearance and method of the construction of buildings and the refurbishment of existing buildings are governed by legislation. The construction process is also regulated by several laws, including Government Decree 191/2009 (IX.15), known as the "Construction Code".

4.3 Regulatory Authorities

The competent building authority is generally responsible for controlling the development process through the issuance of building permits and occupancy permits; however, the consent of several other authorities may be required. National or special agencies deal with projects that require special permitting, such as those involving mining or certain infrastructure.

As of 2022, approval/recommendation by the National Architectural Design Council is required for the architectural plans and technical specifications of the following, among others:

- the State's high-rise construction projects;

- buildings with a total usable area exceeding 5,000 square metres; and
- newly constructed condominium residential buildings consisting of at least six apartments on a plot with a total usable area of more than 1,500 square metres.

The competent land registry is responsible for the qualification of individual parcels of land (such as the qualification of land as agricultural or exempt from agricultural cultivation).

Finally, the local municipality is responsible for determining zoning requirements and the designated use of various zones within its administrative area.

4.4 Obtaining Entitlements to Develop a New Project

Generally, a building permit issued by the competent building authority is required in order to start development of a new project, although not all construction activities are subject to a building permit. The development of special facilities may require additional permits from other authorities. When a project is finished, an occupancy permit is required for the commercial use of the building.

Third parties affected by the project, including owners of neighbouring properties, will typically be involved by the authority in the permit process. They may submit their comments and will usually have the right to appeal against the decision issuing the permit, thus preventing the developer from starting construction or commercial use.

Simplified permitting applies to smaller residential buildings (below 300 square metres).

Agricultural land needs to be exempt from agricultural use in order to be eligible for development. The Hungarian government may facilitate investment by passing a decision listing the exact properties and qualifying them as "targeted investment areas", or by passing a decree and qualifying the investment as strategic from the Hungarian economy's perspective (ie, granting VIP status). Such decree focuses primarily on the investment project rather than only on the lands concerned and can define the scope of matters (eg, environmental, building permission, infrastructural) receiving VIP status, decide on shorter procedural deadlines, and designate certain authorities to be competent with regard to that particular project.

4.5 Right of Appeal Against an Authority's Decision

Decisions by the building authority may usually be appealed before the competent court.

4.6 Agreements With Local or Governmental Authorities

It is specifically permitted by law for developers to enter into development and support agreements with the local municipality, typically providing the framework for co-operation between the parties in order to make the necessary changes to local town planning instruments.

Such agreements must be approved by the general assembly of the municipality.

Similar agreements may also be concluded with utility suppliers, especially in order to reach a certain capacity.

4.7 Enforcement of Restrictions on Development and Designated Use

The competent building authority supervises all construction activities and enforces rules per-

taining to construction. Several other authorities may also be involved, including the heritage protection authority and the environmental authority. Authorities may apply a wide range of measures against unlawful construction, including issuing a notice to comply; if the notice is ignored, they may impose a fine or even suspend the construction until the breach is remedied. Restrictions on designated use may also be enforced by the locally competent land registry, through similar measures.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

All types of entities are available to investors to hold real estate. The most commonly used entities are limited liability companies (*korlátolt felelősségű társaság*, or Kft.), private limited companies (*zártkörűen működő részvénytársaság*, or Zrt.), regulated real estate investment companies (*szabályozott ingatlanbefektetési társaságok*, or SZIT) and real estate investment funds.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Company

The liability of members extends only to the provision of their initial contributions (the amount of each contribution may not be less than HUF100,000). Members shall bear liability for the company's obligations only in very limited cases. The company can be established by a sole member.

Public and Private Limited Company

The shareholders of a public limited company may not be held liable for the company's obligations (with some exceptions). Their obligation to the company extends to the provision of funds covering the nominal value or the accounting par value of shares. Limited companies with shares listed on a stock exchange are called public limited companies, while those with shares not listed on any stock exchange are called private limited companies.

Investment Funds

An investment fund is either an Alternative Investment Fund (AIF) (*alternatív befektetési alap*, or ABA) or UCITS (Undertakings for the Collective Investment in Transferable Securities) fund (*átruházható értékpapírokkal foglalkozó kollektív befektetési vállalkozásokra*, or ÁÉKBV), in accordance with the relevant EU directives and with Act XVI of 2014 on Collective Investment Trusts and Their Managers and on the Amendment of Financial Regulations. An investment fund manager must have initial capital of at least EUR125,000 (or at least EUR300,000 in the case of real estate funds).

Generally, investment funds are exempt from corporate income tax and local business tax.

5.3 REITs

REITs are available in Hungary, but are not commonly used as a high percentage of the shares shall be owned by small investors. Only a public form exists. Exemptions from corporate income tax and local business tax are available.

5.4 Minimum Capital Requirement

The initial capital of limited liability companies may not be less than HUF3 million, while the share capital of private limited companies may not be less than HUF5 million, and the share capital of public limited companies (*nyilvánosan működő részvénytársaság*, or Nyrt.) may not be less than HUF20 million.

An investment fund manager must have initial capital of at least EUR300,000 in the case of real estate funds.

5.5 Applicable Governance Requirements

Limited Liability Company

The supreme body of a limited liability company is the members' meeting. The management of a company is provided for by one or more managing directors. If a company has more than one managing director, said directors may handle management issues as a board or independently, provided that they may raise an objection against the planned or executed actions of any other managing director. Members or founders may provide for the establishment of a supervisory board comprising three natural or legal persons, tasked with supervising management to protect company interests. A supervisory board must be established if the annual average number of full-time employees employed by the company exceeds 200 and the works council did not relinquish employee participation in the supervisory board. In certain cases (depending on the number of employees and net sales of the company), a statutory auditor responsible for carrying out the audits of accounting documents must be appointed.

Public and Private Limited Company

The supreme body of a limited company is the general meeting. Different rules apply to public and private limited companies regarding the convening of and participation in the general meeting. Public limited companies are managed by the board of directors, which comprise at least three natural persons. The board of directors act as an independent body and prepare a report on the management, the financial situation and the business policy of the company at least once every year for the general meeting and at least once every three months for the supervisory board (if any). Public limited companies are required to set up audit committees, and all limited companies must employ an auditor.

Investment Funds

The collective portfolio management activity of investment fund managers is subject to prior authorisation from the National Bank of Hungary. Investment fund managers must have a head office in Hungary and be managed by at least two natural persons under an employment contract.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual entity maintenance and accounting compliance costs are different for each company. Companies are obliged to prepare financial statements for every accounting period, which must be approved by the general meeting and filed with the Registrar of Companies.

Public limited companies and companies keeping double-entry book-keeping are obliged to elect an auditor. However, in the case of private limited companies, the shareholders shall elect an auditor if:

- the average annual net sales of the company exceed HUF300 million; and
- the number of employees is more than 50 on average in the two business years preceding the subject business year.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The most common form of use of real estate for a limited period is a lease or a leasehold. In a lease, the tenant is entitled to use the leased premises, whereas in a leasehold the tenant is also entitled to collect the benefits of the property. Further arrangements include right of use, right of use of a land, right of use for public purposes and usufruct.

6.2 Types of Commercial Leases

There are specific rules for the leasing of residential buildings and premises (with specific rules on properties owned by municipalities). However, the same legislation generally applies to the lease of different types of premises – for example, office spaces, commercial premises, residential buildings or logistics parks.

As of August 2023, if the Hungarian State has a majority stake in a company, the company will require prior approval from the Minister of Public Administration and Development to enter into a lease for any property located in Hungary if the annual gross rent exceeds HUF20 million.

6.3 Regulation of Rents or Lease Terms

The general rules for leases are contained in the Hungarian Civil Code. However, these are not mandatory rules and may be deviated from in the lease, including rent and term.

During COVID-19, specific regulations were enacted – for example, a moratorium restricting the termination of non-residential premises in certain sectors (such as tourism, catering and entertainment). In addition, landlords were not entitled to increase the rent, even if the given lease agreement would have otherwise allowed. However, these regulations and governmental actions ceased to apply from 1 July 2022.

The market reacted to COVID-19 and landlords provided some rent-free periods to tenants that were active in specific sectors significantly affected by COVID-19.

6.4 Typical Terms of a Lease

A lease may be concluded for a definite or an indefinite period. Commercial leases are typically concluded for a definite period, with a term of between five and 15 years. Extension rights are also common – usually for an additional five years. In some cases, a break option is provided, allowing the tenant to unilaterally exit the lease by paying a certain agreed termination fee.

The landlord is usually obliged to maintain and repair the building, its structure and the common areas, while the tenant must maintain and repair the facilities within the leased premises. Rent is usually paid monthly or quarterly in advance.

Hungarian law does not regulate “force majeure”, but epidemics are recognised in Hungarian jurisprudence and are generally considered force majeure events. A force majeure event may have the effect of a so-called “frustration” under the Hungarian Civil Code, provided that it renders the performance of an agreement impossible.

Before COVID-19, leases contained general force majeure rules. Since COVID-19, the parties usually acknowledge that COVID-19 cannot be considered a force majeure event, as they were already aware of its existence during negotiations.

6.5 Rent Variation

Generally, rent will remain the same throughout the term of the lease (unless so-called step rent is agreed). However, indexation is a common practice, allowing landlords to increase rent annually. The most commonly used indices are the Harmonised Indexes of Consumer Prices (HICP) published by Eurostat and the Monetary Union Index of Consumer Prices (MUICP). If rent is determined in HUF, the parties generally use the index published by the Central Statistics Office. A decrease in rent based on indexation is usually excluded.

Landlords often give a three- to six-month rent discount, which in practice means that the tenant is only required to pay 50% (or a certain decreased percentage) of the monthly rent during the discount period. A tenant may no longer be eligible for a rent discount if they are in breach of a material obligation under the lease (for example, if they are in arrears with payment). For retail, turnover rent is common besides or instead of a fixed rent, whereby an agreed base rent is usually topped up with an agreed percentage of the tenant's net turnover.

6.6 Determination of New Rent

Except for indexation, rent can only be changed by the mutual amendment of the lease.

6.7 Payment of VAT

As the main rule, rent for real estate is exempt from VAT, although lessors can opt to apply VAT taxation to the renting of real estate or non-residential real estate in general. The general VAT rate is 27%.

VAT exemption cannot be applied to the renting of places for accommodation purposes or for parking purposes, among others.

6.8 Costs Payable by a Tenant at the Start of a Lease

At the start of the lease, tenants are often obliged to provide security to secure performance of the lease, in the form of a cash deposit, bank guarantee or corporate guarantee. If the costs of fit-out works are to be borne by the tenant (full or partially), the tenant must pay this amount to the landlord in advance, or cover the costs of the fit-out (refurbishment) directly. Tenants are usually requested to take out and maintain throughout the term an all-risk property insurance and liability insurance. Tenants may be requested to provide the landlord with an eviction declaration to be incorporated into a notarial deed at the tenant's cost.

6.9 Payment of Maintenance and Repair

The costs of repair and maintenance of the building, common areas and the leased premises are usually paid by the landlord, but are borne by tenants in the form of service charges. Leases usually include a non-exhaustive list of costs that are to be borne exclusively by the landlord or covered by the service charges.

6.10 Payment of Utilities and Telecommunications

Generally, tenants pay the costs of utilities of the leased premises, either directly to utility providers (on the basis of separate utility agreements) or to the landlord who re-invoices such costs to the tenant. Telecommunication costs and the costs of cleaning the leased premises are borne directly by the tenant.

6.11 Insurance Issues

Generally, tenants should take out all-risk property insurance, for the duration of the lease, against damages and loss in relation to items brought into the leased premises by the tenant, for an amount equivalent to the replacement val-

ue of such items. Tenants must take out liability insurance for personal injury, property damage and economic loss in the amount that is standard for their business. Landlords must maintain all-risk property insurance covering the building and the landlord's property, in addition to maintaining liability insurance.

6.12 Restrictions on the Use of Real Estate

The permitted use of the leased premises is usually agreed in the lease and is subject to the respective zoning, as well as the construction and occupancy permit of the building. Any change to the permitted use is usually subject to the landlord's prior written consent. If the tenant uses the leased premises in a manner contrary to the permitted use, the landlord is usually entitled to terminate the lease.

Hungarian law protects neighbours against disturbances caused by, for example, activities resulting in excessive noise, smell, sound effects or air pollution. In such cases, other tenants may request possession protection from the notary.

6.13 Tenant's Ability to Alter and Improve Real Estate

Tenants' rights to make alterations to the leased premises will depend on the parties' agreement. Usually, such tenant requests must be submitted to the landlord for prior approval. The landlord may grant fit-out or refurbishment-related contribution to the tenant – ie, the works are thus partially covered by the landlord. In some cases, the tenant may change decorative elements not affecting the structure.

6.14 Specific Regulations

Act 1993 of LXXVIII contains specific rules for the leasing of residential buildings and premises. In general, the same legislation applies to the lease of office spaces, commercial premises or logistics parks. The main source of provisions is the lease agreement itself.

6.15 Effect of the Tenant's Insolvency

It is common for the landlord to terminate the lease if liquidation proceedings or involuntary deregistration proceedings are ordered with binding force against the tenant or if the tenant files a request for voluntary winding-up (or even if such procedures are threatened).

Under Hungarian law, liquidators may terminate any contract concluded by the debtor (including leases), except for leases of natural persons related to residential properties. In addition, if a tenant files for bankruptcy, the landlord is prohibited from terminating the lease during the bankruptcy moratorium.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Tenants are generally required to provide landlords with a cash deposit, a bank guarantee or a parent/group company guarantee, or to ensure a suretyship. The amount of security is usually equal to three to 12 months' (gross) rent plus service charges.

In order to satisfy claims of unpaid rent and additional costs, landlords also have statutory lien over tenants' assets located within the leased premises.

It is also common to request a so-called eviction declaration from tenants issued in the form of a notarial deed, under which tenants may be forced to leave the leased premises without a court procedure if the lease agreement terminates for any reason.

6.17 Right to Occupy After Termination or Expiry of a Lease

According to the Hungarian Civil Code, if the tenant continues to use the leased premises after the expiration of the definite term and the landlord does not challenge this, the term of the lease becomes indefinite and may be terminated by ordinary termination. However, this possibility is usually excluded in commercial leases.

If the tenant does not leave the leased premises by the termination date, the landlord is entitled to a so-called usage fee in addition to general compensation claims under the Civil Code. According to the law, the usage fee equals the monthly rent. However, the parties usually stipulate two to three times the amount of the rent in commercial leases. As a final solution, landlords may enforce the eviction declaration provided to them by the tenant.

6.18 Right to Assign a Leasehold Interest

Generally, tenants may sublease or assign the use of the leased premises to a third party with the prior written consent of the landlord. A common exception in commercial leases is subletting to a company that belongs to the tenant's group, in which case notification is sufficient.

6.19 Right to Terminate a Lease

Both tenants and landlords are entitled to terminate the lease in accordance with the general rules of the Civil Code or Act LXXVIII of 1993, or with reference to the reasons contained in the agreement. According to Act LXXVIII of 1993 on the lease and alienation of apartments and premises, the lease agreement ceases:

- if it is terminated by mutual consent;
- if the apartment is destroyed;
- if it is terminated by either party;
- if the tenant dies;
- if the tenant exchanges the apartment for another apartment;
- if the tenant is expelled from Hungary;
- if the tenancy is terminated by a court or other authority; or
- by virtue of law.

In the case of non-residential premises, the lease agreement ceases if the legal person terminates without a legal successor or if the tenant's self-employed activity in the premises has ceased.

It is typical in commercial leases to limit tenants' termination rights. Generally, the tenant is entitled to terminate the lease if it is obstructed or significantly restricted in the proper use of the leased premises for a longer period (45–60 days) and the landlord fails to remedy the defect in due course (30–60 days from the tenant's notification).

Landlords' termination rights are usually broader and can be enacted upon the breach of any material tenant obligation, such as:

- failure to pay rent, service charge or the cost of utilities;
- failure to provide security;
- use of the leased premises contrarily to the permitted use; or
- failure to obtain or maintain licences or insurances.

6.20 Registration Requirements

Hungarian law requires leases to be in writing. Leases cannot be registered with the land registry (contrary to certain other rights of use).

6.21 Forced Eviction

Tenants can be forced to leave without a court procedure if a signed eviction declaration incor-

porated into a notarial deed is available. In the event of default, the notary must attach an enforcement clause to the eviction declaration, on the basis of which the bailiff will force the tenant to leave the property. The enforcement procedure generally takes about six months.

6.22 Termination by a Third Party

According to the Act on Bankruptcy Proceedings and Liquidation Proceedings (Act XLIX of 1991), the liquidator may terminate contracts concluded by the debtor with immediate effect, except for leases of natural persons for residential properties. According to judicial practice, damage claims or compensation due to the termination may not be asserted.

6.23 Remedies/Damages for Breach

In the case of early termination due to the tenant's breach, it is standard that the tenant must pay rent (and service charge) for the remaining term; however, in practice it is rare that landlords request or could enforce such payment for longer than 6–12 months. The actual payment request also depends on the incentives (rent-free period, fit-out contribution, etc). Landlords are interested in re-letting the property as soon as possible at least on the previous rent level, so the tenant is required to cover the period until rent income is ensured from a new tenant, which is primarily covered by the security provided by the tenant at the start of the lease.

Landlords may enforce statutory liens on assets owned by the tenant located within the leased premises, but this is often challenged by the tenant. Landlords may request the issuance of a payment order to the tenant by the notary public – ie, if the tenant fails to dispute the request within the statutory deadline, the landlord's payment request becomes enforceable (if the tenant disputes the payment request, the process may be continued before the civil court). It is also an option to enforce claims by initiating a liquidation procedure against the tenant, but this is not a standard route, as it requires effort from the landlord and the settlement of claims is not ensured.

Please see **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations** regarding security deposits.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Construction contracts typically set out a fixed contract price for the scope of work covered (ie, the contract price is determined before the fulfilment of the work). Unit/itemised prices are also commonly used, which means that the contractor is paid based on the effective fulfilment (ie, the contract price is determined following the fulfilment of the work.

7.2 Assigning Responsibility for the Design and Construction of a Project

If a separate architectural services firm is involved, such firm (designer) will usually be responsible for obtaining the building permit, while the general contractor is responsible for the construction and obtaining the occupancy permit.

Engineering, procurement and construction (EPC) agreements under which the contractor is responsible for both design and construction are also widespread. In the case of EPC agreements, the contractors undertake higher responsibility for budget, milestones/completion deadlines and quality/remedying defects.

Engineering, procurement and construction management (EPCM) agreements are also common, whereby the project manager is responsible for the co-ordination of the entire construction project (often including the design), although the main responsibilities remain with the construction contractor or other (sub)contractors.

7.3 Management of Construction Risk

Limitation of liability clauses, contractual warranties, various forms of insurance, liquidated damages and parent company or bank guarantees covering performance and maintenance periods are commonly used to manage construction risks. In addition to any contractual warranties/guarantees, statutory minimum warranty/guarantee periods apply to different types of built-in materials/superstructures.

7.4 Management of Schedule-Related Risk

The tools most commonly used to manage schedule-related risk are:

- delay penalties (or liquidated damages); and
- withholding certain amounts (from the contract price based on achieving project milestones by the deadline).

These are typically supplemented with a provision that the owner is entitled to claim damages exceeding the amount of the penalty.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Parent company guarantees and bank guarantees are commonly used to guarantee contractors' performance. It is also typical for the contractor to replace the withheld contract price with an equivalent amount of bank guarantee.

A construction trustee regime is applicable above certain construction value thresholds, which aims to ensure due payment within all levels of the construction chain (ie, the owner shall advance the contract price for the respective phases to the trustee, to be released upon certification of due performance).

Another form of security can be a performance warranty, based on which a particular percent (usually 5% or 10%) is withheld from the amount of every contractor's invoice. Such amounts shall be released only if certain requirements are fulfilled by the contractor (eg, the issuance of all required permits).

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors have a statutory lien up to the amount of the outstanding contract price and costs over the assets of the owner that are possessed by the contractor within the scope of the construction agreement. The contractor is not entitled to encumber the property – rather, only the tangible assets of the owner. The lien is removed automatically if the contractor's claims are settled.

7.7 Requirements Before Use or Inhabitation

A structure may only be occupied if the competent authority has issued a final and binding occupancy permit verifying that such structure is suitable for safe and intended use and has been built in line with the building permit.

8. Tax

8.1 VAT and Sales Tax

Generally, the sale and purchase of real estate is VAT exempt. The seller can opt to apply VAT to

the sale and purchase of real estate in general or to non-residential real estate, in which case the sale and purchase would be subject to reverse charge – ie, the purchaser will be responsible for the assessment and payment of VAT.

The VAT exemption does not apply to the transfer of new real estate (ie, real estate that has not been occupied or where fewer than two years have passed since its occupancy or development), nor to building plots. As such, the sale and purchase of such real estate is subject to VAT at the general 27% rate, which must be paid and assessed by the seller.

A preferential 5% VAT rate can be applied to the sale of:

- new residential units in a multi-unit residential building with a total net floor space not exceeding 150 square metres; and
- single-unit residential units with a total net floor space not exceeding 300 square metres.

The preferential VAT rate is expected to be applicable until 31 December 2024. However, if the sale of the new residential unit takes place between 1 January 2025 and 31 December 2028 and the building (or similar relevant) permit has become definitive by 31 December 2024, then the preferential VAT rate can be applied to such sales as well.

The preferential VAT rate will remain applicable with regard to the sale of new residential units in a multi-unit residential building with a total net floor space not exceeding 150 square metres if the building is located in a rust area (as described in **1.3 Proposals for Reform**). Further relief is available to private individuals in the purchase of such residential units in rust areas.

The sale and purchase of a company's shares is VAT exempt.

8.2 Mitigation of Tax Liability

Structuring techniques are available to mitigate transfer tax liability, the applicability of which has been confirmed by the tax authority under specific circumstances.

8.3 Municipal Taxes

Local Real Estate Taxes

Local municipalities can introduce rules for local tax on buildings and building plots in a municipality decree within the limits of the Local Taxes Act.

Real estate tax must be paid semi-annually by the person registered as owner on the first day of the calendar year in which the transaction closes. In practice, the cost of the local business tax is usually divided between the parties on a time-proportioned basis for the year of the transaction.

The maximum rates of local real estate tax in 2023 were:

- approximately EUR5.8 per square metre for buildings and approximately EUR1 per square metre for building plots; or
- 3.6% of the adjusted market value of the building or 3% of the adjusted market value of the building plot, if the local municipality opts to impose the tax in its decree on the value of the real estate instead of its base area.

Local Real Estate Tax Exemption

There are certain tax exemptions (eg, for temporary housing units, building structures used for the disposal of radioactive waste or incorporated land used for agricultural purposes), but

business premises are generally subject to local real estate taxes.

Historical buildings could also be exempt from local real estate tax if they are being renovated – ie, general works and repairs are being performed on the entire historical monument or on its façade and several major structures in order to completely restore the original condition of the building in terms of aesthetic appearance (and at least the original technical fixtures). Tax exemption could be applied for three consecutive years following the date of the building permit or cultural heritage protection permit becoming final. The renovation must be completed within three years; otherwise, the local real estate tax and related interest for the past period shall be due (such amount is secured by a mortgage on the property). The tax exemption must be requested from the tax authority.

In all cases, the respective local municipality's decree should be reviewed for tax exemption and tax rates.

Certain municipalities do not levy real estate taxes.

8.4 Income Tax Withholding for Foreign Investors

No withholding tax is currently applicable in Hungary on dividends, interest or royalties paid to foreign corporate entities. If tax exemption does not apply, 15% withholding tax is payable by foreign private individuals on their income from Hungarian real estate.

Foreign investors' profit (adjusted in accordance with the provisions of the corporate income tax act) from the rental of domestic real estate is subject to 9% corporate income tax. Their revenue from the same activity is subject to 2% local business tax. In addition, the rules of global minimum tax apply for multinational enterprises with revenue above EUR750 million.

Foreign investors can also be subject to corporate income tax on their income from the transfer or withdrawal of a participation in a Hungarian real estate holding company (unless the applicable double tax treaty prohibits the application of such tax by Hungary). A real estate holding company is, generally, a company whose total assets in its balance sheet are comprised of real estate by more than 75% (including the real estate held by related companies and their Hungarian permanent establishments).

8.5 Tax Benefits

The depreciation of assets is generally available for corporate income tax purposes. However, no depreciation may be accounted for in relation to the original cost of land, plots of land (other than those used for mining or the disposal of hazardous waste) or forests, or of the assets that were not activated.

Special tax allowances are available from corporate income tax with regard to the maintenance and renovations of historical buildings, subject to the following further conditions.

- Costs and expenses of the maintenance of historical buildings in the tax year are deductible from the taxable base of corporate income tax (in addition to their counting as expense or cost) up to 50% of the pre-tax profit of a company. Such tax allowance shall not exceed the HUF equivalent of EUR50 million.
- Twice the amount of the costs of the acquired tangible assets relating to the historical buildings and the costs of investment and renovation is deductible from the taxable base of

corporate income tax. Such allowance can be applied – regardless of whether the investment/renovation was put into use – from the tax year of the acquisition or the starting year of the investment until the fifth tax year following the completion of such investment. Such tax allowance shall not exceed the HUF equivalent of EUR100 million per investment project.

INDIA



Law and Practice

Contributed by:
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JSA

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JSA is a national law firm in India with over 350 attorneys operating out of seven offices located in Ahmedabad, Bengaluru, Chennai, Gurugram, Hyderabad, Mumbai and New Delhi. JSA has dedicated teams with extensive expertise in real estate practice across all offices. Clients include Indian and international entities, developers, real estate advisers, banks, non-banking finance companies, funds, real estate investment trusts, high net worth investors, governments, sovereign wealth funds, retailers, hotel owners and operators. JSA advises on legal and regulatory issues for various types of real estate projects, including in relation to the construction and development of hotels, malls, residential and commercial complexes, warehouses, information technology and industrial parks and special economic zones.

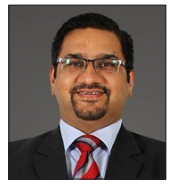
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1. General

1.1 Main Sources of Law

The Indian legal system comprises civil law, customary and personal law, and common law. Real estate transactions are subject to central and state legislation, personal/religious laws, judicial precedents and subordinate legislation (including rules, regulations and by-laws made by local authorities such as municipal corporations, *gram panchayats* and other local administrative bodies). Real estate laws can be categorised as follows:

- laws applicable to the acquisition, transfer and registration of immovable properties, such as the Transfer of Property Act 1882 (TOPA), the Registration Act 1908 (Registration Act), the Real Estate (Regulation and Development) Act 2016 (RERA), the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act 2013, the Benami Transactions (Prohibition) Act 1988, the Indian Stamp Act, 1899, stamp duty legislation enacted by various states, land revenue codes and various other local laws, policies and customs;
- exchange control regulations for foreign investors, such as the Foreign Exchange Management Act, 1999 and the rules and regulations framed thereunder (FEMA), including the Foreign Exchange Management (Non-Debt Instruments) Rules 2019 (Non-Debt Rules) and the Foreign Exchange Management (Debt Instruments) Regulations 2019 (Debt Regulations);
- corporate laws such as the Companies Act 2013 (Companies Act) if any party to the transaction is a company, and the Limited Liability Partnership Act 2008 (LLP Act) if a limited liability partnership firm (LLP) is involved; and
- personal/religious laws that determine title acquired through inheritance or succession.

1.2 Main Market Trends and Deals

The real estate sector has seen more instances of fully developed assets being acquired in "platform" deals, where a developer sells an entire portfolio of assets. Several acquirers are funds looking to acquire and operate fully developed commercial/leasable assets. Investment in debt has continued to decline, including due to corporate restructurings initiated by lenders. Lately, investors have shown significant interest in

logistics and warehousing assets outside Tier-1 cities and in cities developed as "smart cities". The government continues to emphasise the development of infrastructure in Tier-2 and Tier-3 cities, resulting in development and the appreciation of land value in these cities.

There have been several high-value transactions in real estate in the past year, whereby large private equity funds have acquired completed assets and are in the process of moving or have moved such assets into REITs. Leasing documents have become significantly more sophisticated and, in several cases, facilities over 1 million square feet have been taken on lease in single transactions.

Inflation and increases in interest rates may have impacted the residential market, as the cost of acquisition for retail purchasers may have increased, including in smaller cities. Reports indicate that there has been an increase in demand for commercial real estate due to the increased development of global capability centres in India and an increase in work-from-office mandates by companies in India.

Real estate has been revolutionised by the adoption of disruptive technologies, notably blockchain and proptech, the latter of which streamlines and connects the processes for participants in all stages of real estate transactions, including buyers, sellers, brokers, lenders and landlords.

The Andhra Pradesh government has partnered with a Swedish start-up to build its blockchain-based solution. In recent years, NITI Aayog highlighted its efforts towards IndiaChain, a blockchain infrastructure for managing public records and building social applications, which will also be used for maintaining land records. Many state governments are working to integrate blockchain-based ledgers in the digital land record system. Various state governments, such as the Karnataka government, are also implementing measures to digitise records and make the process of land surveys and other procedural aspects (including payment of taxes) easier. Many states have adopted technological solutions to facilitate the payment of registration charges and stamp duties, increasing transparency.

The sector is attracting private credit funds' debt investment where traditional bank financing is unavailable, especially in early stages of development. In addition, family offices in India have become significant investors in real estate and private credit.

A growing trend in the real estate market is the fractional ownership of commercial real estate, allowing retail investors to participate in a high-yield market. According to market data, the market size of fractional ownership properties in India is growing at an annualised rate of 10.5%, and is expected to expand to USD8.9 million in 2025. The Securities and Exchange Board of India (SEBI) amended the SEBI (REIT) Regulations 2014 to introduce a framework for SM REITs on 8 March 2024, to regulate fractional ownership platforms.

1.3 Proposals for Reform

The government has taken steps to ease restrictions applicable to real estate development under FEMA and made certain amendments to the policy applicable to FDI in real estate. While there are currently no significant indications from the government, foreign investors are hopeful that the next progressive step will be to liberalise multi-brand retail trading. The government has announced various initiatives to increase investments in the warehousing and logistics sectors

and to develop sustainable and smart cities, and Tier-2 and Tier-3 cities. The National Logistics Policy and other steps taken to develop the logistics sector in India have yielded positive results, which is expected to result in growth in the real estate sector as well.

2. Sale and Purchase

2.1 Categories of Property Rights

Freehold Rights

Here, a person acquires absolute right, title and interest (including undivided interest) in a property and becomes the sole owner of the property, with unfettered freedom and the right to deal with the property.

Tenancy (Lease) Rights

Here, a person acquires limited interest and rights to a property, with the right to occupy and deal with the property in the manner contractually agreed between parties. Indian law also recognises statutory tenants, who are protected under the applicable rent control statute and can be evicted only on limited grounds. However, most modern developments leased to corporates are not affected by rent control legislation, as corporates do not generally derive protection under it.

Since land is a state subject under entry 18 List II of the State List of the Seventh Schedule to the Indian Constitution, states formulate their own laws for rent and tenancy. Tenancy matters are governed by state-specific statutes, and matters not covered by state legislation are governed by TOPA, which is central legislation.

In addition, the Model Tenancy Act, 2021 aims to increase the efficacy and convenience in regulating the renting of premises in a transparent manner. States are at liberty to adopt this template with necessary changes or to make changes to their existing tenancy and rent laws.

Licences and Easements

Licences are governed under the Indian Easements Act 1882 (Easements Act); easements are also recognised separately. A licensee acquires the permission of the owner to use the property, and use is restricted to contractual terms without de jure possession being granted to the licensee. An easement is a right to compel the owner of another property to allow something to be done or to refrain from doing something on that property, for the benefit of the holder of the easement right.

2.2 Laws Applicable to Transfer of Title

Generally, a person can acquire title to immovable property through:

- an act of the parties, including sale, gift, exchange or lease, governed by TOPA and RERA;
- succession; or
- allotment by government organisations/agencies.

Certain states prohibit companies/firms from purchasing/leasing agricultural land, and prohibit people with income above a certain threshold or who are not already agriculturalists from purchasing agricultural land. Certain states also have land ceiling laws that restrict the acquisition of land beyond specified limits.

2.3 Effecting Lawful and Proper Transfer of Title

Documents governing rights/transfers of immovable property are registered before the jurisdictional Sub-Registrar of Assurances (SRA). Registrations are mandatory for instruments

evidencing a transfer of interest in immovable property of a value more than INR100. Once registered, documents become part of the public record. Such transfers also require the payment of duties (such as stamp duty, registration fee and other cess applicable to each state) and are recorded by the revenue departments, which maintain a separate set of records for each property. Where transfer is effected through succession, revenue records are updated to reflect the inheritance; these become publicly available once recorded.

Insurance companies in India do offer title insurance, although establishing title is often very complicated. Measures are being taken to simplify the manner in which title can be verified, and governments are taking steps to make such records electronic, although it will take some time to do so.

During the early stages of the COVID-19 pandemic, certain state governmental authorities allowed additional time to register documents governing rights/transfers of immovable property. The process of registering documents has now reverted to pre-pandemic methods, and the COVID-19 pandemic and associated lockdowns have had no continued impact.

2.4 Real Estate Due Diligence

Tracing title to property is often complicated, as records are not centrally located and are maintained by different governmental departments. Antecedent documents in each state are often in vernacular languages. Typically, title due diligence is conducted on properties proposed to be purchased for the preceding 30–40 years.

When conducting due diligence, it is not possible to discover all litigation (as the details of litigation are not completely computerised), mortgages by deposit of title deeds and unregistered contracts (which do not require registration under the Registration Act) that have a bearing on the title of the property, so it is important to take detailed representations and warranties. In some states, litigation cases are required to be registered with the SRA in order to become binding or to be considered as constructive notice to a person buying immovable property subject to litigation.

Taking possession of the original title deeds at the time of sale is also extremely important, as they can be used to mortgage/encumber a property. Where the original title deeds are not available, one must ensure there has been no mortgage/encumbrance by deposit of the title deeds by the sellers or their predecessor-in-interest.

Due diligence also sometimes requires the issuing of public notices in local papers, inviting claims in respect of the property and making searches before the court offices. As part of the due diligence on vacant land parcels, it is also advisable for the buyer to conduct a survey of the land to confirm the measurement of the available land.

Some companies offer the use of emerging technologies in title due diligence, but given the difficulties in accurately tracing title the use of such technologies may currently be limited. With increased digitisation of records, the use of such technologies may make the process of title due diligence easier.

2.5 Typical Representations and Warranties

In most transactions, representations and warranties are comprehensive, except where a transfer is on an “as is, where is” basis, and the liability of the seller is limited to the purchase price or a portion thereof. After the COVID-19

pandemic, more comprehensive clauses pertaining to force majeure (pandemic in particular), termination, etc, are being included, but they are often resisted by landlords given the impact of the pandemic on rental income. Landlords typically insist that, where the lessee retains possession of the premises, there should be no provisions for the abatement of rent or other benefits under lease documents.

No warranties are provided under any particular statute, but comprehensive warranties regarding title, zoning and other aspects are generally provided. Customary remedies would be to enforce the indemnity claims through arbitration or litigation, with arbitration being the most preferred means of dispute resolution. Seller title warranties are unlimited in terms of the time period and the amount of damages, as such warranties are considered fundamental. There have been a few instances of late where sellers have asked to limit their liability, but this is not a prevalent practice.

R&W insurance is slowly becoming more popular due to the reduced cost of procuring such insurance; however, please see **2.3 Effecting Lawful and Proper Transfer of Title** regarding title insurance.

2.6 Important Areas of Law for Investors

The most important areas of law for an investor to consider when purchasing real estate are:

- laws applicable to the acquisition, transfer and registration of immovable property;
- Indian exchange control laws for foreign investors;
- corporate laws where the transferor/borrower/landlord/lessee is a company;
- taxation laws; and
- succession and inheritance laws.

2.7 Soil Pollution or Environmental Contamination

The buyer will not be deemed liable for soil pollution or environmental contamination if they can prove that they were not responsible for it. Typically, the buyer is indemnified against any action initiated by the government for the contamination of a property prior to its purchase. Proceedings for environmental contamination are very infrequent, although this may change as environmental issues are attracting more recognition.

Approvals are issued with respect to the property and pass along with the property under the sale transaction to the buyer. Currently, the seller/buyer has no disclosure obligations toward environmental authorities. However, the owner/developer of the property is required to submit periodic reports to the authorities confirming compliance with the terms and conditions of the approvals. The owner must make the necessary applications for the timely renewal of consents obtained from jurisdictional pollution control boards.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The buyer can ascertain the permitted uses of property based on zoning regulations under state-specific town and country planning statutes. To aid the development of strategic areas, government entities may allot land with certain obligations imposed on its development.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Indian Constitution no longer recognises the right to hold property as a fundamental right. However, Article 300(A) was included in the Constitution to affirm that no person would be deprived of their property except by authority of law.

State governments are authorised to acquire land for public purposes. The current land acquisition statute prescribes:

- the payment of compensation of up to four times the market value in rural areas and twice the market value in urban areas;
- safeguards for tribal communities/other disadvantaged groups, compensation for lost livelihood, and caps on the acquisition of multi-crop and agricultural land;
- the return of unutilised land to landowners; and
- the requirement to obtain affected parties' consent for the acquisition of land for companies, except where the acquired land is controlled by the government.

Land parcels acquired by the state governments vest with the state governments free of all encumbrances and any title defects.

2.10 Taxes Applicable to a Transaction

Any transfer of property requires the payment of statutory duties, such as stamp duty and cess and registration fees (which differ from state to state). Where the asset is under construction, GST is also to be paid by the seller. However, GST is an indirect tax, so it can be recovered from the buyer.

In asset transfers, the buyer generally pays the duties, unless they are otherwise agreed to be shared between parties. Most stamp acts provide that, where there is no agreement to the contrary, stamp duty will be paid by the purchaser on sale and by the lessee on lease.

For share transfer transactions, stamp duty at 0.015% of the consideration is payable. Stamp duty on conveyance need not be paid if the property is contributed into a partnership firm. However, in most cases any exit from the partnership by the original contributor will attract the payment of stamp duty as if it is a conveyance.

Exemptions from the payment of stamp duty and certain tax benefits are available to entities operating out of free-trade zones known as "special economic zones".

Generally, capital gains tax would also be payable by the seller on the transfer of property (directly or indirectly). In the case of tax residents of India, the tax rate would range from 20% (plus surcharge and cess) for long-term capital gains to 30% (plus surcharge and cess) for short-term capital gains, depending on the period for which the asset being transferred is held. Unlisted shares or immovable property held for more than 24 months are considered as long-term capital assets, else they are considered short-term capital assets and taxed accordingly.

2.11 Legal Restrictions on Foreign Investors

Persons resident outside India can acquire property or invest in real estate in India only in accordance with FEMA.

While foreign investment into real estate construction and development has been liberalised significantly, certain restrictions remain. An important restriction is that the investment has to be locked in for three years, calculated with reference to each tranche of investment, except in cases where the construction of "trunk infrastructure" is completed. The transfer of a stake from a person resident outside India to another person resident outside India, without repatriation of the foreign investment, is subject to neither lock-in nor government approval. The lock-in is also not applicable to the construction of hotels and tourist resorts, hospitals, special

economic zones, educational institutions and old-age homes.

FDI is permitted in certain completed projects, such as the operation and management of townships, malls/shopping complexes and business centres, with three years' lock-in as mentioned above being applicable to investments in such completed projects. The earning of rent/income on lease of property not amounting to transfer will not be considered as real estate business.

Exchange control laws regulate foreign investments in India by entities in countries that have a land border with India. If the investing/acquiring entity or beneficial owner in an investing/acquiring entity is an entity set up in – or an individual resident in – China, Pakistan, Afghanistan, Nepal, Bhutan, Bangladesh or Myanmar, such investing/acquiring entity would require prior government approval for their proposed investment or purchase of shares (or other equity-linked securities) in an Indian company. "Beneficial ownership" has not been defined, but it is typically pegged to 10% of the shareholding held by the beneficial owner in any investing/acquiring entity. Accordingly, authorised dealer banks (AD Banks) have been authorised by the RBI to secure the necessary declarations from foreign investors certifying that the necessary threshold of beneficial ownership has been complied with. This approval requirement will also be triggered in the event of transfer of ownership of any existing/future FDI in an Indian entity that directly or indirectly results in the beneficial ownership falling within the restriction set out in this paragraph.

Certain additional conditions may apply, especially under any project-specific approvals obtained, lease documents, etc, if, for instance, a foreign entity is investing in, or gaining control over, an Indian investee entity, or if there is any reconstitution of the board of directors of the Indian investee entity, or where the Indian investee entity takes on additional debt and if any charge is created on the project land, pledge of shares, etc. In any change of control, there may be additional compliance requirements, including obtaining pre-facto approvals in connection with the transaction under such project-specific approvals and/or lease documents.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Typical fundraising means for real estate companies include FDI, REITs, alternative investment funds (AIFs) and debt financing, including loans, debt capital markets and external commercial borrowings (ECBs).

FDI

The foreign exchange regime prohibits foreign investment into companies that are engaged purely in "real estate business" – ie, companies dealing in land and immovable property with a view to earning profit therefrom (not including the development of townships, the construction of residential/commercial premises, roads or bridges and REITs regulated under the REIT Regulations). FDI up to 100% is permitted under the automatic route for companies engaged in these sectors, subject to certain limited conditions.

Entities engaged in real estate broking services are also permitted to receive up to 100% FDI under the automatic route. Earning rental income is also not considered real estate business, as mentioned above.

FDI may be through subscription to equity shares/compulsorily convertible instruments, and must comply with pricing guidelines and reporting obligations prescribed by the RBI.

Each phase of a construction development project would be considered as a separate project, so an investor can potentially exit before the completion of an entire project, subject to a lock-in period of three years (see **2.11 Legal Restrictions on Foreign Investors**).

REITs

REITs in India are private trusts set up under the Indian Trusts Act, 1882 and compulsorily registered with SEBI. The set-up of REITs would include the sponsor (who sets up the REIT), the manager (who manages the REIT's assets, investment and operations) and the trustee (a SEBI-registered debenture trustee who is not an associate of the sponsor or manager, and who holds the REIT assets in trust for the benefit of the unitholders/investors). REIT Regulations have been modified to permit REITs to issue debt securities for raising funds, among other things. Furthermore, SEBI has recently amended the REIT Regulations to introduce the concept of SM REITs, with a reduced size of qualifying assets between INR500 million and INR5 billion. This is in contrast to the requirement to have REIT assets with a value of INR5 billion for an initial public offering for non-SM REITs and a minimum initial offering size of INR2.5 billion.

AIFs

AIFs are privately pooled investment vehicles that collect funds from investors (Indian or foreign) for investments, and are regulated by the SEBI (AIFs) Regulations 2012. AIFs must be registered with SEBI, and may invest as private equity or debt funds, or both. The RBI has sought to prevent AIFs from being used by regulated entities (banks and non-banking financial companies (NBFCs)) to evergreen loans, by restricting the ability of AIFs to invest in the securities (other than equity shares) of debtor entities of such regulated entities, if such regulated entities are also limited or general partners in the AIFs. This is the subject of ongoing discussion.

Debt Financing

The most common means of fundraising for real estate developers is by the issuance of non-convertible debentures (NCDs) to NBFCs, banks, financial institutions and other private credit funds. Debt investments by banks are subject to certain prudential norms relating, inter alia, to bank exposure to such investments, as stipulated by the RBI. While previously a preferred means of raising funds, market conditions have affected investments by NBFCs of late. Effective from 1 October 2022, the RBI has stipulated that real estate developers must obtain all the permissions required from the relevant government/other statutory authorities for the project prior to funding by such NBFCs for the development of the real estate project – this has restricted access to funds by the real estate developers in the early stages of the project development from banks and NBFCs. Private credit funds have stepped into this space and typically invest in debt or hybrid securities issued by real estate developers for funding requirements.

ECBs

The RBI has eased the definition of beneficiaries eligible for ECBs to include all entities that can receive FDI. Funds borrowed under ECBs cannot generally be used for real estate activities, except for:

- the construction/development of industrial parks/integrated townships/special economic zones;

- the purchase/long-term leasing of industrial land as part of a new project/modernisation or expansion of existing units; and
- any activity under the "infrastructure sector" definition.

All eligible borrowers are now permitted to raise up to USD750 million or equivalent per financial year under the automatic route.

3.2 Typical Security Created by Commercial Investors

The following types of security are typically created or entered into by commercial real estate investors borrowing funds to acquire or develop real estate:

- mortgages;
- hypothecation or escrow of project receivables and cash flows (subject to compliance with RERA);
- a pledge of shares of the developer company, its parent and/or associate entities; and
- the provision of corporate/personal guarantees, typically created in favour of a security/debenture trustee acting for the lenders' benefit.

To create mortgages, a mortgage deed must be registered with the SRA. Where an equitable mortgage is created by the deposit of title deeds, recording of the deposit of deeds may need to be registered in certain states in India. The security interest created on such assets (tangible/intangible) must be registered with the Registrar of Companies (ROC) and the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), a central database for all security interests created and established to check and identify fraudulent activity in secured loans.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

FDI in Indian companies cannot be secured, and investors must bear the risks typical to equity investments. Accordingly, foreign investors investing under the FDI route are not permitted to have assured returns at the time of exit.

However, investments made in NCDs can be secured, including where issued to permitted foreign investors. Security in such cases is typically created in favour of a trustee. In ECBs, a pledge over shares of an Indian company in favour of a foreign lender requires compliance with the ECB guidelines and the approval of the AD Bank. The creation of a charge over assets situated in India in favour of a foreign lender will be subject to compliance with the Non-Debt Rules and Debt Regulations, and approval from the AD Bank.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Stamp duty is payable on documents, according to the applicable central and state-specific statutes. Insufficiently stamped documents may be impounded and may not be admissible as evidence in Indian courts until the deficient stamp duty (along with any applicable penalties) has been paid. Some documents need to be registered under the Registration Act, with payment of the applicable registration fees. Certain documents, such as powers of attorney, are also required to be notarised and are subject to notarisation fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Certain corporate authorisations are required under the Companies Act, such as board resolutions and shareholder resolutions. Any charge is required to be filed with the ROC and, in the

case of non-compliance, such security interest would be held void against the liquidator and the other creditors of the company in the event of the winding-up of the company, although the obligation for the repayment of money secured by the charge will continue to subsist.

RERA restricts the ability of companies and real estate developers to secure their borrowings.

3.6 Formalities When a Borrower Is in Default

Where the borrower in default is solvent, it is not particularly difficult for a lender to seek to enforce its security pursuant to the provisions of the Insolvency and Bankruptcy Code 2016 (IBC).

Separately, banks and financial institutions that have lent monies to a borrower are entitled to enforce their security interest without the intervention of a court/tribunal, subject to strict compliance with the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act). The SARFAESI Act defines borrowers to mean any person who has been granted financial assistance by any bank or financial institution, or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution, and includes a person who becomes the borrower of an asset reconstruction company consequent to the acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance or who has raised funds through issue of debt securities. However, it should be noted that action under the IBC and the SARFAESI Act cannot be taken simultaneously, since a moratorium is declared upon the admission of an insolvency application under the IBC by a National Company Law Tribunal.

Many lenders are successfully using proceedings under the IBC to enforce their rights under the loan documentation.

3.7 Subordinating Existing Debt to Newly Created Debt

Generally, where the priority of security is not contractually agreed between parties, the security created earlier in time will rank in priority to the security that is created subsequently. A first-ranking charge will have priority over a second-ranking charge at the time of security enforcement. However, it is possible for existing secured debts to become subordinated to new debts when an intercreditor agreement setting out the ranking of debt or a subordination agreement is signed.

In Indian lending transactions, shareholder/promoter loans are typically unsecured and subordinated.

3.8 Lenders' Liability Under Environmental Laws

Lenders will not ordinarily incur liability under Indian environmental laws simply by holding a security interest. If a lender takes over management and control of the borrower after the enforcement of security, such lender may incur liability as the person in possession of the polluting premises, or as a person responsible for the conduct of the borrower's business.

3.9 Effects of a Borrower Becoming Insolvent

The ideal outcome of an insolvency application under the IBC is a successful corporate insolvency resolution process (CIRP), failing which liquidation is commenced. There are also provisions for voluntary liquidation. Where such a debtor goes into liquidation, the IBC provides the manner in which secured debt will be dis-

charged. Typically, dues to workmen (employees whose rights are protected under the Industrial Disputes Act, 1947) are prioritised over dues to lenders who have relinquished their security interest to the liquidation process. Similarly, wages and dues owing to employees (other than workmen) are ranked pari passu with lenders who have relinquished their security to the liquidation estate.

3.10 Taxes on Loans

As noted in **3.2 Typical Security Created by Commercial Investors**, mortgage deeds need to be registered with the SRA in order to be enforceable. All lending documents need to be adequately stamped as per the stamp duty rates applicable in the relevant state in India.

CERSAI is a central registry set up under the SARFAESI Act, where banks and financial institutions subject to the SARFAESI Act are required to file charges subject to a nominal fee. Registration must be done within 30 days from the date of the transaction and is not required if:

- the creditor is not a bank, financial institution or asset reconstruction company, etc, referred to as a "secured creditor" in the SARFAESI Act; or
- the security interest is in the nature of a lien on goods, pledges of movables, etc.

Apart from the above, there are no existing, pending or proposed rules, regulations or requirements mandating the payment of any recording or similar taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Planning authorities are constituted for the implementation and governing of zoning regulations. Considering the changing dynamics of a city, every state facilitates the updating and revising of an existing master plan at least once every ten years, by carrying out a fresh survey of the area within its jurisdiction, to revise the existing master plan and indicate the manner in which the development and improvement of the entire planning area is proposed.

Certain states facilitate the acquisition of lands by government organisations for industrial and residential developments. Developments in such areas are mainly governed by the rules and regulations framed by such government organisations.

Any exception to the zoning regulations will require prior consent from the state government, and the process for obtaining this is time-consuming.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The construction of new buildings and refurbishments in any state is governed by the National Building Code, the applicable town and country planning statute, and the applicable municipal law, including the building by-laws framed by planning authorities. Building and development control regulations require various approvals to be obtained from different authorities for the construction or refurbishment of buildings.

Zoning regulations sometimes have provisions for the protection and preservation of properties identified as heritage properties. Consents from the pollution control board, environmental department, fire department, airport authority, water supply and sewerage board and electricity board are also required.

4.3 Regulatory Authorities

There is no single regulatory authority or statute to govern the entire real estate sector, so the relevant authorities have been covered separately hereinabove.

4.4 Obtaining Entitlements to Develop a New Project

An application must be submitted to the jurisdictional municipal or planning authority along with all relevant title documents, plans/designs/drawings of the development and in-principle approvals from the relevant authorities.

Once it is satisfied that the building will comply with building by-laws once constructed, the municipal/planning authority provides consent. In some jurisdictions, a certificate is also often issued by the municipal/planning authority after the pillars are constructed, confirming that the construction has commenced in compliance with the sanctioned plan.

After completion of the development, the municipal/planning authority also issues a certificate confirming that the building is fit to be occupied. Although minor deviations may be compounded by collecting a fee, major deviations in the development may result in the project not being issued a completion certificate.

4.5 Right of Appeal Against an Authority's Decision

The applicable town and country planning/municipal statutes prescribe the timelines within which planning authorities are required to grant approval or reject plans for the development of buildings.

Where a plan submitted for approval to the authority has been rejected or not expressly approved, the applicant may prefer an appeal to a higher authority, which is required to grant or reject the application within a prescribed time period. Where no response is received, the plan is often deemed to have been approved, although such deemed approval is not preferred and developers still seek to receive written approvals.

In the event of any arbitrary action being initiated by a planning authority, the aggrieved party can approach a High Court, invoking its high prerogative writ jurisdiction.

4.6 Agreements With Local or Governmental Authorities

Government entities enable parties to procure land for the development of strategic projects/areas – whether industrial, commercial or residential – by entering into:

- concession agreements;
- development agreements whereunder the developer is required to develop the property and is entitled to lease/sell built-up spaces in favour of third parties; or
- lease-cum-sale agreements.

The property is conveyed in favour of the allottee only upon compliance with the conditions in the agreements.

Where land is allotted by the government, the process of obtaining approvals for the implementation of the project is generally faster. In some large projects, the developer may be required to lease/relinquish a small portion of the property in favour of the electricity supply company for the setting up of a sub-station to supply power to the development.

4.7 Enforcement of Restrictions on Development and Designated Use

Authorities enforce the regulations and restrictions fairly commonly; if the development is not in compliance with the applicable laws, approvals such as the completion certificate evidencing completion of the project will not be given.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Real estate assets can be owned/held by private limited companies, public limited companies, LLPs and partnerships, as well as REITs.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Private and public limited companies are required to be incorporated under the Companies Act 2013 and to adopt charter documents setting out the objects and regulating the operations of the entity. LLPs are incorporated under the LLP Act 2008. Foreign investment into LLPs engaged in construction development activities requires regulatory approval.

The costs for setting up companies or LLPs in India are about the same, but the cost of operations for a company would likely be higher than the cost of operations for an LLP.

Partnerships can also hold land, but foreign investment in partnerships requires regulatory approval. It is relatively inexpensive to set up and register partnerships but this may not be a preferred structure since the liability of the partners is not limited.

REITs are set up and operated in accordance with the REIT Regulations 2014.

Typically, foreign investors prefer private limited companies, while domestic investors prefer partnerships and LLPs for smaller holdings. LLPs are also increasingly being preferred for smaller ownership of holiday/luxury rental real estate on a time share basis or under similar arrangements amongst partners of LLPs.

Companies are generally subject to corporate income tax at the rates of 22%, 25% or 30% (subject to applicable surcharge and cess), as may be applicable. LLPs are subject to income tax at the rate of 30% (plus applicable surcharge and cess).

REITs are governed by a special income tax regime whereby they are granted limited pass-through status due to which certain income is taxed directly in the hands of the investors. Income in the nature of interest and dividends received from "special purpose vehicles" as well as rental income received from immovable property held directly by the REIT are subject to tax in the hands of the investors of the REITs, subject to conditions prescribed. Any income that has not been accorded pass-through status would be subject to tax in the hands of the REIT and be exempt in the hands of the investors.

5.3 REITs

REITs are permitted to invest in land and any permanently attached improvements to it, whether

leasehold or freehold, including any other assets incidental to the ownership of real estate. However, there have been a limited number of REITs since the introduction of the SEBI REIT Regulations in 2014.

REITs in India are only permitted to be publicly owned – ie, units of the REIT must be listed on stock exchanges. REITs can raise funds through an initial offer to the public and not private placements, and subsequently through follow-on offers, rights issues and qualified institutional placements. REITs are mandated to distribute at least 90% of the net distributable cashflows to investors on a half-yearly basis, and to conduct a full valuation of all REIT assets on a yearly basis through a registered valuer.

The SEBI REIT Regulations do not prohibit investment in units by domestic or foreign investors. While there are regulatory restrictions on direct investment in real estate under the Non-debt Rules, investment in REIT units is exempted from the ambit of this restriction for FDI as well as foreign portfolio investment entities. The benefits of using a REIT include the following:

- unlocking invested capital for developers, especially in the commercial space;
- investors have access to investment opportunities in real estate;
- net worth and deposit requirements prescribed for sponsor and managers ensure that these platforms have sound and stable financial health;
- as regulated entities, these platforms provide more confidence to investors;
- limitations on the number of investors and the creation of SPVs that apply to private limited companies are not applicable to REITs; and
- the mandatory listing of units provides for liquidity and exit opportunity for investors.

Please see **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity** regarding taxation implications for REITs.

5.4 Minimum Capital Requirement

There are no minimum capital requirements for companies, LLPs or partnerships. REITs are required to comply with regulations relating to asset size and minimum offer.

5.5 Applicable Governance Requirements

Private limited companies must have at least two directors on their board, while public limited companies need at least three directors. Public companies also need to comply with additional requirements, such as having independent directors on their board. Companies that have paid-up capital over a prescribed threshold are also required to appoint a company secretary.

One-person companies can be incorporated by Indian citizens who are resident in India. It has been proposed that non-resident Indians should be allowed to incorporate one-person companies.

LLPs and partnerships are required to have at least two designated partners/ partners.

There has been increased attention on compliance with ESG (environment, social and governance) norms in India; although not legally mandated, investors may require companies to undertake certain compliances in this regard. Directors of companies now need to pay heed to environmental issues, and some recent court decisions throw light on such obligations.

5.6 Annual Entity Maintenance and Accounting Compliance

The costs for entity maintenance vary based on the type of entity involved. Annual compliance costs for a private limited company would typically be around GBP15,000, and similar or lower costs can be anticipated for compliance by LLPs.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The law recognises leases and licences that permit a person to occupy and use real estate for a limited period of time without acquiring the absolute title to said real estate. The transaction is a lease if it grants an interest in the premises; it is a licence if it gives a right to a permissive user with no interest in the premises.

6.2 Types of Commercial Leases

The law does not differentiate between different types of commercial leases. Most commercial leases are based on fixed rental and fixed term concepts. There are triple-net leases where the tenant bears the cost of the property tax, insurance and maintenance charges, and profit-sharing leases where the rent is based on a percentage of the lessee's revenue, but these are not as common.

6.3 Regulation of Rents or Lease Terms

Rent or lease terms are freely negotiable in contracts entered into between parties, except in a few states in India where some properties are regulated by rent control statutes and where there are statutory tenants. Rent and lease terms largely depend on the city, the location of the building and the market rents payable for similar buildings. While some state governments proposed that landlords of residential premises should not evict tenants during the COVID-19 pandemic, such restrictions are not generally in force now.

6.4 Typical Terms of a Lease

Duration of Lease Term

There are no regulations governing the term of a lease, which can be contractually agreed and recorded by the parties.

The initial term of a lease is generally three to five years. Tenants can opt for longer leases of ten years. It is common to have an agreement to lease for a longer period (paying nominal stamp duty) and to execute lease deeds thereunder, as such structuring can result in lower stamp duty.

Maintenance and Repair

Maintenance and repair of the actual premises occupied by the tenant are generally the tenant's responsibility. In most cases, major or structural repairs (that are not attributable to the tenant) are excluded from the tenant's scope.

Frequency of Rent Payments

In most commercial leases, rents are payable on a monthly basis in advance. For retail leases (malls, hotels and so on), lease rent or a portion thereof can be based on the turnover of the lessee's revenue at the establishment. Where a furnished space is provided, rent may be payable on the furniture and fittings only until the cost of such furniture and fittings has been fully depreciated.

COVID-19 Issues

Under TOPA, the tenant has the option to terminate the lease if the property is destroyed or becomes unfit for occupation because of fire, tempest, flood, violence by mob or any other

irresistible force. After the COVID-19 pandemic, several tenants were not using the premises due to the lockdown imposed, which resulted in claims for waivers and reductions of rents. In some cases, landlords agreed to such requests. The courts have held that a lease is an executed contract where the landlord has performed its part of the contract once it has delivers possession, and the inability of the tenant to use the property due to the lockdown is a temporary event that will not entitle the tenant to seek the abatement of rent, unless there is a clause in the rent deed that specifically exempts the payment of rent during such time.

6.5 Rent Variation

In a typical commercial lease in India, rent will escalate every three years. The rate of escalation is generally between 10% and 15%.

6.6 Determination of New Rent

The concept of rent review and escalation based on market rent is not common in Indian leases. Where a rent review is agreed to in a long-term lease, an independent expert determines the prevailing market rent. The determination of rent is typically subject to certain exclusions, including disregarding:

- goodwill attached to the premises by reason of the tenant's business or occupation of the premises; and
- the effect of tenant improvements at the premises.

6.7 Payment of VAT

VAT has been subsumed by GST, which is payable on leases of property/assets for commercial use and is borne by the tenant. The tenant can claim input tax credit of such tax paid, subject to conditions. Tax on lease rent is deducted at source in terms of the Income Tax Act 1961 by the tenant prior to paying rent to the landlord.

6.8 Costs Payable by a Tenant at the Start of a Lease

In most commercial leases, a tenant is required to pay the landlord an interest-free refundable security deposit (IFRSD), which is held by the landlord as security for the tenant's obligations during the lease term. The quantum of deposit is commercially agreed but the practice differs from state to state and can vary between three and 12 months' rent.

6.9 Payment of Maintenance and Repair

In addition to rent, tenants usually pay maintenance charges and a fixed parking fee based on the number of parking spaces provided exclusively to the tenant. The landlord generally takes responsibility for the maintenance and repair of the common areas, the cost of which is charged back to tenants on a fixed-cost basis (with an agreed escalation) or on an actual cost-plus basis, with the landlord receiving a management fee of 15–20% of the cost incurred in providing the services.

All such payments (other than municipal taxes borne by the tenant) made to the landlord for use of the property are subject to withholding tax as well as GST. Any IFRSD is subject to the deduction of tax at source as rent.

6.10 Payment of Utilities and Telecommunications

Utilities (including power, back-up power, water, etc) are paid by each tenant of the building based on actuals.

6.11 Insurance Issues

In most instances, the insurance obtained is a fire and perils policy covering loss of property.

The cost of insurance is sometimes charged back to the tenants as part of the maintenance charges.

In India, business interruption (BI) insurance is not sold as a standalone product and is dependent upon property coverage. BI cover in India can be taken as a separate policy only in conjunction with a fire insurance/machinery/boiler explosion policy, or as part of a package in products such as industrial all-risk insurance, which covers both property damage and business interruption. It offers protection to the net profit, standing charges and an increase in the cost of working to maintain normal output/turnover.

The COVID-19 pandemic and consequent lockdown orders did not trigger payments under such BI policies because they have not resulted in physical damage to the insured property of the policyholders.

The Supreme Court of India has consistently held that, when interpreting insurance contracts, the terms of the policy will govern the contract between the parties and it is not for the court to make a new contract, however reasonable, if the parties have not made it themselves. Thus, it is unlikely that courts will interpret BI policies to cover the COVID-19 pandemic or the lockdown, unless such situations are specifically covered by the policy.

6.12 Restrictions on the Use of Real Estate

The usage of a project/building is dependent on the zoning of the land and any conditions running with the land. At times, land is allotted to a landlord for a determined purpose, such as biotechnology or IT-related uses, and the landlord would impose the same restrictions on the tenants. Non-compliance with the usage conditions could result in a termination of the lease.

6.13 Tenant's Ability to Alter and Improve Real Estate

Generally, a tenant is only permitted to perform non-structural alterations at the premises (including fit-outs); structural alterations are only permitted with the landlord's prior consent, which may be conditional. The landlord may also require the tenant to reinstate the premises to the condition they were in prior to the alteration upon the expiry or termination of the lease.

A tenant that takes land on a long-term lease would have the right to develop the land as they require, subject to the applicable law. Upon the expiry or termination of the lease, development on the land would revert to the landlord, at no cost or at an agreed cost, based on the contractual understanding.

Under Indian law, the owner of the land and the owner of the building constructed thereon can be different people. Any gain on a transfer of development rights in a property is subject to tax as income of the landlord. The transfer of development rights to the tenant for developing the land and for commercial exploitation is subject to GST and is taxable in the hands of the tenant (under the "reverse charge mechanism"). GST payable by the tenant is subject to conditions and is calculated in the manner prescribed under law.

6.14 Specific Regulations

Laws relating to leases do not differentiate between residential, industrial, commercial or retail leases, but commercial treatment may differ from market to market.

No asset class distinctions relating to leases have been introduced due to the COVID-19 pandemic.

6.15 Effect of the Tenant's Insolvency

It is market practice to include a termination event in the lease that is triggered by the tenant's insolvency, as the tenant would not be able to comply with its obligations under the lease.

However, where the tenant is under a CIRP process, from the date of the admission of the application by the relevant authority, a moratorium is declared with the effect of, inter alia, prohibiting the recovery of any property by an owner/lessor where such property is occupied by or in possession of the tenant under insolvency.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Payment of IFRSD/premium is the most common security provided to the landlord. At times, the landlord may require the tenant to provide a bank guarantee for securing certain payment obligations.

6.17 Right to Occupy After Termination or Expiry of a Lease

If contractually permitted, the tenant may continue to occupy the premises as a monthly tenant after the expiry/termination of the lease or if the landlord does not refund the IFRSD in time. In all other cases, the tenant would have to leave the premises on the date of the expiry/termination of the lease, failing which the landlord can approach the court to evict the tenant, who will be a trespasser. The landlord can also claim mesne profits from the tenant for such unauthorised occupation.

6.18 Right to Assign a Leasehold Interest

Under TOPA, a lessee may transfer absolutely, or by way of mortgage/sublease, the whole or part of their interest in the property, and any transferee of such interest or part may again transfer it, subject to the lessee not ceasing any of the liabilities attached to the lease and there being no contract to the contrary. In respect of a statutory tenant, state legislation (such as the Maharashtra Rent Control Act 1999) also prescribes restrictions on transfers. The sublessee has to abide by the lease agreement executed between lessor and lessee.

6.19 Right to Terminate a Lease

Events of default and termination rights are contractually agreed between parties, including granting a cure period following such event of default. Such events would be standard events, such as breach of lease terms, failure to pay rent for more than two rent cycles, etc.

6.20 Registration Requirements

Leases of immovable properties from year-to-year or for more than 12 months or reserving a yearly rent require mandatory registration at the SRA. The Registration Act requires the deed to be registered within four months of its execution. An additional four-month extension may be granted at the discretion of the SRA, by levying a penalty, provided such non-presentation of the instrument within four months of execution was due to unavoidable circumstances. After registration, the lease is recorded in the local Registry of Deeds.

Stamp duty is payable on the lease deed before it is registered, by the buyer, unless it is otherwise agreed to be shared between the parties. Most stamp acts provide that, where there is no agreement to the contrary, stamp duty will be

paid by the purchaser on a sale and by the lessee on a lease.

Although licences are not normally required to be registered, it is mandated by certain states (such as Maharashtra under the Maharashtra Rent Control Act).

6.21 Forced Eviction

Where a tenant is in breach of the lease, the landlord would have to follow the procedure set out in the lease deed to evict the tenant, including giving the tenant an opportunity to cure the default. Thereafter, the landlord can issue a notice of termination and initiate legal action to recover the premises (and mesne profits) where the tenant remains in occupation. Where termination is during the lock-in period, the landlord may seek lease rent for the balance of the lock-in period. The process of tenant eviction may take three to seven years.

6.22 Termination by a Third Party

A third party cannot terminate a lease unless contractually agreed. If a condemnation event by a government body occurs, the lease will stand terminated as the property will vest with the governmental authority concerned. Compensation for such acquisition is typically paid to the owner of the property, unless the sharing of compensation is contractually agreed between the owner and the lessee.

6.23 Remedies/Damages for Breach

Such remedies are typically limited to the ability of the landlord to claim remaining rent and mesne profits. Such claims are also subject to limitation laws; claims may be made within three years of the breach pursuant to which the claim has arisen. In India, only direct damages can be claimed, unless a party has undertaken to indemnify the counterparty for any specific kinds of losses. Typically, landlords collect IFRSD and may take bank guarantees to ensure they have adequate remedies in case of a tenant's breach. Landlords may also pursue arbitration or court proceedings, depending on the terms of the lease deed.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Construction contracts are typically categorised as lump-sum turnkey fixed-price contracts, bill of quantities-based contracts (item-rate contracts), and work package-based contracts.

For projects where a detailed bill of quantities is possible, owners opt for an item-rate contract. For large infrastructure construction projects, lump-sum turnkey contracts and work package-based contracts are common.

Regardless of pricing structure, construction contracts incorporate detailed clauses to address eventualities that may affect completion time and contract price, including change in law, force majeure, change in scope/variation and suspension. Contracts typically provide for mechanisms to adjust the contract price upon the occurrence of such eventualities. Contractually agreed price escalation clauses with thresholds are also negotiated – eg, escalation on account of a change in the price of a specified raw material.

7.2 Assigning Responsibility for the Design and Construction of a Project

Split structures and design-and-build structures are commonly used for risk allocation and rewards for construction projects.

A split structure (whereby owners appoint an architect for design and a separate contractor for construction) is prevalent for the construction of real estate or manufacturing units. Under this arrangement, the owner bears the sole responsibility for design risks, while the contractor is responsible for executing the construction. Contractors may seek to shift responsibility for construction failures onto design issues, leading to counterclaims.

For design-and-build structures, the owner enters into a lump-sum turnkey contract with a qualified entity responsible for the entire project. Owners have a right to review and certify the contractor's compliance. Contractors are often responsible even after completion, during an agreed defects liability period.

7.3 Management of Construction Risk

Warranties as to quality and workmanship, structural stability, fit-for-purpose warranties, adherence to applicable laws, technical specifications and adherence to prudent industry practice are undertaken by contractors, subject to normal wear and tear, with industry-specific and technical exceptions.

Contractors may be required to provide the owner with a corporate guarantee or a fund-based performance guarantee. The retention of payments is also common, and such guarantee/retention amount is released after completion of the defect liability period.

Indemnity for claims due to breach of contract/law, bodily injury, death, loss of property, gross negligence, wilful misconduct or fraud are prevalent in construction contracts. The overall limitation of liability typically varies between 50% and 100% of the contract price.

Contractors are also required to obtain and maintain adequate insurance, including contractor's all-risk insurance, third-party liability insurance and workman insurance.

7.4 Management of Schedule-Related Risk

Time is of the essence in construction contacts, with fixed project schedules for key milestones and a target completion date. The project schedule is typically subject to the extension of time clauses, which are contractually agreed. To ensure compliance with a time schedule, the owner may require the contractor to furnish a corporate or fund-based performance guarantee. The retention of payments is also common.

The owner may have the contract performed through a third party in case of non-performance by the contractor, at the contractor's cost, pursuant to the Specific Relief (Amendment) Act 2018.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Corporate guarantees, performance bank guarantees and retention payments are typically sought from contractors to ensure performance. However, in cases where there is a perceived risk regarding the financial standing of the contractor, the owner may negotiate additional security, such as letters of credit, parent guarantees, performance bonds, escrow accounts or third-party sureties. Such additional security is typically required in large infrastructure projects developed under a PPP model.

It is also common to penalise delays in performance of work by requiring the contractor to pay damages, or by prescribing liquidated damages.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors/designers do not typically have a lien or encumbrance on a property in the event of non-payment. In most contracts, a delay in payment attracts penal interest. Furthermore, non-payment beyond a certain threshold of time constitutes an event of default by the owner, leading to the suspension of works and termination. The contract usually provides for a mechanism to address disputed payments, failing which dispute resolution may be invoked by the disputing party. However, in procurement contracts involving the sale of goods, an unpaid seller has a lien under Indian law, on the undelivered goods. Once delivered, the unpaid seller has the right to sue for the price of such goods.

7.7 Requirements Before Use or Inhabitation

In most states, a building comprising more than a prescribed number of floors can only be occupied after an occupancy certificate has been obtained from the relevant planning authority.

8. Tax

8.1 VAT and Sales Tax

VAT has been subsumed by GST, which is payable on the leasing, licensing or transfer of development rights of land (at 18%), and on the transfer of property that is under construction. The leasing of residential apartments for residential use is exempt from GST.

GST on the transfer of property that is under construction varies, as follows:

- 1% on affordable residential apartments;
- 5% on residential apartments (other than affordable residential apartments); and
- 5% or 12% on commercial apartments, depending on the type of project, with restrictions on the availability of input tax credit.

GST is not applied on the sale of constructed property. The tax burden can be passed onto the buyer commercially.

8.2 Mitigation of Tax Liability

In certain circumstances/structures, stamp duty on the transfer of immovable property can be lower than the typical stamp duty rates for conveyance – eg, where property is contributed by a partner into a partnership firm. However, such structures have to be analysed individually.

8.3 Municipal Taxes

Municipal taxes are calculated based on the location, size, age and occupation of the property (self-occupied/tenanted). Sometimes, taxes are based on rents received. There are no exemptions against the payment of property taxes, except for properties used for charitable purposes/religious institutions.

8.4 Income Tax Withholding for Foreign Investors

Tax consequences in India follow the residential status of the income-earning person. Residential status is determined for every tax period (ie, April 1 to March 31 financial year).

Deemed Resident (Individuals)

An Indian citizen having India-sourced taxable income exceeding INR1.5 million during the tax year will be deemed to be India-resident if they are not liable to tax in any other country by reason of domicile/residence/other similar criteria.

A company is regarded as non-India-resident if it is a foreign company incorporated outside India

and its place of effective management is not in India.

Any income of a non-resident from property situated in India is subject to tax in India, and withholding tax applies.

A foreign company's income is usually taxed at 40% (plus applicable surcharge and cess). However, gains on the sale of real estate held as investment are taxed at 20% (plus applicable surcharge and cess) or 40% (plus applicable surcharge and cess), depending on the period of holding. Outward remittance by non-residents is guided by FEMA. Where the payment of consideration for the purchase of property is from a person resident in India, such payment is also subject to withholding tax at 1%, subject to certain thresholds.

Where consideration received on the transfer of an immovable property (whether capital asset or business asset) is less than 90% of the value of the property for the purpose of the payment of stamp duty as per local laws, the value of the property for the payment of stamp duty is deemed as consideration received for the levy of income tax. Similarly, where the consideration paid for the acquisition of immovable property is less than 90% of the property value for the payment of stamp duty as per local laws, the difference between the value of the property for the payment of stamp duty and the consideration discharged is taxed as income of the purchaser, at the applicable rates.

Tax on non-resident taxpayers may, however, be reduced if favourable tax treaty provisions apply.

Rental income also qualifies for the following deductions/rebates:

- a deduction of 30% of rental income (allowance towards repairs and maintenance);
- property taxes paid to the local authority; and
- interest paid on loans used to purchase the property.

However, the set-off of loss arising from interest paid in excess of rental income is subject to certain limitations.

Structured Real Estate Transactions

Gains (long-term) arising on the sale of shares of an Indian company holding real estate assets are generally taxable at 10% (plus applicable surcharge and cess) where the seller is a non-resident or foreign company.

Indian tax laws require the transfer of shares to take place at a fair market value, calculated in a prescribed manner.

It is mandatory for parties entering into a purchase or sale of immovable property to obtain and quote their Permanent Account Number (PAN) allotted by the Indian tax authorities on the conveyance document.

8.5 Tax Benefits

Depreciation/other business expenses may be claimed as deductions only if the taxpayer is in the business of commercially letting out properties, or where plant and machinery inseparable from the property are let out with the property.

INDONESIA



Law and Practice

Contributed by:
Yogi Sudrajat Marsono, Heru Pamungkas, Agnes Maria Wardhana and Andin Aditya Rahman
Assegaf Hamzah & Partners

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Assegaf Hamzah & Partners (AHP) is a full-service firm and one of the largest law firms in Indonesia, based in Jakarta and Surabaya. The real estate group stands out as a prominent presence in the Indonesian real estate sector, leveraging a profound understanding of local laws, regulations and market dynamics to offer comprehensive legal solutions to both domestic and international clients involved in various real estate transactions. Expertise encompasses a wide array of real estate matters, including acquisitions, investments, disposals, leasing, development projects, joint ventures and financing, spanning the residential, commercial, industrial and hospitality sectors. Work ranges from advisory, regulatory compliance audits, due diligence exercises and the preparation of transaction documents up to assisting in real estate-related disputes in courts and arbitrations. As part of the Rajah & Tann Asia network, the firm is supported by experts and legal resources in nine Asian jurisdictions, all with extensive knowledge of their own domestic commercial and legal landscapes.

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1. General

1.1 Main Sources of Law

The fundamental basis for property law stems from Law No 5 of 1960 on Basic Agrarian Principles ("Agrarian Law"). The Agrarian Law is detailed and enforced through the following supplementary regulations, among others (together, "Land Regulations"):

- Government Regulation No 24 of 1997 on Land Registration;
- Government Regulation No 18 of 2021 on Management Rights, Land Rights, Apartment Units and Land Registration;
- Minister of Agrarian Affairs and Spatial Planning/National Land Agency (MOA) Regulation No 3 of 1997 on the Implementation Provisions of Government Regulation No 24 of 1997 on Land Registration, most recently amended by MOA Regulation No 16 of 2021; and
- MOA Regulation No 18 of 2021 on the Procedures for Determining Management Rights and Land Rights.

Other notable regulations include the following, all of which were most recently amended by Law No 6 of 2023 on the Enactment of the Government Regulation in Lieu of Law No 2 of 2022 on Job Creation ("Job Creation Law"):

- Law No 26 of 2007 on Spatial Planning ("Spatial Planning Law");
- Law No 28 of 2002 on Building ("Building Law");
- Law No 20 of 2011 on Apartments ("Apartment Law"); and
- Law No 1 of 2011 on Housing and Settlements.

Private or contractual agreements, excluding land-related aspects, are governed by the Indonesian Civil Code.

1.2 Main Market Trends and Deals

Based on publicly available information, the main trends in the real estate sector include the following.

- Industrial property investment in industrial estates and special economic zones (SEZs) is trending, driven by government tax and customs incentives and improved infrastructure, such as enhanced port access and toll roads. As the current government is prioritising the development of regions outside of Java and relocating the capital to Nusantara, East Kalimantan, property transactions in the new capital are on the rise.
- Commercial property transactions, such as office building acquisitions, remain stagnant, and there is a growing preference for lease arrangements for virtual offices and co-working spaces.
- Residential property ownership is on trend, especially with the current tax incentives for purchasing new homes or apartments under IDR5 billion (about USD320,000) as part of the government's efforts to raise the economy post-pandemic.

Specifically for Jakarta, the development of mass transportation infrastructure, such as the Jakarta MRT phases 1 and 2, Jakarta LRT and Jakarta-Bandung high-speed train, has led to the expansion of residential neighbourhoods, hotels, apartments, malls and shopping centres.

1.3 Proposals for Reform

Since the implementation of the Job Creation Law, the government has focused on digitising licensing procedures through the Online Single

Submission (OSS) system, administered by the Ministry of Investment. This system integrates with other government institutions and provides a centralised spatial planning map accessible to the public. Efforts are also underway to centralise building-related licences through the Ministry of Public Housing's online platform.

Although digitalisation of land documents like titles and mortgage deeds is progressing, challenges such as overlapping claims and unregistered lands persist. Therefore, physical land certificates are still used for property transactions.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights can be acquired in the following categories.

- Freehold Title (*Hak Milik,* or HM) – HM is the strongest and most extensive land title that can be owned by Indonesian citizens and certain Indonesian legal entities determined by the government. It grants an indefinite ownership right.
- Right to Build (*Hak Guna Bangunan,* or HGB) – HGB allows Indonesian citizens and legal entities, including foreign investment companies (commonly called PMA Companies), to build and construct on the land. Initially granted for a maximum of 30 years, it can be extended for another 20 years, and renewed for an additional 30 years.
- Right to Cultivate (*Hak Guna Usaha,* or HGU) – HGU is granted for the purpose of agriculture, fisheries or animal husbandry, and may be granted to Indonesian citizens and legal entities, including PMA Companies. Initially granted for a maximum of 35 years, it can be extended for another 25 years, and renewed for an additional 35 years.
- Right to Use (*Hak Pakai,* or HP) – HP permits the use of land by Indonesian citizens, legal entities, foreign investment companies, foreign citizens residing in Indonesia, foreign companies with representative offices in Indonesia, and representatives of foreign states or international organisations. Initially granted for a maximum of 30 years, it can be extended for another 20 years, and renewed for an additional 30 years. HP granted to government institutions or foreign representatives may be given without a specified term.
- Management Right (*Hak Pengelolaan,* or HPL) – HPL is granted based on an MOA decree to government institutions, state-owned enterprises (SOEs) and regional government enterprises, among others, typically for managing public facilities such as ports, SEZs and industrial estates developed or managed by the government or SOEs.
- Strata Title – strata title is granted to Indonesian nationals, Indonesian legal entities, foreign citizens holding a stay permit in Indonesia, foreign companies with representative offices in Indonesia, and representatives of foreign states or international organisations, for the ownership of apartment units.

HGB, HGU and HP can be granted on either state-owned land or HPL land. A typical arrangement for investors to operate in industrial estates or SEZs managed by government institutions or SOEs is by applying for HGB above HPL land.

In addition to registered land titles, there are types of unregistered/uncertified land (documents such as Letter C, *Girik* or *Petok* issued by village authorities) and other forms of customary (*adat*) law acknowledgement of ownership.

2.2 Laws Applicable to Transfer of Title

Transfer of land title is regulated under the Land Regulations.

Additional approval may be required for the transfer of certain land titles, as follows.

- Transfer of land titles in an industrial estate will require approval from the estate manager.
- Transfer of land titles above HPL will require approval from the holder of the HPL, which is typically regulated in a land utilisation/management agreement between the HPL title holder and the title holder above such HPL.

2.3 Effecting Lawful and Proper Transfer of Title

The transfer of land title is documented in a deed of land transfer or *akta jual beli* (AJB) drawn up before a land deed official, known as *Pejabat Pembuat Akta Tanah* (PPAT), which has jurisdiction over the land's location. Full payment of the land price must be made upon executing the AJB at the latest. The official will assist in the registration of the title transfer to the local land office and in obtaining a land title certificate under the new title holder's name.

HGU, certain HM and HP designed for agriculture purposes require a land transfer licence to be obtained from the MOA before any transfer can take place.

2.4 Real Estate Due Diligence

Buyers typically request a limited due diligence process, including reviewing:

- the land title certificate;
- any encumbrance or mortgage documents;
- the payment of land and building tax or *pajak bumi dan bangunan* (PBB);
- spatial planning conformity documents; and
- the corporate documents of the parties.

For industrial estates, buyers often seek a thorough review of the estate regulations and environmental documents of the estate manager to ensure the business operations align with the estate's designation.

Buyers are advised to conduct land checks to obtain the land registration certificate from the local land office, confirming the status of encumbrances, disputes or confiscations, and to conduct court searches to obtain a court clearance certificate indicating the property is free from disputes.

Due diligence is crucial for potential buyers to identify property risks, verify ownership, assess the property's status and examine its historical background. By doing so, the buyer can be deemed as a "good faith buyer", which is a form of legal defence if the transaction is disputed.

2.5 Typical Representations and Warranties

Common representations in a commercial property transaction are as follows:

- the seller is the sole and rightful title holder, and has full authority to transfer the property ownership;
- the seller has obtained the necessary approvals to sell the property, including corporate approval and obligations to third parties (such as notification or approval from lenders, estate managers or the HPL holder);
- the seller has obtained the requisite government licence, specifically for HGU, certain HM and HP designed for agriculture purposes; and

- the property is free from any encumbrance, mortgages, claims and/or disputes from any third party.

Common warranties in a commercial property transaction are as follows:

- the seller is not currently undergoing bankruptcy proceedings or suspension of debt repayment – this is particularly important post-pandemic;
- there are no joint ownership, physical occupation or any other claims from any third parties; and
- the property has no outstanding tax obligations.

Representations and warranties typically survive the closing of the transaction, with no limitation on the liability for breach of representations and warranties, unless expressly agreed otherwise. In the event of misrepresentation, the buyer typically has the right to initiate legal proceedings against the seller to seek remedy or compensation. Indemnity terms may also be included, which provide options for refundable payments, price adjustments or contract termination with compensation.

2.6 Important Areas of Law for Investors

For corporate investors seeking real estate for business purposes, noteworthy areas of law include:

- company law and regulations, most notably Law No 40 of 2007 on Limited Liability Companies, as amended by the Job Creation Law ("Companies Law") – investors typically opt to establish a PMA Company to facilitate real estate acquisition or to acquire shares in a domestic company;
- investment laws and regulations, particularly to identify sectors that are open to foreign investment or reserved for domestic players, and sectors that necessitate partnerships with local micro, small and medium enterprises;
- business licensing regulations, outlining the requirements for the location and ownership of property for specific business activities (for example, manufacturing companies and data centres must be located in an industrial estate);
- spatial planning laws and regulations, regulating spatial designation and utilisation from city/region to national level, with which all business activities must comply;
- building laws and regulations, which regulate the requirements for building construction and utilisation; and
- environmental laws and regulations, mandating licences for environmental management, such as waste management and emission standards.

Other notable areas of law applicable to corporate and individual investors include:

- housing and apartment laws and regulations, which are pertinent for corporate investors involved in developing housing, settlement areas and apartments, as well as for individual investors or expatriates seeking residence in Indonesia; and
- tax laws and regulations, which regulate the application of taxes in the sale and purchase of real estate.

2.7 Soil Pollution or Environmental Contamination

Law No 32 of 2009 on Protection and Management of the Environment, as most recently amended by the Job Creation Law ("Environ-

mental Law"), generally applies the "polluter pays" principle. Nonetheless, law enforcement authorities can investigate instances of pollution or contamination, particularly those arising from the handling of hazardous and toxic wastes, which may incur criminal sanctions.

Parties may regulate the extent of obligation of the seller and/or buyer concerning soil pollution, environmental contamination and usage restrictions (such as groundwater extraction or changes in property usage) in transaction documents, commonly in the sale and purchase agreement. This include indemnification for any violations related to pollution or environmental contamination, usage restrictions for subsequent property buyers and indemnification for environmental claims.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Spatial designations are governed by regional regulations at the city/region and provincial level. To ascertain a land's spatial designation, a party must apply for a Spatial Planning Conformity (*Kesesuaian Kegiatan Pemanfaatan Ruang,* or KKPR) from the MOA through the OSS.

The KKPR is valid for three years and can be extended for two years. For businesses that have acquired land, the KKPR's validity aligns with the tenure of the land.

For national strategic projects, a recommendation for a KKPR may be granted, even if the project location does not align with the existing spatial designation.

2.9 Condemnation, Expropriation or Compulsory Purchase

Indonesian law does not recognise governmental condemnation, expropriation or compulsory purchase of property. However, there are circumstances where property ownership can be relinquished, including:

- land acquisition by the government for public purposes, with compensation paid to title holders;
- property confiscation based on a criminal court decision (eg, in corruption cases);
- if the land ownership document is annulled by an administrative court decision;
- voluntary relinquishment by its owner;
- if the land title term expires and title is not renewed (the previous title holder has a priority right to apply for renewal within two years after expiration, subject to certain requirements, including continued utilisation of the land); and
- if the land is abandoned or destroyed.

2.10 Taxes Applicable to a Transaction

Buyers are subject to 5% duty on the purchase price on acquiring land and buildings (*Bea Perolehan Hak atas Tanah dan Bangunan,* or BPHTB), whereas sellers are subject to 2.5% income tax, to be paid prior to the closing of the transaction. For property transactions with developers, 11% value-added tax (VAT) applies, which must be paid after signing the AJB. Until June 2024, an exemption applies for the purchase of new houses or apartment units priced under IDR5 billion (approximately USD320,000) under the post-pandemic incentives implemented by the Ministry of Finance.

Transfers of land plots in industrial estates or of apartment units in practice are usually subject to administrative transfer fees imposed by the estate manager.

Notary/PPAT fees for drawing up the deed of land/property transfer are capped at a maximum of 1% of the transaction price.

The transfer of shares in a property-owning company may incur income tax on any capital gains arising from the transaction.

2.11 Legal Restrictions on Foreign Investors

Foreign individuals or entities having representative offices in Indonesia are limited to HP and strata titles.

Landed houses must meet the following criteria:

- classified as luxury houses with a specific minimum price per province (typically exceeding IDR5 billion or the equivalent of USD320,000 for Java and Bali islands);
- limited to one plot of land per person/family; and
- the land area must not exceed 2,000 square metres.

Apartment units have restrictions on minimum price, minimum size and maximum number of units, and they must be utilised for residential settlement, which varies depending on province (ie, over IDR3 billion or the equivalent of USD190,000 for Jakarta, and IDR2 billion or the equivalent of USD128,000 for the rest of Java and Bali islands).

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial property, including large property portfolios, are generally financed through loans obtained from financial institutions such as banks or other lenders. The process involves applying to the lender, undergoing a credit evaluation, negotiating credit terms, finalising the facility agreement, and receiving disbursement upon approval. For individuals, the most common type of loan is House Ownership Credit (*Kredit Pemilikan Rumah*), typically used for purchasing residential properties.

Another financing option is through real estate investment trusts (REITs), which are known as *Dana Investasi Real Estate* (DIRE) in Indonesia and are designed to collect funds to be invested mostly in property portfolios. A DIRE is conducted through a collective investment agreement between an investment manager and a custodian bank, with investors' contributions managed to build a portfolio of properties or shares. Please see **5.3 REITs** for further details on REITs.

3.2 Typical Security Created by Commercial Investors

A commercial real estate investor typically creates a mortgage security, granting the lender a security interest in the property being acquired or developed. This arrangement serves as collateral, allowing the lender to sell the property to recover the debt in case of default, through either public auction or private sale.

Mortgage security is incorporated in a mortgage certificate issued by the local land office, which holds executorial power similar to a court decision with permanent legal force, enabling the lender to enforce their rights in case of the debtor's default.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting mortgage security over real estate to foreign lenders, although the enforcement of the mortgage would

still necessitate a public auction or private sale in Indonesia. Repayments to foreign lenders under security documents or loan agreements are likewise not subject to restrictions, except for the general limitation on foreign exchange controls, which include a restriction on payments outside of Indonesia using the Indonesian Rupiah, and the conversion of IDR beyond a specific nominal threshold requires an underlying document.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Mortgage security is granted by a mortgage deed drawn up by a PPAT in the location of the land. The PPAT is entitled to a service fee of up to 1% of the transaction amount specified in the deed for this service.

Registering the mortgage deed to obtain a mortgage certificate from the land office incurs non-tax state revenue (*Penerimaan Negara Bukan Pajak,* or PNBP) based on the mortgage value. Fees range from IDR50,000 for values up to IDR250 million to IDR50 million for values exceeding IDR1 trillion. These rates are correct at the time of writing and are subject to change from time to time by the government.

The execution of a mortgage right is carried out through a public auction based on the executorial title granted in the mortgage certificate, known as *parate* execution, or through a private sale, agreed upon by the mortgage holder and the debtor.

For *parate* execution, auction fees apply as set out by each State Assets and Auction Service Office (*Kantor Pelayanan Kekayaan Negara dan Lelang,* or KPKNL), which include registration fees, announcement fees, auctioneer fees and relevant PNBP.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There is no requirement under Indonesian law, such as financial assistance or corporate benefit rules, that restricts the imposition of security over properties.

Under Law No 4 of 1996 on Mortgages ("Mortgage Law"), a mortgage must be preceded by a loan agreement (or any document underlying the indebtedness) that obliges the debtor to provide the mortgage as security for repayment.

Some banks or creditors may have stricter rules. For working capital loans, companies often need to submit yearly financial reports and updates on loan usage. For real estate loans, proof of purchase may be required.

3.6 Formalities When a Borrower Is in Default

Based on the Mortgage Law, the execution of a mortgage involves the following mechanisms.

- Default by the debtor: mortgage execution typically begins when the debtor defaults.
- Notice of default: upon default, the mortgagee typically issues a notice of default to the debtor, providing them with an opportunity to remedy the default within a specified period.
- Enforcement options: if the default is not remedied, the mortgagee can execute the mortgage by way of a public auction based on the executorial title granted in the mortgage certificate, or through a private sale if mutually agreed as stipulated in the mortgage deed. Such a sale can only occur after one month from the date of written notification to the debtor and announcement in two regionally circulated newspapers, provided no objections are raised.

- Sale of the mortgaged property: proceeds from the sale are used to repay the outstanding loan amount, including any accrued interest, fees and execution expenses, with any surplus being given to the debtor. If the proceeds are insufficient to cover the debt, the mortgagee may pursue other legal avenues to recover the remaining balance.
- Registration of transfer: following the sale of the mortgaged property, the transfer of ownership of the land title is registered with the Land Office, and the mortgage is discharged.

There were no significant limitations regarding the lender's capacity to enforce the mortgage during the pandemic, aside from occasional closures of court services, which affected court proceeding schedules in general.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt may become subordinated to newly created debt. Multiple creditors can hold mortgages on one property, or a single creditor may hold multiple mortgages on the same property. In such cases, each mortgage is ranked based on its registration date at the Land Office, which determines its repayment priority.

3.8 Lenders' Liability Under Environmental Laws

Lenders are generally not liable under the Environmental Law for any pollution of the real estate not caused by the lenders; see **2.7 Soil Pollution or Environmental Contamination** regarding the application of the Environmental Law.

3.9 Effects of a Borrower Becoming Insolvent

Under Law No 37 of 2004 on Bankruptcy Proceedings and the Suspension of Debt Payment Obligations ("Bankruptcy Law"), if a borrower becomes insolvent, any lender holding security interests (including mortgages) has the authority to execute their rights within two months after the commencement of the state of insolvency.

If the two-month deadline has passed, the receiver is obliged to request a public auction of the collateral through the KPKNL, while ensuring the rights of the creditors who hold claims to the proceeds from the sale. In the event of an unsuccessful public auction, the supervisory judge may approve a private sale of the properties.

In any event, the receiver has the authority to release the collateral property by paying the respective creditor either the market value of the collateral property or the amount of debt secured by it, whichever is lower, at any given time.

3.10 Taxes on Loans

In Indonesia, fees in the form of PNBP on mortgage or mezzanine loans are imposed at the time of the registration or recording of the mortgage deed or related documents with the Land Office. Please see **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security** regarding mortgage registration fees.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Spatial planning policies are formulated through the Regional Spatial Plan (RTRW) and the Detailed Spatial Plan (RDTR). Governments enact regulations governing spatial planning and zoning, which are structured as follows:

- government regulation for RTRW at the national level;
- presidential regulation for National Strategic Areas;
- regional regulation or governor regulation for RTRW for each province; and
- regional regulation or regulations by regional heads for RDTR and RTRW for each city/regency.

The central government consistently integrates the RTRW and RDTR into the national land map, serving as a basis for the government in processing and issuing KKPR, which is a prerequisite for business licences.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Following the enactment of the Job Creation Law, government controls on building construction involve the application of a risk-based approach, imposing technical norms, standards, guidelines and criteria for the function, design, method of construction and refurbishment work for each type of building, depending on:

- building construction complexity, including simple, non-simple and special building, according to factors such as the number of floors and maximum area;
- building functions, encompassing residential, religious, business, social, cultural and special functions;
- building requirements, such as coefficients standards for different types of buildings and technical, architecture and structural designs;
- building licensing obligations for construction, utilisation, maintenance, inspection, preservation and demolition processes – major approvals include Building Construction Approval, which is required before commencing construction and is valid for two years, and a Certificate of Building Worthiness, which is required before building utilisation and is valid for five years;
- roles of the community, including building construction contractors and technical advisers; and
- sanctions for non-compliance, including warnings, suspension of licences and/or demolition orders.

4.3 Regulatory Authorities

The following authorities are responsible for regulating development and spatial designation.

- The Ministry of Investment, along with local or provincial One-Stop Integrated Licensing Agencies, manages KKPR confirmation issuance in areas with established RDTR, on behalf of the MOA. This involves aligning proposed business activities with the RDTR and issuing KKPR through the OSS system.
- The MOA, alongside local land offices, grants KKPR approval in areas without RDTR, subject to the proposed business activities aligning with RTRW regulations.
- Regional governments, including executive (Mayor/Regent) and legislative (Regional House of Representatives) branches, enact regulations for RTRW and RDTR. The Spatial Planning Department can provide written confirmation on spatial planning designations upon request.

Changes to spatial designations are significantly restricted, occurring only once every five years or in response to national strategic initiatives. These changes must be initiated by the regional government with the MOA, meaning they cannot be instigated solely by a single business entity but require regional government action.

4.4 Obtaining Entitlements to Develop a New Project

When initiating new projects, the following procedures must be conducted:

- land entitlement, through the acquisition of land title or through lease or co-operation agreements with land title holders;
- KKPR, confirming that the intended land use aligns with spatial designations;
- environmental approval, detailing the project's environmental impacts, including potential environment harm and waste management;
- building documentation, comprising the Building Construction Approval, to be obtained prior to commencing construction, and the Certificate of Building Worthiness, to be applied for after the completion of the construction for its utilisation; and
- application for a business licence based on the relevant business scope – commercial operations can commence once the business licence is obtained.

For significant building refurbishments encompassing alterations in function, layers, area, appearance, specifications and dimensions of components, and retrofitting activities, the building owner must obtain a revised Building Construction Approval before commencing any construction activity.

Public engagement, involving residents and social organisations, is encouraged in determining spatial planning and overseeing building development. Input can be submitted to the central government (the MOA for spatial planning; Ministry of Public Works and Public Housing for building construction) and regional government.

4.5 Right of Appeal Against an Authority's Decision

Generally, under administrative law, an appeal may be initiated against a decision made by an authority, including licence or approval for development or designated land use (ie, KKPR).

Such appeal can be initiated if the decision is provided in writing, is issued to a specific party, and is considered final and definitive, imposing obligations on its receiver. Examples of such decisions include KKPR documents, Building Construction Approvals and decrees granting land titles.

The appeal process encompasses administrative remedies, such as submitting an application to the relevant government authority. The MOA can revoke KKPR due to procedural and/or administrative errors, including discrepancies in the applicant's data or physical location mismatches. Owners of adjacent land or objecting parties can submit an objection to title decrees to the local land office, which may initiate land remeasurement or boundary determination.

A lawsuit can be initiated with the Administrative Court, which holds jurisdiction to examine and adjudicate disputes pertaining to administrative decisions.

The procedural steps in administrative court cases are as follows.

- Filing a lawsuit: the applicant files a lawsuit within 90 days of receiving notification of an administrative decision.
- Dismissal review: following the filing, the court conducts a dismissal review to verify compliance with the criteria for the administrative lawsuit. The applicant has 14 days to contest any dismissal decision by the court.

- Preparatory examination: prior to the main hearing, the judge may undertake a preparatory examination to clarify the lawsuit. The applicant has 30 days to rectify any deficiencies in information in its lawsuit.
- Case examination: the court proceeds to examine the case, with a panel of three judges. The parties are given opportunities to present their arguments.
- Judgment: the court renders its judgment, which may involve rejecting, granting or deeming the lawsuit invalid.
- Appeals: if a party is dissatisfied with the judgment of the administrative court, they can appeal to the administrative appeals court. If dissatisfied with the decision of the appeals court, they may further appeal to the Supreme Court, whose ruling is final and binding.

4.6 Agreements With Local or Governmental Authorities

It is necessary to apply for and obtain licences for all development projects, regardless of the owner or developer.

The prevailing laws and regulations do not provide any mechanism to enter into an agreement with local or governmental authorities to facilitate development projects. However, government regulations do offer incentives for specific investments, with the following examples.

- National Strategic Projects benefit from a streamlined permit processing, spatial planning adjustments via KKPR recommendations from the MOA, a specialised land acquisition process for public purposes, 0% BPHTB, financial aid, government guarantees and fast-tracked resolution of legal and social impacts. To qualify, projects must be evaluated and approved by the Co-ordinating Minister of Economic Affairs and the President, focusing on infrastructure investments exceeding IDR500 billion (approximately USD33 million), and typically executed by government institutions, state-owned enterprises or private sectors through PPPs.
- Investments in SEZs are eligible for streamlined business licence processing, simplified expatriate utilisation, fiscal benefits like tax holidays, 0% VAT, exemptions from import duties on specific goods, and deductions on local taxes.
- Investments in Indonesia's new capital city, Nusantara, come with benefits including a corporate income tax rate of 0% for up to ten years, 0% import VAT, 0% tax on luxury goods, 0% import duties and 0% PBB for up to ten years.
- Investments in industrial estates are guaranteed KKPR confirmation/approval, along with simplified application processes for environmental and waste management approvals managed by the estate managers.

4.7 Enforcement of Restrictions on Development and Designated Use

The enforcement of restrictions on development and designated land use involves several authorities, with various measures, as follows.

- The MOA, including land offices and regional offices, is the primary authority responsible for supervision, evaluation monitoring and reporting land designation usage, conducted through the following various measures:
  (a) verifying KKPR applications based on land documents (titles, leases, etc), proposed business scope, alignment with RDTR/RTRW, and proposed construction plans;
  (b) forming an inspectorate to supervise development and designated use, over-

seeing spatial utilisation, conducting inspections and ordering suspension of violations; and
(c) public participation by reporting non-compliance in development and designated use to the MOA or regional government via documents, website, email or social media.

- Regional governments, including the Civil Service Police Unit, ensure public order by conducting patrols and security measures to address non-compliance with development and land use regulations, as per regional laws. Construction projects not aligning with spatial designations may face suspension or demolition.
- Law enforcement officials investigate claims, reports or complaints regarding violations of designated land use, which are punishable under the Spatial Planning Law. If a criminal offence is proven, an investigation will be processed to prosecution level, up to in-court criminal proceeding.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Investors typically hold properties by way of direct land title ownership. Local individual investors mostly prefer HM as it holds an unlimited term. PMA Companies typically holds HGB, whereas foreign investors are subject to ownership restrictions (see **2.1 Categories of Property Rights**). Due to such restrictions, foreign investors usually prefer to establish a PMA Company to acquire land, or to subscribe for shares in an existing real estate company. Despite having foreign investment status, a PMA Company is considered an Indonesian entity, so is eligible to hold a HGB, HP, HGU and strata title.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The most common type of entity used to invest in real estate in Indonesia is a limited liability company, including PMA Companies, the constitutional documents of which are the articles of association (AOA), covering the following key aspects.

- Corporate details, including the company's name, legal domicile, any branch offices and the duration of its establishment, whether limited or unlimited.
- The business scope, delineating the areas of operation based on the classification of business activities.
- Capital structure – companies allocate their capital into shares. The entire capital is known as authorised capital, while the portion contributed by shareholders is the issued and paid-up capital.
- Corporate organs, which include:
  (a) the board of directors, comprising one or more directors responsible for day-to-day operations and authorised to act on behalf of the company;
  (b) the board of commissioners, consisting of one or more commissioners tasked with collective supervision and advisory roles over the board of directors; and
  (c) the general meeting of shareholders, comprising all shareholders, holding the highest authority in the company. The AOA typically govern the procedures for convening meetings of the directors, commissioners and shareholders, specifying quorums, meeting invitations and resolutions in lieu of physical meetings. The AOA may also impose restrictions on directors' actions by requiring corporate approvals from the board of commissioners or the general meeting of shareholders.

In terms of the tax benefits and costs of a company holding real estate assets, the company can record BPHTB for the acquisition of land and buildings owned and utilised by the company, and expenses incurred for the extension of land titles (such as HGB, HP or HGU), as deductible expenses from taxable income. Meanwhile, PBB remains the same in amount and application regardless of whether the real estate assets are held by a company or an individual.

5.3 REITs

A REIT is an instrument used to raise funds from investors to be invested in real estate assets, assets related to real estate and/or cash equivalents, as regulated by the Financial Services Authority (*Otoritas Jasa Keuangan,* or OJK) under OJK Regulation No 64/POJK.04/2017 for conventional DIRE and OJK Regulation No 30/POJK.04/2016 for Sharia-compliant DIRE. These vehicles are available to individual domestic investors and PMA Companies, subject to compliance with Indonesian investment regulations. However, the DIRE is not open to foreign individual/entity investors.

The advantages of investing in REITs include:

- dividend distribution: REITs are required to distribute profits to the unitholders on an annual basis in amounts of at least 90% of net profit after tax, providing investors with a stable income stream;
- tax benefits: REITs are not subject to corporate income tax, allowing for higher distributions to investors; and
- tangible assets: REITs invest in physical real estate, exposing investors to potential appreciation in property values over time.

To qualify as a REIT, the following requirements must be fulfilled.

- Investment structure: a REIT is established based on a DIRE, a collective investment contract (CIC), which is made by and between the relevant investment manager and custodian bank. The investment manager manages the portfolio, and the custodian bank oversees collective deposits. The investor will hold the participation unit of the CIC as ownership.
- Portfolio composition: a DIRE must invest at least 80% of its net asset value in real estate assets (either directly or indirectly through the acquisition of control in real estate companies). These assets must have been income-producing assets prior to their acquisition or, if the relevant lands and buildings are still in the construction stage, must generate income within six months after the acquisition. Meanwhile, the remaining value may be invested in other assets, such as securities in real estate-focused companies, money market instruments, Indonesian securities portfolios and/or other financial instruments, and/or in cash and cash equivalents. The investment manager must ensure that at least 51% of the relevant DIRE's revenue is derived from real estate assets.
- Investment restrictions: REITs are prohibited from investing in vacant land or properties under development, except for certain activities like refurbishment, retrofitting and renovation.
- Asset restrictions: REITs are prohibited from lending or pledging their real estate assets for the benefit of third parties.
- Trading restrictions: REITs are prohibited from engaging in short selling or purchasing securities on margin.
- Debt issuance: REITs are prohibited from issuing debt securities but can borrow funds without issuing debt securities for the purpose of purchasing real estate assets, up to a

maximum of 20% of the total value of the real estate assets to be purchased.

5.4 Minimum Capital Requirement

PMA Companies must have a minimum issued and paid-up capital of IDR10 billion upon establishment.

PMA Companies are also subject to minimum investment values (regulated in the Minister of Investment/Investment Coordinating Board Regulation No 4 of 2021 on Guidelines and Procedures for Risk-Based Business Licensing Services and Investment Facilities) of more than IDR10 billion, exclusive of land and buildings, for each business scope. Investment values can be in the form of shareholder capital, loans and/or other sources of funds.

5.5 Applicable Governance Requirements

PMA Companies are subject to the following governance requirements.

- Each company is required to obtain the relevant business licence based on a risk-based assessment of each business scope engaged. Before obtaining a business licence, companies must first meet the basic requirements of KKPR, environment approval and a building licence – ie, a building construction permit and a certificate of building worthiness.
- Investment reporting must be conducted quarterly through the OSS system administered by the Ministry of Investment, outlining the company's realisation of investment in the particular quarter (ie, any purchase of machineries), use of manpower, production and distribution of goods/services, and export realisation (as applicable).
- Presidential Regulation No 13 of 2018 on Implementation of Know-Your-Beneficial-Owner Principle by Corporation for the purpose of Prevention and Eradication of Money Laundering and Terrorism Financing mandates the disclosure of PMA Companies' ultimate beneficiary owners (UBO) to the Ministry of Law and Human Rights.

5.6 Annual Entity Maintenance and Accounting Compliance

Apart from taxes, Indonesian legislation does not mandate any annual entity maintenance fee payable to the government.

Regarding accounting compliance, the Companies Law mandates that directors of a company must submit an annual report, including financial statements, within six months after the end of the company's financial year. These financial statements must adhere to standard accounting guidelines. Furthermore, the financial report must undergo auditing by a certified public accountant if the company:

- collects or manages public funds;
- issues debt acknowledgment letters to the public;
- is publicly listed or state-owned; or
- possesses assets and/or total business turnover of at least IDR50 billion.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The prevailing regulations acknowledge various arrangements, such as lease, lease to build and lease-to-own, which are applicable to real

estate properties, including commercial leases for spaces, buildings, land and/or structures.

Other lease mechanisms recognised in Indonesia include utilisation of HPL land by a third party. In this case, the lessee enters into a utilisation agreement with the HPL holder, which allows the lessee to develop the land, to utilise the land, and to apply for land title over the HPL.

Build-Operate-Transfer (BOT) Schemes

BOT schemes entail the utilisation of state-owned assets such as land by another party to construct buildings and/or facilities, which are then operated by that other party for an agreed-upon period before being returned to the state along with the buildings and/or facilities. They are regulated by Government Regulation No 27 of 2014 on Management of State/Regional Assets, as most recently amended by Government Regulation No 28 of 2020 ("Asset Management Regulation").

Leases of State/Local Government Assets

Such leases involve the utilisation of state/local government assets by another party for a certain period in exchange for a cash consideration. The lease term is five years and can be extended, pursuant to the Asset Management Regulation.

These mechanisms are not only for commercial purposes but are also for industrial, residential and other uses.

6.2 Types of Commercial Leases

Besides the traditional lease, Indonesia also recognises lease-purchase, which is a mixed agreement that includes elements of both a sale and a lease. In a lease-purchase agreement, as long as the price has not been fully paid, ownership of the goods remains with the seller-lessor, even though the goods are in the possession of the buyer-lessee. Ownership only transfers after the buyer-lessee pays the final instalment to settle the price of the goods.

6.3 Regulation of Rents or Lease Terms

In Indonesia, regulations regarding leases are generally regulated under the Indonesian Civil Code. However, there is no limitation on the formulation of lease terms in agreements; lease terms are generally freely negotiable.

However, certain leases, such as those for state-owned goods or residential purposes, may be subject to more specific regulations. For example, Ministry of Finance Regulation No 115/PMK.06/2020 on the Utilisation of State-Owned Assets applies to leases of state-owned goods, imposing restrictions on lease term, price determination and payment methods. House leases for residential purposes must comply with Government Regulation No 14 of 2016 on Housing and Residential Area Management as most recently amended by Government Regulation No 12 of 2021 on Amendments to the Housing Management Regulation, which specifies the minimum requirements for a written lease agreement, including the rights and obligations of the parties, lease term, price and force majeure clauses.

Leases of central government or regional government assets must adhere to the Asset Management Regulation, its amendments and implementing regulations. This regulation stipulates various requirements, including the permissible duration of lease terms, essential provisions to be incorporated into lease agreements – such as the rights and responsibilities of each party – and the intended purpose of the lease.

The COVID-19 pandemic has not resulted in specific ongoing regulations regarding lease terms in Indonesia.

6.4 Typical Terms of a Lease

The terms of a lease of business properties are freely negotiated between the parties. The typical terms are as follows.

Length of Lease Term

Parties typically define the commencement, conclusion, any potential extensions and the procedure for extending the lease. Restrictions may vary based on the nature of the leased asset. For instance, for state or regional government properties, the standard lease term is commonly set at five years, with the possibility of extension.

Maintenance and Repair

The agreements would detail the services and maintenance covered by the lessor and the costs entailed. Operating costs, including equipment repair and maintenance, are usually the lessee's responsibility.

Frequency of Lease Payments

Parties typically regulate lease payments in the lease agreement. In a revenue-sharing model, for example, lease payments are usually agreed to be made quarterly, based on the audited financial report.

Pandemic Issues

Following the COVID-19 pandemic, some lease agreements stipulate a pandemic as a force majeure event.

6.5 Rent Variation

The rent payable typically does not change throughout the lease term, with the possibility of cost adjustments at the start of a new period, based on the agreement of the parties.

6.6 Determination of New Rent

Rent changes require mutual agreement, typically in writing. Once agreed upon, changes can occur only with written consent. It is common to cap rent increases at a certain rate, considering increases in the tax-assessed value of the property or inflation.

6.7 Payment of VAT

11% VAT is payable on rent for land and/or buildings. The VAT is collected and remitted by the taxable entrepreneur who rents out the land and/or buildings.

6.8 Costs Payable by a Tenant at the Start of a Lease

A deposit may be required upon lease commencement, in addition to lease payment. This deposit serves to secure the lessee's obligations and acts as the lessor's protection against damages, unpaid rent or breaches of lease terms. Lessees may also be obliged to pay a monthly service charge to the lessor, plus applicable VAT.

6.9 Payment of Maintenance and Repair

In the context of apartments, the Apartment Law obliges developers to separate apartments into individual units, common areas (such as rooves, stairs, elevators, pipelines, electrical networks, floors, walls and other parts that are integral to the apartment building), common objects (swimming pools, gardens, parking lots and other parts that are not in functional unity with the apartments) and common land.

Based on the Apartment Law, the management of an apartment building includes operational activities, maintenance and care of common areas, common objects and common land, which are managed by the Association of Owners and Occupants of Apartments (PPPSRS).

In carrying out the management, PPPSRS is entitled to receive and manage management fees, payable by the owners and occupants (lessees) in proportion to their ownership. Typically, management fees consist of operational costs, maintenance costs and repair costs. The operational and maintenance costs are charged to the occupants/lessees, while repair costs are charged to the owners.

6.10 Payment of Utilities and Telecommunications

The Apartment Law provides that utilities and telecommunications costs for properties with multiple lessees are shared proportionally by owners and occupants through management fees handled by the PPPSRS.

6.11 Insurance Issues

The lessor usually insures the building, while some agreements require lessees to insure items within the properties.

Lessees' ability to claim business interruption due to the pandemic depends on insurance policy terms. However, such claims are often denied, as pandemics are not usually considered valid reasons to defer obligations like lease payments.

6.12 Restrictions on the Use of Real Estate

Article 99 of the Apartment Law imposes restrictions on certain kinds of use, such as damaging or altering public infrastructure, endangering others or public interests, violating regulations, changing the agreed upon function or use of the apartment building, or diverting public infrastructure and common facilities for the development or management of the apartment building.

In addition, lessors may specify restrictions in the lease agreements, such as limiting the use of properties in a manner consistent with the permitted zoning and the lessee's business licences.

6.13 Tenant's Ability to Alter and Improve Real Estate

Generally, according to Article 1554 of the Indonesian Civil Code, the party leasing out the property is not allowed to alter the form or arrangement of the leased property during the lease term. However, parties to a lease agreement may agree otherwise. Typically, lessees are required to obtain prior approval from the lessor for such alteration. In the context of a lease of space (in a building), structural alteration by a lessee is not allowed.

Furthermore, if modifications are desired, besides needing the lessor's consent, they must also comply with the existing Building Construction Permit of the relevant building.

6.14 Specific Regulations

There are no specific regulations that apply to leases of categories of properties, such as residential, industrial, offices, and retail or hotels.

Leases of land or property in Indonesia are primarily governed by the Indonesian Civil Code, with additional regulations such as the Apartment Law. These laws outline the rights and responsibilities of lessors and lessees. The Apartment Law categorises apartments into four types:

- public apartments;
- special apartments;
- state apartments; and
- commercial apartments.

These regulations impact leases by providing specific guidelines for different types of real estate, ensuring clarity and fairness in lease agreements. However, there are no specific asset class distinctions related to COVID-19 legislation in these laws.

6.15 Effect of the Tenant's Insolvency

Under the Bankruptcy Law, if a lessee is declared bankrupt, the receiver or the party renting out the property temporarily can terminate the lease agreement, provided that prior notice is given within a certain period, according to local customs. According to Article 38 of the Bankruptcy Law, a period of three months is considered sufficient. This ground for termination can be stipulated under a lease agreement.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is typical for lessors to request a security deposit from lessees, often equivalent to three months' rent and service charges, as a form of protection against potential lease violations.

6.17 Right to Occupy After Termination or Expiry of a Lease

Based on Article 1573 of the Indonesian Civil Code, if a lessee continues to occupy the property after the lease term has expired without being challenged by the lessor, a new lease will automatically begin. This principle, known as a silent agreement, is recognised in Indonesian law, where what is customarily agreed upon is considered part of the existing agreement, even if not explicitly stated.

To ensure that a lessee vacates on the agreed date, the lease agreement must specify the deadline for vacating and authorise actions by the lessor, such as imposing fines or cutting off access if the lessee fails to do so. It is also advisable to incorporate clauses allowing fines deducted from the security deposit or retaining the deposit until the lessee vacates.

6.18 Right to Assign a Leasehold Interest

The ability of a lessee to assign its leasehold interest in the lease or to sublease all or a portion of the leased properties depends on the terms of the lease agreement. Under the Indonesian Civil Code, subleasing is prohibited unless the lessor's consent is obtained. Therefore, some lease agreements may permit assignment or subleasing, while others may restrict or prohibit it.

Typically, the lessor/owner would also require notification from the lessee on the change of control in the case of the assignment of a leasehold interest.

6.19 Right to Terminate a Lease

Under the Indonesian Civil Code, written leases end automatically when the lease term expires. For oral leases, termination occurs when one party notifies the other, following the necessary notice period as per local custom. In addition, if the leased property is completely destroyed during the lease term due to an unforeseen event, the agreement is automatically terminated by law.

Early termination grounds are typically outlined in the lease agreement, including due to expiration, mutual agreement (without any events of default), force majeure, a default event and/or other grounds as agreed by the parties (such as change of control, bankruptcy, cessation of business, the stopping of payment of debts, and the appointment of a receiver over its properties).

6.20 Registration Requirements

A lease is not required to comply with registration requirements or specific execution formalities, as it is based on a contractual arrangement between the lessor and the lessee. However, it can be registered with the land office for administrative purposes, although this is not mandatory. This registration records the lease on the land certificate, clarifying the status of the land as a leased object for both parties involved in the lease and/or any third-party stakeholders.

6.21 Forced Eviction

If a lessee defaults before the end of the lease term, the lessor can only evict them based on a court decision seeking the lessee's immediate vacation from the properties. To obtain this decision, the lessor must first issue a warning letter to the lessee. If the lessee ignores the warning letter, the lessor can then file a civil lawsuit in court to request the eviction decision. Generally, the court will take months to issue a decision for eviction, or longer if the dispute is taken to a higher court.

6.22 Termination by a Third Party

Neither the government nor any other third party can terminate a lease. A lease can only be terminated by its own terms, by mutual agreement of the parties, or if declared void by a court decision.

6.23 Remedies/Damages for Breach

In cases of breach of an agreement, the non-defaulting party may seek compensation for losses and/or damages resulting from the breach. Such compensation can be sought by way of filing a lawsuit against the defaulting party. Indonesian courts recognise material losses (ie, actual losses caused by such breach) and punitive damages (non-material, typically for potential losses or damage to reputation).

If stipulated in the lease agreement, a penalty may be imposed. Security deposits are typically non-refundable, and are instead fully retained by the lessor.

Conversely, if the lease fee has been paid upfront by the lessee, the remaining lease fee may not be refunded to the lessor. Although not legally mandated, lessors commonly request a security deposit for the lease, typically amounting to three months' lease and service charges.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Based on Law No 2 of 2017 on Construction, as most recently amended by the Job Creation Law ("Construction Law"), and Government Regulation No 22 of 2020 on Implementing Regulation of Construction Law, as most recently amended by Government Regulation No 14 of 2021 on Amendment to Government Regulation No 22 of 2020 ("Construction Service Regulation"), payment structures for construction projects include:

- advance/upfront payment;
- payment based on time progress (typically monthly);
- payment based on project milestone (progress payment); and
- turnkey/payment upon completion of works (lump-sum).

In integrated engineering-procurement-construction-commissioning (EPCC) agreements, payment arrangements for the procurement of tools and equipment can be structured as unit price payments, wherein the project owner pays for each unit of tools or equipment procured.

In certain instances, the project owner may choose a provisional sum arrangement, allocating a predetermined amount for tools and equipment procurement in the agreement. This sum provides flexibility for potential variations in costs or unforeseen expenses during the project's execution.

7.2 Assigning Responsibility for the Design and Construction of a Project

The different methods used for assigning responsibility for the design and construction of a project are referred to as the delivery system under the Construction Service Regulation, and include:

- design-bid-build (DBB), in which a contractor will make an agreement with the project owner to provide a specific type of construction service; and
- design-build (DB), in which the contractor will make an agreement with the project owner to provide multiple construction services.

Under DBB, typically one contractor will handle the design work, while another contractor takes on the construction phase. Each contractor will be responsible for the specific tasks based on its agreement with the project owner. Conversely, in the DB method, both the design and construction works are carried out by a single contractor.

7.3 Management of Construction Risk

Warranties are common to manage construction risk on a project, specifically guarantees issued by a financial institution.

Depending on the nature of the project, the contractor may furnish various types of warranties to the project owner. The Construction Service Regulation and Presidential Regulation No 16 of 2018 on Government Goods/Services Procurement recognises the following types of guarantees:

- Bid Bond – a type of guarantee aimed to assure the project owner of the bidder's seriousness regarding their bid and their financial capability to execute the project if awarded;
- Advance Payment Bond – to ensure the repayment of any advance payments made by the project owner before the commencement of work on a construction project;
- Performance Bond – to provide assurance to project owners that they will be adequately protected in the event of contractor default, non-performance or failure to achieve the determined quality or performance standards; and
- Warranty Bond – guarantees the maintenance of the construction during the specified maintenance period.

There is no legal limitation to such warranties, which are typically governed by the agreement between the contractor and the project owner.

7.4 Management of Schedule-Related Risk

Construction agreements commonly include penalties in the form of fines for contractors who fail to meet specified milestones or deadlines. These fines are typically calculated daily, with the amount usually set at a fraction of the agreement's value, often 1/1000.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Project owners often seek additional security measures, especially when contractors require project financing for project execution. Typically, project owners will demand that contractors provide guarantees, commonly in the form of performance bonds or third-party sureties. If the

contractor lacks sufficient assets to secure the project in the event of performance default, the project owner may insist on a corporate guarantee from the contractor's parent company.

7.6 Liens or Encumbrances in the Event of Non-payment

In practice, contractors will not be given any form of land title and may not place any lien or encumbrance on the project, since ownership of the land and building remains with the project owner.

However, in cases of non-payment, the construction company may notify the local land office of a dispute and request to block the land title. Subsequently, the land office may block any attempts by the project owner to transfer property ownership or alter the land title, which will be in effect for 30 calendar days unless a court order/decision is obtained.

7.7 Requirements Before Use or Inhabitation

Buildings are legally required to obtain a Certificate of Building Worthiness (*Sertifikat Laik Fungsi,* or SLF), which is applied for after the completion of the construction and prior to the building utilisation. An SLF is issued by the regional government, except for complex and hi-tech buildings that are reserved to be issued by the Ministry of Public Works and Public Housings.

8. Tax

8.1 VAT and Sales Tax

VAT is imposed on the buyer of new property at a rate of 11%. Conversely, Corporate Income Tax (CIT) is imposed on the seller for both new and second-hand property at a rate of 2.5%.

As of 2022, VAT exemptions may apply to the sale of landed retail houses and apartments. Similarly, CIT exemptions may apply to transactions involving the sale and purchase of land and buildings with government entities, state-owned enterprises with special assignments from the government, or regional government-owned enterprises with special assignments from the regional government.

8.2 Mitigation of Tax Liability

To mitigate tax liabilities, buyers frequently opt to acquire land located within SEZs. Based on Government Regulation No 40 of 2021 on Special Economic Zones, a SEZ offers exemptions from CIT and VAT for the sale and purchase of land and/or buildings.

8.3 Municipal Taxes

PBB is imposed on property owners. If the property is leased, the lease agreement may stipulate that the lessee bears or compensates the lessor for any PBB incurred by the lessor. These taxes are paid to the municipal government. In addition, depending on each municipal government, a municipal retribution may be collected for occupying business premises.

Companies operating in an SEZ may receive incentives in the form of tax deductions for PBB and other municipal taxes, as well as retribution. The deduction ranges from 50% up to 100%.

8.4 Income Tax Withholding for Foreign Investors

The Agrarian Law prohibits foreign entities from directly owning land in the country. Consequently, foreign individuals or companies are unable to hold land titles in Indonesia. However, a potential avenue for foreign entities is to establish a company within Indonesia to hold properties and generate income through rental activities.

It is important to note that income derived from such rental activities would be categorised as dividends rather than traditional rental income, and therefore dividend tax rates will apply.

8.5 Tax Benefits

A company can derive advantages from owning property by leveraging depreciation expenses to lower its taxable income. Depreciation can be calculated annually on properties, allowing companies to deduct this expense from their gross revenue, thereby potentially decreasing their tax liability. The depreciation period for permanent buildings is 20 years, with an annual depreciation rate of 5%. Meanwhile, non-permanent buildings have a depreciation period of ten years, with an annual depreciation rate of 10%.

IRELAND



Law and Practice

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Maples Group advises global financial, institutional, business and private clients on the laws of Ireland as well as the British Virgin Islands, the Cayman Islands, Jersey, Luxembourg and the Marshall Islands through its leading international law firm, Maples and Calder. With offices in key jurisdictions worldwide, the Maples Group has specific strengths in corporate, commercial, finance, investment funds, real estate, litigation, and trusts. The real estate team at Maples Group Dublin has specialist legal knowledge across the full spectrum of commercial property sectors. The team works closely with our tax, finance, corporate and funds colleagues to provide the legal expertise necessary to efficiently structure and deliver significant real estate transactions.

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1. General

1.1 Main Sources of Law

The main source of Irish real estate law is statute. The key legislative provisions are set out in:

- the Land and Conveyancing Law Reform Act, 2009 (the "2009 Act");
- the Registration of Title Act, 1964 (the "1964 Act");
- the Registration of Deeds and Title Act, 2006;
- the Landlord and Tenant Acts, 1967-2019 (the LTA); and
- the Residential Tenancies Acts, 2004–2022 (the RTA).

The other main source of Irish real estate law is case law, derived from judgments of the Irish courts.

1.2 Main Market Trends and Deals

The year 2023 was a challenging one for real estate markets across Europe, and the Irish market was no different. We expect 2024 to be a year of recovery, with interest rates stabilising and ultimately declining.

The dominant asset classes in the Irish real estate market are currently office, residential (including social and affordable housing), industrial and retail. Within those classes, the largest deals in Ireland involved large-scale residential multi-family developments, property redress schemes (PRS) and student accommodation schemes, logistics portfolios and regional retail parks and shopping centres.

The Irish office market has been dominated by a "flight to quality", with developers, building owners and occupiers collaborating to meet environmental, social and governance (ESG) objectives and comply with net zero targets and impending EU regulations. The demand for Grade A sustainable office space will continue to split the market, leading to an increase in the refurbishment and retrofitting of older assets.

Ensuring adequate and affordable housing is a key concern of the Irish government which is being addressed through the "Housing for All" plan. To achieve its housing objectives for 2022–2030, the government aims to deliver 312,750 homes, comprising 88,400 social, 53,800 affordable or cost rental and over 170,000 private units, with a state investment of EUR40 billion. As a result, this sector has strong growth prospects for 2024.

The Irish retail sector has demonstrated its resilience with consumer confidence and retail sales increasing throughout 2023. Several new international entrants to the Irish market are seeking retail space with, for example, Swedish retailer Arket and Chinese retailer Icicle due to open their first Irish stores in Dublin in 2024. High-end retail centres performed well in 2023 with, for example, The Blanchardstown Centre securing new leases with leading brands such as Lego, Calvin Klein, Tommy Hilfiger and Nike in the past year.

There is no doubt that the impact of rising inflation, increases in interest rates and the resultant uptick in associated property costs have induced a period of price discovery in Irish real estate. However, inflationary pressures have now eased somewhat, and interest rates appear to have stabilised, with a marginal reduction expected throughout 2024.

Ireland remains the European Union's fastest-growing economy and an excellent place to invest and do business. It offers a high degree of economic and political stability with the benefit

of a common law legal system and a favourable tax structure that is relatively easy to understand. Ireland is strongly aligned with the EU and benefits from the common trade area and access to talent from across Europe.

1.3 Proposals for Reform

Electronic Conveyancing

There has been a move towards the use of electronic signatures for the acquisition of real estate, but procedures to deal with electronic signatures have not yet been implemented by the Land Registry so original wet ink signatures are still required for most documents dealing with real estate. See **2.3 Effecting Lawful and Proper Transfer of Title** for further detail on the use of electronic signatures.

Reform of Planning Law

The Planning and Development Bill 2023 (the "Planning Bill")

The Planning Bill aims to modernise and reform planning law in Ireland. The reforms include:

- significant restructuring and resourcing of the current planning appeals board, An Bord Pleanála (the "Bord"), which will be renamed *An Coimisiún Pleanála*;
- the introduction of statutory timelines for decision-making, including for *An Coimisiún Pleanála*;
- new strategic ten-year development plans for local authorities;
- reform of the planning Judicial Review; and
- new provisions for urban development zones.

The bill is currently making its way through the legislative process and it is hoped that it will be enacted by Q2 2024.

Irish Funds Review 2030

This review highlighted the importance of institutional funding for the ownership of commercial and residential property and supported the maintenance of both the real estate investment trust (REIT) and Irish real estate funds (IREF) regimes in their current form. It is proposed that the leverage limits in the IREF regime be aligned with the Central Bank's macroprudential limits and that reinvestment conditions and leverage limits in REITs be more flexible.

2. Sale and Purchase

2.1 Categories of Property Rights

The categories of property rights that can be acquired in Ireland are as follows:

- freehold title, which confers absolute ownership; or
- leasehold title, which confers ownership for the period of years granted by the relevant lease.

2.2 Laws Applicable to Transfer of Title

Historically, Irish law was based on legislation predating the establishment of the Irish State. The 2009 Act replaced much of the old law and modernised conveyancing practice. The 2009 Act is the main statute applicable to the transfer of title in Ireland and applies to all asset classes, including residential, commercial, industrial, offices, retail, and hotels. The RTA govern the residential landlord and tenant sector, and the LTA govern the commercial landlord and tenant sector.

2.3 Effecting Lawful and Proper Transfer of Title

When ownership of a property is registered in the Land Registry, the deeds are filed with the

Land Registry and all relevant particulars are entered on folios that form the registers that the Land Registry maintains. In conjunction with the folios, the Land Registry also maintains maps (referred to as filed plans). Both folios and filed plans are kept in electronic form.

The Registry of Deeds provides a system of voluntary registration for deeds that affect property. The purpose was to give priority to registered deeds over unregistered but "registrable" deeds. There is no statutory obligation to register a deed in the Registry of Deeds, although failure to do so may result in a loss of priority.

Tailte Éireann (which launched in March 2023) is the state organisation responsible for the registration of property transactions in Ireland and encompasses both the Land Registry and the Registry of Deeds. *Tailte Éireann* also provides national mapping and surveying infrastructure and a property valuation service for Ireland.

Title insurance is used in property transactions in Ireland but is not widespread.

While the use of electronic signatures has increased in Ireland, in part due to the COVID-19 pandemic, the transfer of Irish real estate is still required to be effected by way of original wet ink signature. The Electronic Commerce Act 2000 (the "E-Commerce Act") governs the use of electronic or digital signatures in Ireland. Previously, interests in land were specifically excluded from the ambit of the E-Commerce Act. However, the Electronic Commerce Act 2000 (Application of Sections 12 to 23 to Registered Land) Regulations 2022 (the "Regulations") amended the E-Commerce Act and allowed for the legal recognition of the electronic execution of documents dealing with interests in registered land. Notwithstanding the Regulations, practice has not yet changed in Ireland as the Land Registry – while welcoming the introduction of the Regulations – has clarified that it is not currently in a position to accept electronic or digital signatures on documents submitted to it for registration. Ultimately, Land Registry practice will dictate whether electronic signatures are acceptable on documents relating to real estate interests. An exception to this is the contract for sale which may be executed by electronic signature. While it was possible to use an electronic signature to execute contracts previously, the 2023 Law Society of Ireland General Conditions (the "General Conditions") provide express confirmation of the parties' consent to electronic exchange of contracts, the use of counterparts and the potential to use electronic signatures. As with all the General Conditions, this condition can be amended in a contract for sale by a special condition.

2.4 Real Estate Due Diligence

A buyer's lawyer will investigate the seller's title to the property pre-contract to ensure the buyer will acquire a good marketable title. The underlying principle is one of caveat emptor ("buyer beware").

The Law Society of Ireland produces a template contract for sale for property transactions. This requires the seller to list the documentation and searches to be provided in relation to the property and incorporates the General Conditions. The General Conditions make assumptions about the property and place certain disclosure obligations on a seller, which the seller can only exclude by inserting a bespoke special condition in the contract for sale. In this way, the buyer should be on notice of any deviations from the template. In commercial property transactions, it is normal for the seller to seek to limit the warranties being provided in the General Conditions. Where the

seller's knowledge of the property is limited (eg, in an enforcement sale), it is usual to limit many of the warranties.

The buyer's lawyer also carries out searches against both the seller and the property.

2.5 Typical Representations and Warranties

The principle of caveat emptor is diluted somewhat by the General Conditions, which place a number of warranties and disclosure requirements on the seller. For instance, the General Conditions include numerous warranties relating to matters such as notices, planning compliance, boundaries, easements and identity. These warranties can be excluded or amended by way of special condition by agreement between the parties.

In addition to any specific disclosures, sellers often limit the warranty provided in respect of planning and building control compliance by reference to documentation and certificates of compliance with planning and building regulations in the seller's possession and provided to the buyer. Where the property is being sold in an enforcement scenario (ie, by a receiver, a liquidator or a mortgagee), it is common for many of the warranties contained in the General Conditions to be expressly excluded or varied/limited by reference to knowledge. While parties are free to negotiate the terms and warranties provided in a contract for sale, generally speaking the COVID-19 pandemic has not resulted in new warranties or representations being provided.

Parties to a contract for sale are also free to negotiate whether any of the representations and warranties included will be subject to certain limitations or caps on liability, or if they have a limited validity period. Where no such period is included, the time period in which proceedings must be brought in respect of a breach of the contract defaults to the provisions of the Statute of Limitation 1957 – that is, six years from the date the action accrued where the agreement was executed as a simple contract, or 12 years where the contract was executed as a deed.

There are also implied covenants as to ownership on the part of the seller, which are detailed in the 2009 Act.

A seller can be liable for misrepresentation. General Condition 29 of the General Conditions provides that a buyer will be entitled to compensation for any loss suffered as a result of an error, which includes any non-disclosure, misstatement, omission or misrepresentation made in a contract for sale. However, as outlined above, a seller may seek to exclude or vary this condition by inserting an appropriate special condition in the contract for sale.

Representation and warranty insurance is available in the Irish market. However, it is not frequently used as part of real estate transactions, except where real estate is being acquired by way of a corporate rather than an asset acquisition.

2.6 Important Areas of Law for Investors

An investor should ensure that the title to the property is good and marketable, that the property complies with the Local Government (Planning and Development) Acts 1963 to 1999 and the Planning and Development Acts 2000 to 2023 (together, the "Planning Acts") and environmental laws, and that the property has all the necessary easements for access and services. Investors will also need to ensure they understand the application of Irish tax law.

2.7 Soil Pollution or Environmental Contamination

A buyer may have secondary liability for soil pollution or environmental contamination. If the person or entity that caused the pollution or contamination cannot be identified, the current owner or occupier of the property could become liable under the applicable environmental legislation for remediation. It is therefore important that environmental due diligence be carried out by a buyer where compliance with environmental laws is a concern.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The Planning Acts govern planning and zoning matters in Ireland and regulate the zoning and permitted uses of areas through a variety of development, sustainability, landscape conservation and special amenity plans.

Each local authority has a development plan that sets out the planning policy of the local authority for a six-year period. This is due to change to a ten-year plan under the Planning Bill.

A buyer's solicitor should carry out a planning search as part of the planning due diligence, and this search should specify the zoning applicable to the property.

The State Authorities (Public Private Partnership Arrangements) Act, 2002 (the "2002 Act") enables local authorities to enter into joint-venture public private partnership (PPP) arrangements with the private sector. A PPP is an arrangement between the public and private sector for the provision of infrastructure or services. Under this model, contractors in the private sector become long-term providers of a service, rather than merely building an asset upfront. This allows local authorities to plan resources and monitor services, rather than provide them directly.

2.9 Condemnation, Expropriation or Compulsory Purchase

Local authorities and other state entities, the National Asset Management Agency (NAMA) – a body established by the Irish government in 2009 to function as a "bad bank" acquiring property loans from Irish Banks – and the Industrial Development Agency (IDA) – Ireland's inward investment promotion agency – all have the ability to purchase lands compulsorily in connection with their statutory functions.

Local authorities can compulsorily acquire lands in the following circumstances:

- where property is derelict and poses a danger in the community;
- for the purpose of developing infrastructure; and
- for conservation/preservation purposes.

NAMA has extensive statutory powers to acquire land compulsorily where this is necessary to allow NAMA to fulfil its statutory function and derive the best value from the property assets secured to it.

The IDA also has the ability to acquire property compulsorily for the purpose of industrial development. A key function of the IDA's role is acquiring land for development purposes, so the IDA's statutory power to acquire land compulsorily is quite broad.

2.10 Taxes Applicable to a Transaction

A transfer of Irish real estate and certain other property, including shares, is liable to stamp duty payable to the Irish Revenue Commissioners ("Revenue"). Stamp duty is charged on the con-

sideration payable for the property, or the market value in certain instances. Usually, the buyer is liable for the payment of stamp duty, although both parties can be liable in certain transactions, such as voluntary transfers.

Where an instrument is liable to stamp duty, a stamp duty return must be filed online via the Revenue's e-stamping system within 44 days. Failure to file and pay within this period will result in late filing and interest charges.

The rate of stamp duty payable on the transfer of non-residential (commercial) property is currently 7.5%.

The rate of stamp duty on transfers of residential property is 1% on considerations up to EUR1 million and 2% on consideration over this threshold. Since May 2021, an increased rate of 10% stamp duty applies if ten or more residential units are acquired in a 12-month period. This measure was enacted to discourage large-scale residential acquisitions. The increased rate applies if the units are in one development/area or are located in different areas throughout the country. It does not apply to apartment units.

Where non-residential property is transferred and subsequently utilised for the construction of residential accommodation, a stamp duty refund is available, which effectively reduces the rate from 7.5% to 2%. This scheme is subject to several conditions including that construction must have commenced by 31 December 2025 and within 30 months of the date of transfer of the land.

Stamp duty on the transfer of Irish shares is generally charged at 1% of their value. Transfers of shares or interests of corporate entities (including Irish and non-Irish incorporated companies) and partnerships can be subject to 7.5% duty where the entity derives over 50% of its value from Irish land intended for development, held as trading stock, or held with the sole or main object of realising a gain on disposal. This provision is subject to a number of conditions, including that the transfer is one that transfers control of the land. Transfers of minority holdings may not be impacted. Transfers of entities holding certain residential property may also be subject to the 10% rate of stamp duty outlined above.

Stamp duty exemptions are available for transfers of property between group companies and on certain transfers of property between spouses, civil partners, and cohabitants.

2.11 Legal Restrictions on Foreign Investors

All investors, including foreign investors, need to comply with anti-money laundering legislation.

A new law, the Screening of Third Country Transactions Act 2023 (the "2023 Act") is due to come into force in the second quarter of 2024. This will establish Ireland's first regime for screening investments from third-party countries (ie, those outside the EEA and Switzerland) in certain Irish industries that could pose a risk to the state's security or public order, in conjunction with an EU regulation. The industries include energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure. Transactions falling within the scope of the act will need to be notified to the Minister for Enterprise, Trade and Employment in advance and will require the consent of the minister to proceed.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions are financed by banks and non-bank lenders advancing both senior and mezzanine debt to fund the acquisition and development of commercial property.

The choice between bank financing or financing by alternative lenders is influenced by the commercial terms on offer. Alternative lenders are not subject to the regulatory restraints imposed on banks, so have a different appetite for risk. There is a trend towards alternative lenders providing development finance at much higher loan-to-value ratios than banks. Such financing is usually made available at a higher margin with prepayment, arrangement and exit fee mechanisms, as well as equity interests in the transactions.

3.2 Typical Security Created by Commercial Investors

A lender will provide finance secured over the relevant property that will be registered as first-ranking in the appropriate property registry, thereby securing priority of the security for the lender's benefit. Where a lender is providing finance for development purposes, it would be normal for them to receive collateral warranties from the members of the professional team, such as architects, designers and engineers, as well as step-in rights.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on the granting of security over real estate to foreign lenders or repayments to foreign lenders. Pursuant to the Companies Act 2014 (the CA), the directors of an Irish company have the authority to exercise the company's power to borrow and to mortgage or charge its property, subject to Irish law and its constitutional documents. The 2023 Act will affect foreign lenders in certain situations, and they should understand its implications. See **2.11 Legal Restrictions on Foreign Investors** for further details on the 2023 Act.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Registration of Security

A fee of EUR40 is payable in respect of the registration of security with the Companies Registration Office (the CRO). It is a statutory requirement for security created by an Irish company to be registered with the CRO within 21 days, and registration must be completed electronically. Failure to comply may only be remedied by a costly court application.

The creation of security does not attract tax, although a written notification must be made to Revenue by both the charge-holder and any subsequent transferee of that charge where a company creates a fixed charge over its book debts.

Witholding Tax

Where repayments under a security document or loan agreement include interest payments with an Irish source, a 20% withholding tax must be applied to the payments in Ireland. Numerous exemptions are available to companies that make payments of Irish-source interest to foreign lenders. Foreign lenders, which are "qualifying lenders", should be entitled to receive Irish-source interest payments free from the withholding tax; qualifying lenders include certain foreign banks, companies that are resident for tax purposes in the EU or in jurisdictions with a double tax treaty agreement with Ireland, and certain treaty lenders.

Capital Gains Tax

The sale of Irish real estate, or of unquoted shares in companies deriving the greater part of their value from Irish real estate, will be subject to Irish capital gains tax. The gain is calculated on the proceeds of sale minus acquisition and enhancement costs, and minus the incidental costs of acquisition and the incidental costs of disposal.

Irish capital gains tax is subject to a withholding procedure applicable to the seller's capital gains tax liability. The procedure requires the buyer to withhold 15% of the consideration and pay this amount to Revenue unless the seller provides a clearance certificate. A capital gains clearance certificate is automatically available on application to Revenue if the seller is resident in Ireland for tax purposes. A non-resident seller will need to agree and discharge its capital gains tax liability in order to obtain a clearance certificate. This withholding procedure only applies to a buyer where the consideration payable to the seller exceeds the relevant threshold at the date of the transfer agreement (currently EUR500,000 or EUR1 million if the asset sold is a house or an apartment).

The current rate of capital gains tax is 33%.

Registration Fee

A registration fee of EUR175 is payable to register security in the Land Registry and EUR50 to register security in the Registry of Deeds.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The CA prohibits the provision of financial assistance by an Irish company in the form of a guarantee, security or otherwise to a person that is purchasing or subscribing for shares in the company or its holding company. There is a validation procedure by which financial assistance may be approved in advance, and the approving documentation must be filed with the CRO by the company within the prescribed time.

The CA contains a prohibition on Irish companies providing guarantees or security in relation to the debts or obligations of its directors (or directors of its holding company) or persons connected to those directors (including family members and spouses). There is an exemption from this prohibition if the debts or obligations relate to a group company.

There is a general requirement that Irish companies derive benefit from transactions into which they enter.

3.6 Formalities When a Borrower Is in Default

Appointing a Receiver

A receiver is typically appointed by a secured creditor under contractual powers granted by the debtor under the security document. The receiver's function is to take possession of the secured assets (including any real estate) and discharge any unpaid indebtedness from the realisation proceeds.

The CA provides that a receiver of the property of a company can do all things necessary or convenient to achieve the objectives for which they were appointed. The CA specifies powers that a receiver may exercise (in addition to the powers conferred on them by the order or instrument pursuant to which they were appointed, or any other law).

It is also possible to apply to the High Court to have a receiver appointed over assets – for example, if a trigger event set out in the security document for the appointment of a receiver

has not occurred, but the secured assets are in jeopardy.

Registering Security Interests

Before certain security interests created by a company can be valid and have priority over subsequent security interests, they must be registered in the CRO within strict time periods, or the charge may be rendered void against the liquidator and any creditor of the company, and priority will be lost. Where a certificate of charge has been issued by the Registrar, it is conclusive evidence that the charge has been registered. The priority of charges runs from the date of filing, and not from the date of creation of the charge.

Priority of Charges

The rules on the priority of charges take effect subject to the rules on priority contained in any other enactment governing the priority of such charges. Consequently, the priority of charges created by companies over real estate will be determined in accordance with the order in which they are registered in the Land Registry or the Registry of Deeds, as the case may be.

Enforcement and Realisation of Security

The timeframe for the successful enforcement and realisation of security on property in Ireland can vary greatly. If the borrower is co-operative, the enforcement process can proceed smoothly, especially where possession is voluntarily surrendered. If the borrower is not co-operative, however, the process can take time and may involve court applications, particularly if the validity of the security is challenged or if possession is not voluntarily surrendered. If a receiver is appointed over the assets of a company, certain statutory filing and advertising requirements must be adhered to.

The situation can be more complex where security is over a principal private residence, and certain conditions set out in the 2009 Act will have to be complied with when enforcing the security. Where the consent of the borrower is not forthcoming, a court order will be required prior to a lender possessing or selling a property. These requirements can cause delays in a lender enforcing its security.

An Irish company (or its directors, creditors and shareholders holding at least 10% of the company's paid-up voting share capital) may petition the High Court to appoint an examiner in circumstances where that company is unable (or is likely to be unable) to pay its debts but where there is a reasonable prospect of the survival of the company. During the period that an examiner is enquiring into the affairs of a company, a moratorium prevents secured creditors from enforcing their security without the consent of the court.

The government has not sought to restrict a lender's ability to foreclose as a result of the COVID-19 pandemic.

3.7 Subordinating Existing Debt to Newly Created Debt

As set out in **3.6 Formalities When a Borrower Is in Default**, a real estate lender must register the charge/mortgage with the CRO to perfect security. Once the security is perfected, newly created debt cannot obtain priority over existing debt, other than by agreement.

The priority of debt can also be structured through the following:

- contractual subordination;
- structural subordination; or
- intercreditor arrangements.

3.8 Lenders' Liability Under Environmental Laws

Lenders may be reluctant to enforce security in circumstances where the borrower has environmental liabilities due to the application of the principle of strict liability under Irish environmental legislation. There is a risk in these circumstances that a lender may be liable under environmental laws for environmental contamination despite not having caused the contamination.

3.9 Effects of a Borrower Becoming Insolvent

Under Irish law, both the creation of security and the making of payments by a company within six months prior to it being placed into insolvent liquidation are liable to be set aside as an unfair preference if the company intended to prefer the creditor benefiting from the transaction over its other creditors. In the case of a connected person, the period is extended to two years and the transaction is deemed, unless shown to the contrary, to give that person preference over other creditors, and to be an unfair preference and accordingly invalid.

Where a company is being wound up, a floating charge on the undertaking or property of the company created within 12 months before the date of commencement of the winding-up (or two years if the floating charge is created in favour of a connected person) will be invalid, unless it is proved that the company was solvent immediately after the creation of the charge. This provision does not apply to:

- money actually advanced or paid, or the actual price or value of goods or services sold or supplied, to the company at the time of or subsequent to the creation of, and in consideration for, the charge; or
- interest on that amount at the appropriate rate.

3.10 Taxes on Loans

There is no requirement for either lenders or borrowers to pay recording taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Planning Acts apply to strategic planning and zoning and regulate the zoning and permitted use of areas.

The relevant local authority is the entity responsible for controlling land use and occupation. An independent third-party appeals board, the Bord, is responsible for the determination of planning appeals. The Planning Bill aims to modernise this area of law. See **1.3 Proposals for Reform** for further details on the Planning Bill.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design and construction of buildings is regulated by the Building Control Acts 1990–2020, the Building Regulations 1997–2022 and the Building Control Regulations 1997–2021 (together, the "Building Regulations"). The Building Regulations provide for proper building standards, fire safety, workmanship, conservation of energy and access for people with disabilities.

4.3 Regulatory Authorities

The relevant local authority is the entity responsible for controlling land, building use and occupation.

The Bord is responsible for the determination of planning appeals.

Planning permission is required for any development of land or property unless the development is exempt from this requirement.

Planning permission may not be required for certain non-structural works to the interior of a building or for works that do not materially affect the external appearance of the structure. However, an application to the local authority for a Fire Safety Certificate or a Disability Access Certificate may be required in accordance with the Building Regulations.

The Building Regulations require a commencement notice to be lodged with the building control authority prior to commencing works, together with plans and specifications, a preliminary inspection plan and various certificates and notices. It is an offence not to submit a commencement notice, and failure to do so cannot be rectified at a later date. A certificate of compliance on completion must be submitted to and registered by the building control authority before the building or works may be opened, occupied or used.

Certain licences may also be required, depending on the type of property and the type of development proposed.

4.4 Obtaining Entitlements to Develop a New Project

If the planning authority consents to an application for planning permission, it will issue a decision to grant planning permission and notify the relevant parties of its decision. An appeal of the decision can be submitted to the Bord within four weeks (such an appeal may be submitted by the parties involved or by third parties). The Bord has a statutory timeframe of 18 weeks from the receipt of an appeal in which to reach a determination.

A new planning process was introduced in 2022 for Large-Scale Residential Developments. This process involves a pre-application stage, an application stage, and an appeal stage. The Bord must reach a decision on an appeal within 16 weeks (this may be extended in certain circumstances). Increased housing supply is a focus under “Housing for All”, the Irish government’s housing plan to 2030.

4.5 Right of Appeal Against an Authority’s Decision

Anyone applying for planning permission or who has made written submissions or observations to the planning authority on a planning application can appeal a subsequent planning decision to the Bord; see **4.4 Obtaining Entitlements to Develop a New Project** for further detail.

4.6 Agreements With Local or Governmental Authorities

As outlined in **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**, the 2002 Act enables local authorities to enter into PPP arrangements with the private sector. Types of PPPs include:

- Design-Build-Finance-Maintain PPPs, which may be used to provide schools and similar infrastructure where the public sector has use of the asset but does not require the private partner to provide the service – for example,

in the case of a school, the public sector employs the teaching staff; and
- Design-Build-Finance-Operate-Maintain PPPs, which may be used in the case of a water-treatment plant where the private sector staffs the plant to ensure service delivery on behalf of the public sector contractor.

4.7 Enforcement of Restrictions on Development and Designated Use

The Planning Acts govern restrictions on development and permitted use. The procedure for planning offences is as follows:

- issue a warning letter;
- serve an enforcement notice; and
- institute legal proceedings.

The warning letter, which must be served within six weeks of receiving a complaint, gives a developer up to four weeks to rectify or make a submission in respect of the issue.

Any submission received from a developer or owner must be taken into account when deciding whether to serve an enforcement notice. An enforcement notice sets out the requirements of the local authority in order for the issue to be rectified by the developer/owner and contains a timeframe within which the work must be completed. Non-compliance with an enforcement notice is an offence, and the local authority may institute legal proceedings in the District Court.

In urgent cases, the local authority may apply to the Circuit or High Court for an order directing that particular actions take place or cease, as the case may be. The statute of limitations applies to planning enforcement for unauthorised development. Typically, this means that the period during which enforcement action can be taken for breach of a condition of a planning permission is limited to seven years from the life of the planning permission (usually five years).

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Irish companies, non-Irish companies (such as companies incorporated in Luxembourg), limited partnerships, REITs and Irish-regulated funds are used by investors to acquire real estate assets.

A REIT is a type of public limited company (PLC) that must meet certain criteria; it will not be liable to corporation/income tax on its property rental income or profits, or to capital gains tax on disposals of assets of its property rental business. A REIT must be in operation for a minimum of 15 years in order to avoid any latent capital gains tax exposures when it ceases to be within the regime. REITS are not commonly used in the Irish market, where just one remains.

Institutional investors historically used Qualifying Investor Alternative Investment Funds (QIAIFs) to acquire Irish real estate. QIAIFs are most commonly established as Irish Collective Asset-management Vehicles (ICAVs). Previously, ICAVs offered investors some tax advantages, but this has changed as are now subject to a 20% withholding tax on profit distributions to investors and are exposed to a deemed income tax charge of 20% if they have debt costs above certain thresholds. As a result, ICAVs have not been as popular for Irish real estate investment in recent years.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

ICAV

The ICAV is a corporate vehicle similar to an investment company and may be structured as an umbrella fund with segregation of liability between sub-funds.

The Instrument of Incorporation is the ICAV's constitutional document.

Unregulated Structures

Private Company Limited by Shares (LTD)

A Private Company Limited by Shares (LTD) is a simplified entity that has the capacity of a natural person. The constitution of an LTD comprises one document. The LTD does not have an objects clause and has full unlimited capacity to carry on any legal business, subject to any restrictions in other legislation.

Designated Activity Company (DAC)

An Irish company may also be formed as a Designated Activity Company (DAC), which is a private limited company. The constitution of a DAC comprises a memorandum of association and articles of association. The memorandum of association sets out the objects of the DAC, and the DAC can do any act or thing stated in the objects.

PLC

A PLC is another type of Irish company, under which the liability of members is limited to the amount, if any, unpaid on shares held by them. Similar to a DAC, the constitution of a PLC comprises a memorandum of association and articles of association. The memorandum of association sets out the objects of the PLC, and the PLC has the capacity to do any act or thing stated in the objects.

A REIT is a type of Irish PLC aimed at facilitating collective investment in real estate. The constitution of a REIT comprises a memorandum of association and articles of association, with provisions typical of an Irish PLC. The articles of association will impose certain restrictions and obligations on the shareholders of the company to enable the company to qualify as an Irish REIT.

5.3 REITs

REITs are not commonly used in the Irish real estate market. See **5.1 Types of Entities Available to Investors to Hold Real Estate Assets** for further details.

5.4 Minimum Capital Requirement

There is no mandatory minimum capital requirement for Irish private companies.

The Central Bank (CB) does not apply a minimum capital requirement for QIAIF ICAVs, which are externally managed by an alternative investment fund manager (AIFM). However, an internally managed QIAIF ICAV must have a minimum paid-up share capital equivalent to EUR300,000.

In addition, ICAVs structured as QIAIFs must apply a minimum initial subscription requirement of EUR100,000 per investor. Exemptions from this minimum subscription requirement can be sought by certain categories of knowledgeable investors, including the directors of the QIAIF, the investment manager and its senior employees.

5.5 Applicable Governance Requirements

REITs

REITs must comply with the corporate governance provisions set out in the CA applicable to PLCs. In addition, any market on which a REIT's

shares are admitted to trade will have regulatory, listing and other relevant rules, as applicable.

ICAVs

An ICAV is represented by its board of directors (the "Board"), at least two of whom must be Irish-resident. The appointment of directors is subject to the prior approval of the CB, under its fitness and probity regime. The Board has a general fiduciary duty to ensure that the requirements of the ICAV Act 2015 are complied with, and remains responsible for the management of the ICAV and the supervision of all its delegates.

The Board must observe Irish Funds' Industry Corporate Governance Code (the "Code"), which aims to ensure that the Board performs effective oversight of the ICAV's activities. Among other subjects, the Code contains recommendations in relation to Board composition, which include the requirement for at least one representative of the AIFM/investment manager and at least one director to be fully independent of all service providers to the ICAV.

ICAVs are required to be audited annually and must also submit their annual reports and monthly statistical returns to the CB.

Each ICAV is required to appoint numerous regulated service providers to carry out various governance roles. Most significantly, the AIFM Directive requires that each QIAIF must identify an AIFM, which is the entity primarily responsible for the investment and risk management of the QIAIF, subject to the overall supervision of the Board.

It is also possible for an ICAV to be authorised as an internally managed QIAIF, whereby the Board assumes the responsibility as the AIFM.

Every ICAV must appoint an independent Irish-regulated depositary to carry out multiple functions, including the safekeeping of assets, regulatory oversight and cash flow monitoring obligations. In addition, the depositary must enquire into the conduct and management of the ICAV in each financial year and report to the shareholders.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual maintenance and accounting compliance costs vary from structure to structure.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A person or entity may enter into either a lease or a licence with the owner of a property to occupy and use the property, without acquiring the property outright.

A licence is more suitable for shorter-term arrangements. A licensee under a licence does not obtain exclusive possession of the property, but rather has mere permission from the owner to enter the property.

In contrast, a lease confers a legal interest in the property to the tenant, and this interest may typically be assigned or transferred, subject to the requirement to obtain consent from the landlord.

6.2 Types of Commercial Leases

There are two main categories of commercial leases:

- a lease on a short-term basis for a term of up to five years; or

- a lease on a medium- to long-term basis, usually for ten years to 15 years.

6.3 Regulation of Rents or Lease Terms

Commercial leases are freely negotiable, subject only to statutory provisions. Recent Irish case law has emphasised that a court will not imply terms into a lease where it has been freely negotiated, even in the context of the COVID-19 pandemic. Generally, any rent arrears remain payable unless an alternative agreement is reached between the landlord and tenant.

Certain areas in Ireland have been designated as Rent Pressure Zones (RPZs). RPZs are located in parts of Ireland where rents are highest, and where households have the greatest difficulty finding affordable accommodation. RPZs now cover most urban areas in Ireland. Under current legislation, any increase in the rent charged on residential property cannot exceed general inflation, as recorded by the Harmonised Index of the Consumer Prices, or 2% per year pro rata, whichever is lower.

6.4 Typical Terms of a Lease

It is now unusual to have a lease with a term in excess of 15 years in the Irish market. Previously it was not unusual to have leases with terms of between 20 and 30 years.

In general, commercial leases in Ireland are full repairing and insuring leases, and a tenant will have full repairing obligations. The obligations are imposed directly by a repair covenant in the lease or, in the case of a multi-let development such as an office block, shopping centre or business park, the obligations may be imposed indirectly through a service charge that imposes an obligation on the tenant to reimburse the landlord for repair works carried out to the structure and common areas of the development.

Payment obligations are subject to agreement between the parties, although the most common payment is quarterly in advance.

The practice that developed during 2020 and 2021 of landlords agreeing to rent abatements or standstill arrangements for rent-free periods where premises were closed due to COVID-19 is no longer common practice, and landlords now generally refuse to include such provisions in newly negotiated leases.

With the increased focus on ESG factors in real estate transactions, green leases are becoming increasingly important and incorporate clauses that promote the sustainable operation and management of buildings. In January 2023, the Irish Property Working Group of The Chancery Lane Project published a suite of green lease clauses for use in commercial leases in Ireland. These clauses, or variations thereof, are expected to become increasingly permanent fixtures in the terms of a typical commercial lease.

6.5 Rent Variation

Usually, a commercial lease will provide for a rent review periodically throughout the lease, generally at five-yearly intervals. The rent may be either increased or decreased (the 2009 Act prohibits “upward-only” rent-review clauses from February 2010, but not with retrospective effect). Commercial landlords and tenants employ certain mechanics on occasion to control the variation in the rent – for example, a fixed or stepped rent over the term of a lease may be provided for, or the rent may be linked to the variation in the Consumer Price Index.

6.6 Determination of New Rent

Usually, rent is reviewed upwards or downwards to market rent and agreed between the landlord and tenant. If agreement cannot be reached

between the parties, the lease may provide for referral to an expert or an arbitrator for determination.

6.7 Payment of VAT

In the case of a commercial/business lease, a landlord may elect (but is not obliged) to charge VAT on the rents, in which case VAT applies at the relevant rate (currently 23%).

6.8 Costs Payable by a Tenant at the Start of a Lease

Stamp duty is payable on commercial leases at 1% of the average annual rent. It is the tenant's responsibility to discharge the stamp duty. A tenant may also be obliged to pay insurance rent, any initial service charge contribution and, if commercially agreed, a deposit.

6.9 Payment of Maintenance and Repair

A landlord or management company will normally maintain common areas in a multi-let building or estate and recoup the costs from the tenants through a service charge.

6.10 Payment of Utilities and Telecommunications

Normally, a tenant is responsible for all outgoings consumed on the premises, and these are usually metered and paid directly by the tenant to the provider. Utilities and telecommunications consumed on the common areas are normally paid by the landlord and recouped from the tenants via a service charge.

6.11 Insurance Issues

The landlord will usually insure the property, and the tenant will refund the amount of the premium to the landlord as insurance rent under the lease. Typical risks insured against for property damage are fire, flooding, storm, malicious damage, subsidence and lightning. Terrorism insurance is also available in the Irish market. Some tenants and businesses have recovered costs under business interruption insurance, depending on the terms of the relevant insurance policy.

In 2022, the Irish Commercial Court issued its third judgment in favour of the claimants in a case taken by a group of publicans against a large insurance group in Ireland in relation to the non-payout of proceeds in respect of business interruption insurance due to closures necessitated by the COVID-19 pandemic. The decision was presided over as a test case for the jurisdiction and should offer greater clarity for policy drafters seeking to bring certainty as to the level of risk assumed by insurers providing business interruption cover.

6.12 Restrictions on the Use of Real Estate

A lease will contain a user clause outlining the permitted use of the property by the tenant. If a tenant wishes to change the permitted use, the consent of the landlord is generally required (legislation provides that such consent may not be unreasonably withheld).

6.13 Tenant's Ability to Alter and Improve Real Estate

Depending on the provisions of the lease, a tenant may be permitted to alter or improve the property, usually subject to the landlord's consent and the tenant's obligations on yield-up of the premises, which normally include returning the property to its original condition. Structural alterations are generally prohibited, with internal non-structural alterations permitted subject to the prior written consent of the landlord.

6.14 Specific Regulations

The RTA govern leases of residential property in Ireland, provided the term does not exceed

35 years. Any residential property for lease must meet certain standards under the Housing (Standards for Rented Houses) Regulations 2019. The LTA govern leases of industrial, office, retail or hotel space.

6.15 Effect of the Tenant's Insolvency

Commercial leases usually include a provision entitling a landlord to terminate a lease by way of forfeiture if the tenant becomes insolvent. If the obligations of the tenant under the lease are guaranteed by a guarantor, the guarantor may be required to take a new lease on the same terms as the previous lease for the length of the term remaining.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Normally, where a tenant's covenant strength is less than that required by a landlord, the landlord will seek a guarantor for the obligations of the tenant (or a bank guarantee or cash deposit).

6.17 Right to Occupy After Termination or Expiry of a Lease

Where a commercial tenant has been in continuous occupation for a minimum period of five years, it will obtain a statutory right to a new tenancy unless it has renounced its statutory rights. A lease term will expire automatically and so, while a landlord is not required to serve notice on a tenant to ensure the tenant vacates a premises, in practice, where a deed of renunciation has not been executed by a tenant, a landlord will be in contact with the tenant to arrange an orderly yield-up of the premises and ensure compliance by the tenant with the covenants in the lease and, in particular, with the repair and yield-up obligations.

6.18 Right to Assign a Leasehold Interest

Usually, the provisions of a commercial lease contain restrictions on a tenant's right to assign or sublet the lease without the landlord's prior written consent. Under the LTA, a landlord cannot unreasonably withhold consent to the assignment or subletting of the entirety of a premises; this provision overrides the contractual terms of any business lease. The assignment or subletting of part of a premises is usually prohibited under the terms of a commercial lease.

6.19 Right to Terminate a Lease

Generally, a commercial lease is terminated by the expiry of the term or the exercise of a break option, or by agreement between the landlord and the tenant.

Usually, a commercial lease contains a re-entry clause, which entitles a landlord to forfeit the lease where the tenant breaches an obligation. Forfeiture is an equitable remedy and can be effected without a court order, if done peaceably; however, forcible re-entry is a criminal offence. The landlord should seek an ejectment order from the court if the tenant remains in occupation and resists re-entry by the landlord.

6.20 Registration Requirements

A commercial lease for a period in excess of one year is required to be in writing but need not be executed as a deed. However, it is advisable to have a lease executed as a deed.

Leases can be registered in the Registry of Deeds, although this practice is no longer widespread.

Leases with a term in excess of 21 years should be recorded with the Land Registry. A new leasehold folio will be opened in respect of the lease

provided that the term of the residue of the lease at the time of registration exceeds 21 years.

Leases for a term not exceeding 21 years do not need to be recorded and can affect registered land without registration.

6.21 Forced Eviction

As previously stated, a commercial lease may be terminated by forfeiture. While this can be effected without a court order, in some circumstances a court order will be required – for example, if the tenant refuses to vacate the property. A court application can take from six to 12 months.

6.22 Termination by a Third Party

A commercial lease may not typically be terminated by a third party; it can only be terminated by the parties to the lease.

6.23 Remedies/Damages for Breach

If there is a guarantee in the lease, a landlord may look to the guarantor to remedy the tenant's breach. Alternatively, if the tenant has paid a rent deposit, the landlord may be permitted to use all or part of the deposit to remedy the breach, depending on the terms of the agreement governing the deposit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common basis for the pricing of construction contracts is a fixed-price sum, where the price includes the risks associated with the construction of the works, except to the extent excluded under the contract. Other forms of pricing are also used, such as re-measurable contracts (where the client takes the risk for the quantities needed for the works) or GMP (guaranteed maximum price) contracts. GMP contracts can vary in how they are structured but they typically involve an open-book system subject to a shared allocation with the contractor, where the final contract price is below the GMP).

7.2 Assigning Responsibility for the Design and Construction of a Project

The client can assign responsibility for design and construction by:

- awarding a design-and-build (D&B) contract to a main contractor whereby it takes full responsibility for both design and construction, including the work of its external professional team and subcontractors; or
- appointing its own design team and entering into a build-only construction contract if it wishes to maintain more control over the design of the development.

Funders may prefer the D&B model, as it offers a sole point of responsibility for design and construction.

7.3 Management of Construction Risk

A contractor usually provides insurance-backed indemnities to the client as part of the construction contract. It has become more common for contractors to seek to limit their liability with a cap on their general liability under the contract and excluding certain damages, such as indirect and consequential damages and losses. Such exclusions have not become the market norm, but contractors are increasingly pushing for such concessions due to the strong market demand for experienced and capable contractors.

7.4 Management of Schedule-Related Risk

Most forms of construction contracts in Ireland make provisions for the application of liquidat-

ed damages if the contractor does not reach completion by the agreed date. The liquidated damages must be based on a pre-genuine estimate of the losses to be incurred by the client if the works do not complete on time and can be capped at a percentage of the contract value. In the event of delay due to the default of the contractor, the client is entitled to set off the liquidated damages against payments due to the contractor.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is normal for a client to seek the provision of a performance bond from the contractor as a form of security for the proper performance of the works, and this would typically be in addition to the retention by the client of a set percentage (normally 5%) of the payments to the contractor during the construction of the works. Depending on the financial robustness of the contractor, a parent company guarantee may also be required.

7.6 Liens or Encumbrances in the Event of Non-payment

The creation of liens and encumbrances is not common. It is noteworthy, however, that under the Construction Contracts Act 2013, contractors and subcontractors have a statutory right to suspend their works or refer a payment dispute to statutory adjudication in the event of non-payment of a due amount.

7.7 Requirements Before Use or Inhabitation

Under the Building Regulations, a building cannot be occupied or used until prescribed compliance documentation has been submitted to the relevant building control authority and entered onto the relevant statutory register.

8. Tax

8.1 VAT and Sales Tax

Sales of commercial property can be divided into two categories: sales of new property, and sales of old property.

In relation to new buildings, VAT must be charged at the rate of 13.5%.

A property is considered "new" where it has been developed in the previous 20 years, or where buildings on it have been developed or redeveloped in the previous five years. The first sale of residential property by the person who developed the property is always subject to VAT.

Sales of old property are exempt from VAT. In a VAT-exempt sale of property, to avoid a claw-back of VAT that the seller may have previously recovered, the seller and buyer may agree to make an exempt sale VAT-able and jointly opt to tax the sale of the property.

Exemptions

Transfer of Business applies to the sale of a property that has been let in the past, on the basis that the buyer intends to carry on the same sort of business as the seller (ie, letting the property), and will only apply provided the sale is to a person who is accountable for VAT purposes (ie, a person who is obliged to register and account for VAT).

Where the transfer of business relief applies to the sale of an "old" property, no VAT adjustment (known as a Capital Goods Scheme Adjustment) should arise for the seller, and the buyer will take over the property's obligations from the seller under the capital goods scheme.

Where the transfer of business relief applies to the sale of a "new" property, the seller may be able to claim further VAT input credit where it was not entitled to recover the VAT incurred on the acquisition or development of the property.

8.2 Mitigation of Tax Liability

As mentioned in **2.10 Taxes Applicable to a Transaction**, where non-residential property is transferred and subsequently utilised for the construction of residential accommodation, a stamp duty refund is available, which effectively reduces the rate from 7.5% to 2%.

Stamp duty on the transfer of Irish shares is generally charged at 1% of their value. Previously, stamp duty was mitigated on large-scale acquisitions through selling the corporate vehicle holding the property; however, transfers of corporate entities and partnerships can be subject to 7.5% duty where the entity derives over 50% of its value from Irish land intended for development, held as trading stock, or held with the sole or main object of realising a gain on disposal. This provision is subject to a number of conditions, including that the transfer involves the transfer of control of the land.

There are stamp duty exemptions for intra-group transfers of real estate.

8.3 Municipal Taxes

Commercial rates are imposed by local authorities against businesses premises; the local authority determines the level of rates.

An abatement from the payment of commercial rates may be possible where a property is vacant, although this depends on the local authority in question and varies between the different authorities.

8.4 Income Tax Withholding for Foreign Investors

Tenants of non-resident owners of Irish property are obliged to withhold tax from rental income prior to remitting overseas, at the standard income tax rate of 20%. This can be avoided if the landlord has employed an Irish agent to collect the rents.

Non-resident individuals investing in Irish property are charged Irish income tax on taxable rental profits, on a fiscal-year basis. A non-resident individual or partnership is subject to rental income tax at between 20% and 41%. A non-resident company is subject to 25% tax on rental income, minus deductible rental expenses.

Capital gains tax is applicable at a rate of 33% on the gains made on a disposal of property in Ireland. If the seller is non-resident, this will only relate to the sale of specified assets.

8.5 Tax Benefits

Although, historically, Ireland did allow individuals to offset the cost of investment properties against their other income, such schemes were severely curtailed from 2007. There are now minor reliefs, such as the rent-a-room relief, which exempts up to EUR14,000 annually. Commercial landlords can claim tax depreciation (Capital allowances) on capital expenditure for fixtures and fittings. This is provided at a rate of 12.5% over eight years. Certain types of industrial buildings (eg, factories) can qualify for industrial building allowance at a rate of 4% over 25 years.

ISRAEL



Law and Practice

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1. General

1.1 Main Sources of Law

The main sources of real estate law are the following statutes:

- the Land Law, 1969 (the "Land Law");
- the Planning and Construction Law, 1965;
- the Contracts Law (General Part) 1973;
- the Contracts Law (Remedies for Breach of Contract), 1970;
- the Leasehold and Borrowing Law, 1971;
- the Sale Law, 1968;
- the Real Estate Tax Law (Appreciation and Purchase), 1963;
- the Tenant Protection Law, 1972;
- the Pledge Law, 1967; and
- the Arrangements Law, formally known as the Economic Efficiency Law (Amendments to Legislation to Achieve the Budget Goals), which is submitted to the Israeli Parliament for approval once a year alongside the Budget Law, and which consolidates legislative changes in various fields, including real estate.

1.2 Main Market Trends and Deals

Shortage of residential units has been one of the main challenges of the Israeli real estate market in past years. The Israeli market began exploring the option of construction of long-term lease projects (which is uncommon in Israel), though in the last one to two years this track has been almost totally abandoned.

With the intention of encouraging residential construction, tax benefits were given, such as tax benefits to land owners selling their land and where the land is used for construction of residential units within a given (short) period. Additionally, legislative changes occurred in the field of urban renewal, in order to reduce barriers and allow the execution of residential projects.

The sharp interest-rate increase, rising inflation and the global economic crisis led to a significant slowdown in the real estate market over the past year. There has been a reduction in the demand for office and commercial space and for the purchase of residential units, as well as a sharp decrease in construction. 2023 was the weakest year this century for the Israeli real estate market.

1.3 Proposals for Reform

As part of the efforts that have characterised legislative processes in the field of Israeli planning and construction law in recent years, many

changes have been made (or are intended to be made) to facilitate planning and construction procedures, and to speed them up. Such changes include the following:

- the powers of local planning committees to approve city plans were expanded;
- the pre-conditions for filing an appeal against a decision to approve a plan were tightened;
- a special planning committee is to be established, whose role is to advance residential plans; and
- changes are to be made to speed up the approval procedures for building permits.

Following the October war, a temporary order was approved to allow construction of a protected area (a concrete shelter) in residential units without a building permit.

2. Sale and Purchase

2.1 Categories of Property Rights

Israeli law recognises five types of property rights:

- ownership;
- leasehold;
- mortgage;
- right of way; and
- easement.

A very important element of Israeli real estate law is that an obligation to perform a real estate transaction has to be in writing, excluding lease rights that do not exceed five years.

2.2 Laws Applicable to Transfer of Title

The Land Law stipulates the principles for executing a real estate transaction for all types of property – residential, commercial, offices, etc.

Other statutes govern specific areas and stipulate further provisions, which are usually binding on the seller or the landlord and which protect the buyer or the tenants. An example is the Sale Law, which applies primarily to the sale of residential units.

2.3 Effecting Lawful and Proper Transfer of Title

Article 7(a) of the Land Law prescribes as follows:

"A transaction in immovable property requires registration. The transaction is completed by registration, and the time at which the Registrar approves the transaction for registration shall be regarded as the time of registration."

In other words, a real estate transaction is completed only by registration in the applicable Land Registry. Registration is computerised and accessible via the internet, both for viewing and for registration of transactions.

Israel does not have registration or title insurance, as in the United States and other jurisdictions, perhaps because there is no need: in Israel, registration is conclusive and is relied upon.

One element that affects timing of registration is the demand for tax authorisation as a condition for registration of transactions. However, it is possible to facilitate tax payment and authorisation automatically against payment by the buyer of fixed advances on account of tax payments (also those that apply to the seller).

Article 13 of the Land Law stipulates that "a transaction in immovable property extends to the land… and a transaction in respect of a specific part of the property is invalid". Therefore, title (as opposed to leasehold) cannot be reg-

istered with regard to land that is not registered as a separate parcel or as a separate unit in a "co-operative house" in the land registry.

A "co-operative house" is the common way of registering ownership with respect to a building or a project that has two or more units, residential or other, and is different from the US condominium. In past years, Israeli law has accepted the option of 3D registration, though the process for this is complex.

2.4 Real Estate Due Diligence

A due diligence review is conducted prior to a real estate transaction, with the scope varying according to the type, complexity and value of the property, and to other parameters. The review may include the following:

- checking the registration and any restrictions that may exist with regard to the registered rights, such as mortgage, lien or expropriation;
- planning restrictions – what may be built on the property, and whether a valid permit was issued for the existing building;
- physical inspection – ie, of the land, of construction on the land, of infrastructure, etc;
- third-party rights such as tenants, or obligations towards planners or contractors; and
- outstanding taxes and levies on the property, including those that will be imposed on the seller and that will be required in order to register the transaction.

Depending on the value and complexity of the property, various professionals may be retained for the due diligence process (lawyers, accountants, insurance consultants, tax experts, engineers, assessors, etc).

2.5 Typical Representations and Warranties

The seller of real estate must act in good faith and make representations as to what they know about the property, its registration status, defects, and any restrictions and obligations imposed on it. This does not limit the buyer's duty to perform a due diligence review.

The seller must provide representations about matters that cannot be examined, such as agreements with regard to the property.

A seller who fails to fulfil this disclosure obligation can be sued for damages suffered by the buyer, and in some cases may be at risk of the contract's cancellation.

There are also specific obligations for a developer who builds and sells real estate property. Such a developer is subject to enhanced duties, both with regard to the representation and with regard to details and provisions that must be included in the sale agreement and its appendices, such as:

- a duty to complete the registration of the property in the land registry within a specific period of time; and
- a duty to guarantee the buyer's payments until construction has been completed.

There is no survival period for the seller's representations, though naturally there is a term of obsolescence. Representation and warranty insurance is not customary in Israel.

A cap on the seller's liability for a breach of its representations and warranties is not standard, and rarely exists.

Following the COVID-19 pandemic and its contractual consequences, the wording of clauses regarding circumstances beyond the control of the parties (and which will not be considered a breach), is now handled with extra care and caution.

2.6 Important Areas of Law for Investors

Before entering into a transaction for real estate property, the buyer should inspect the items detailed in **2.4 Real Estate Due Diligence**.

If the property is part of a "co-operative house", the buyer should inspect the "co-operative house" documents; if the rights to the property are long-term lease rights, the terms of the lease should be reviewed.

2.7 Soil Pollution or Environmental Contamination

There is no specific law in Israel dealing with responsibility for soil contamination; therefore this subject is handled in accordance with the seller's responsibilities in the contract, and with general legal obligations, such as the obligation to act in good faith and under court precedents (that are binding).

The seller of a property has a duty to disclose extensive information about hidden defects, such as soil contamination. This duty does not require actual knowledge of the contamination, and mere negligence is sufficient to establish the seller's full liability towards the buyer.

The allocation of responsibilities between the parties is examined based on (among other things) the extent of the seller's responsibility in disclosing the contamination, compared to the scope of the inspections that the buyer was required to conduct.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

General information about zoning and building rights with respect to real estate property can be extracted from the websites of the planning authorities. One can obtain official information by filing an application and paying an application fee (negligible amount). In some cases, the applicant is required to submit a measurement of the property in order to receive said official information.

A landowner seeking to rezone their property or add building rights can initiate a planning process, provided that the proposed plan is consistent with binding plans that are higher up in the planning hierarchy, and subject, of course, to the planning policy of the applicable planning authorities. In the last decade, general city plans have been approved for many of the larger cities in Israel, stipulating planning policies and principles such as:

- permitted uses;
- height limits and density; and
- the location of public buildings and public areas, road systems, etc.

Any initiated plans must comply with these principles.

2.9 Condemnation, Expropriation or Compulsory Purchase

Various laws allow property to be expropriated for public use (such as roads, parks, recreation areas, nature reserves, parking areas, etc).

Before initiating such a procedure, authorities must post notice of the intended expropriation in the vicinity of the property, and deliver this notice to the owner in person, to allow them to

appeal against it. The compensation to be paid for the expropriation depends on:

- the decrease in value that results from the change of designation of the land from commercial to public designation;
- the percentage expropriated from the land;
- the stage of the expropriation process; and
- the legislation under which the expropriation was carried out.

If the land is expropriated but not used for the purpose for which it was expropriated, or if the need for such public use has ended, the original owner can claim back their land or its monetary equivalent.

2.10 Taxes Applicable to a Transaction

Pursuant to the Land Tax Law (Appreciation and Purchase) 1963 (the "Land Tax Law"), the buyer must pay purchase tax and the seller must pay land appreciation tax in any real estate transaction.

Generally, purchase tax is 6%; there are progressive rates for residential properties that may exceed this figure. Land appreciation tax (which is capital gains tax) is equal to 23% of the seller's capital gain on the transacted property applicable to a seller that is a corporation. The appreciation tax rate for individuals ranges from 25% to 47%, depending on the date of purchase of the sold property.

However, if the seller's business is the development and sale of real estate property, it will be subject to income tax rather than land appreciation tax.

There are specific exemptions with regard to land appreciation tax on residential apartments. The most common is an exemption on the sale of an apartment if the seller has no other residential unit. There are discounts on purchase tax that apply to an Israeli resident purchasing its only residential unit. Such exemptions apply only to Israeli residents.

In addition, if the seller makes a profit on the sale that results from a change in the applicable city plan, the seller has to pay a land betterment levy to the local authority within whose jurisdiction the property is located, in addition to land appreciation tax. Such levy is calculated as 50% of the gain attributed to the property due to the approval of the city plan.

A gift between certain immediate relatives can be exempted from land appreciation tax, and can be subject to reduced purchase tax rates.

Note that there is no inheritance or estate tax in Israel, so the transfer of real property by will or succession is not taxable.

Land appreciation tax and purchase tax pursuant to the Land Tax Law (as above) applies if the transfer is of shares in a "real estate entity" – ie, an entity that primarily owns real estate property.

2.11 Legal Restrictions on Foreign Investors

There is no restriction on the transfer of privately owned real estate to foreigners. Rights in land administered by the Israel Land Authority (ILA) can be transferred to foreigners, subject to certain limitations.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

In most cases, transactions in commercial real estate are financed by Israeli banks or Israeli insurance companies.

Parties that cannot obtain such financing approach private financers; the terms of such loans from private financers will usually be less convenient for the borrower.

Large projects can raise money by issuing debentures or shares.

3.2 Typical Security Created by Commercial Investors

The collateral available to the financing entity is first and foremost the property itself. Sometimes, the borrower is required to provide additional securities. In the last few years, there have been hardly any non-recourse loans; in other words, the lender has recourse against the borrower.

The property itself is pledged by registering a mortgage at the Land Registry (if the borrower is not registered at the Land Registry), and until registration is completed the collateral can be in the form of an obligation from the ILA or any other third party registered as the owner at the Land Registry, for registering a mortgage together with registration of the borrower's rights in the land.

All income accruing from the property is also pledged as collateral and insurance receivables.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over privately owned real estate to foreign lenders. The registration of a mortgage at the Land Registry in favour of a foreign lender on land owned by the ILA (as mentioned in **2.11 Legal Restrictions on Foreign Investors**) is subject to the terms and conditions set out by the ILA.

There are no legal restrictions regarding loans from foreign lenders or on repayments being made to a foreign lender, except for obligations under tax laws and restrictions under the Anti-Money Laundering Law.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Registration of pledges is subject to the payment of a small fee to the Land Registry. The fee is fixed and is not a function of the value of the property (and is negligible). The cost of notarising a document is also fixed and negligible.

Lenders charge for the preparation of their documents, and for the costs of the consultants they use for the transaction. These amounts could be significant.

Financing agreements commonly stipulate that the cost of foreclosing on the collateral in the case of default will be borne and paid by the borrower. Such costs may be significant.

Upon foreclosure, property is liquidated by selling it and collecting the debt from the proceeds. On the sale of a property in such a case, the borrower shall have to pay land appreciation tax pursuant to the provisions of the Land Tax Law, as described previously.

3.5 Legal Requirements Before an Entity Can Give Valid Security

When resolving to pledge the entity's property, directors must weigh up the best interests of the company and its shareholders, and must verify

that the pledge and financing transaction do not cause a reduction in the entity's capital.

3.6 Formalities When a Borrower Is in Default

A borrower seeking to foreclose on a mortgage or pledge created over a residential apartment must comply with Article 81B1 of the Execution Law 1967, which stipulates that, in the case of a loan that is repaid by instalments and where the borrower defaults on at least one instalment, the lender may file a petition to foreclose only six months after the date of default, and only with regard to the amount in arrears and not with regard to the entire loan amount. If it was not stipulated that the loan would be repaid in instalments, the lender may, upon default, file a petition for full recovery of the loan as of the actual date of default.

The borrower has a right to perform a self-sale and for this has an additional 90 days at their disposal. If the borrower does not exercise this right and does not file an objection, the sale procedure will continue. This may take a few months, and in cases where the borrower's eviction from the residential unit is required, this may take longer. On average, the period for the realisation of a residential unit (provided that the borrower does not file an objection) is up to one year.

The realisation of real estate assets that are not residential units is faster. A borrower has the right to repay the debt within 60 days from the date of submission of the application for realisation, or to object to it. The procedure will include the appointment of a receiver, publication procedures, etc. If the borrower does not file an objection, the whole process should take about six months from the date of filing the case at the enforcement office.

If the borrower submits an objection, the case will continue in court; and it is difficult to estimate the case's length until its conclusion.

The lender will rank higher than other creditors only if they procured the appropriate registration for their rights. The best protection is granted by registering a mortgage in the Land Registry or – if the borrower's rights are not yet registered in the Land Registry – by a pledge with the Registrar of Companies (in the case of a company) and in the Registry of Pledges (in the case of an individual).

3.7 Subordinating Existing Debt to Newly Created Debt

In the case of two or more pledges of the same kind, the one that was registered first will prevail. A fixed charge will prevail over a floating charge. Obviously, the ranking can be changed by agreement between the owner and the lenders.

3.8 Lenders' Liability Under Environmental Laws

The lender does not hold possession or rights in the property. Foreclosure is usually affected by selling the property to a third party, not by transferring it to the lender. The lender is therefore not deemed the possessor and is not liable for compliance with environmental laws with respect to the property. However, such incompliance may affect the property's value.

3.9 Effects of a Borrower Becoming Insolvent

The borrower's insolvency does not in itself void security interests created by the borrower in favour of a lender. However, the Insolvency and Economic Rehabilitation Law allows the court to cancel liens or other securities in some cases – for example:

- a lien that was pre-formed via the process of invalid creditor preference;
- a lien over a property for which no adequate, or inadequate, consideration was given, and which was given while the borrower was insolvent or a short time before insolvency; and
- a lien intended to smuggle the borrower's assets.

3.10 Taxes on Loans

Registration of a mortgage is subject to the payment of a very small fee to the Land Registry, as is the registration of a pledge with the Registrar of Companies (if the borrower is a company) and the Registry of Pledges (if the borrower is an individual).

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Planning and Construction Law 1965 (and the regulations promulgated thereunder) defines the relevant planning bodies – ie, regional committees, local committees and national bodies (such as the National Planning and Construction Council, the Committee for Protection of the Coastline Environment, etc). It also defines the hierarchy among them, and the plans that each is authorised to approve. Each of the planning and construction committees is subject to another one higher up in the hierarchy, though they also have independent discretion with respect to certain matters.

Building plans must always comply with those of higher hierarchy, including regional and national outline plans. Certain subjects are regulated on a national level, such as coastline preservation, gas stations and railways.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Local committees may stipulate instructions for their jurisdiction, relating to (for example) the aesthetic design of the building, its entrance elevations, and its integration into the environment. Some cities in Israel, such as Tel Aviv, adopt specific plans for the preservation and restoration of heritage buildings that define which buildings must be preserved and/or restored, and categorise them according to the level of restoration required. The most protected level requires restoration of all elements and prohibits any additional new construction.

4.3 Regulatory Authorities

There are three levels of planning authorities:

- the National Council, which is in charge of planning and stipulating state-wide instructions and policy;
- the regional committees, which are in charge of promoting and implementing the instructions of the National Council in their respective regions; and
- the local committees, which promote and approve plans on the local level, designate uses, define the land-to-building ratio, stipulate building restrictions, etc.

As mentioned, there are also state-wide terms and conditions, such as building and uses on the coastline or near gas stations.

One planning subject that has been on the planning agenda in the last decade is the building of intracity and intercity public transportation facilities. This also affects construction in the city

centres and the regulations for the construction of parking spaces, as some of the effort in this respect is directed towards massive reduction of parking space allocations and stipulation of a maximum of applicable parking space construction, to make it harder to use private cars and to encourage use of public transportation. A public transportation project is in progress and works are currently being carried out in many regions of Israel, with some transportation lines having already begun operation.

4.4 Obtaining Entitlements to Develop a New Project

All "construction work", which is defined very broadly under Israeli law, requires a building permit from the applicable local planning and construction committee.

A building permit must comply with all plans that govern the relevant land in terms of the land-to-building ratio, location within the lot boundaries, height, designated use, etc.

An owner of real estate property who wishes to construct a building that will not comply with the current plans can apply for a specific city plan. If such a specific plan conflicts with other plans of higher hierarchy, it may also have to be approved by the regional planning and construction committee if it conflicts with regional plans, or by the National Planning and Construction Council if it conflicts with nationwide plans, etc.

Anyone who sees themself as adversely affected were a proposed plan to be approved may file an objection to the proposed plan.

The planning bodies will examine the proposed plan and the objections. It is not possible to object to an application for a building permit that complies with the governing building plans.

4.5 Right of Appeal Against an Authority's Decision

Planning committees' decisions to approve or reject a plan or an application for a concession relief or exceptional use (use that does not comply with the zoning) can be appealed to the Appellate Board or the Administrative Courts.

Decisions of the Administrative Courts can be appealed to the High Court of Justice, subject to receiving leave to appeal.

As stated previously, it is not possible to object to an application for a building permit that complies with the governing building plans.

4.6 Agreements With Local or Governmental Authorities

In some cases, a permit for new construction requires performance of certain development works in the vicinity of the property, regarding traffic, utilities, etc. The local authority charges development levy from the applicant for this purpose, which is usually a "one-time" charge (not a repeated charge), calculated according to the size of the lot and the intended scope of the new construction. The local authority may, in rare cases, require the developer to perform such works on account of payment of the development levy.

4.7 Enforcement of Restrictions on Development and Designated Use

The Planning and Construction Law is a penal code, and is enforced by the law enforcement agencies, including municipal inspectors. A person or entity may face enforcement actions and be exposed to criminal and financial sanctions if they:

- violate the Planning and Construction Law;

- build without a permit or in violation of a permit; or
- use any property in violation of a permit.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Investors can hold real estate through any vehicle they choose, either in their capacity as individuals or through corporate entities (companies, partnerships, etc). The main issues considered are tax planning and limitation of liability, as well as the ability to participate in decision-making.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A company has a separate legal identity to that of its shareholder. A limited liability company protects its shareholders such that, subject to special circumstances, a shareholder of a limited liability company has no exposure should any lawful activity of the company fail. A limited partnership also has a separate legal identity to that of its limited partners. Limited partners that are not involved in the management of the partnership have similar protection as shareholders in a limited liability company, though the general partner (and limited partners that are involved in the management of the partnership) have certain liability to its actions.

A corporation and partnership that purchases real estate will be required to pay a purchase tax at a rate of 6% of the purchase price (see **2.10 Taxes Applicable to a Transaction**). A corporation selling real estate will be taxed with corporate tax for the accumulated appreciation – ie, it will pay appreciation tax at the rate of 23%. In a partnership, each member of the partnership will pay land appreciation tax (capital gains tax) according to their own status.

REIT funds are entitled to benefits in purchase tax, appreciation tax and income tax, subject to certain restrictions.

5.3 REITs

In Israel, there are only a few real estate investment trust (REIT) funds, traded on the stock exchange – most invest in commercial real estate, and some in residential real estate. Those who wish to invest in real estate and enjoy a relatively high return on investment (compared to other low-risk investments) can do so by purchasing participation units in a REIT fund. Unlike investing directly in real estate, investing in REIT funds is simple and does not require high investment amounts. The REIT mechanism in Israel is reminiscent of the trust funds mechanism – everyone is a partner in the trust fund according to their share in the fund.

Both foreign and Israeli entities can invest in REIT funds in Israel.

In order to accelerate the integration of the general public into the real estate market through REIT funds, and to protect the general public, the activities of REIT funds were regulated by legislation in 2006. The law established several obligations and restrictions on REIT funds (such as the obligation to make regular distributions of the fund's profits to its shareholders every year), and granted tax benefits to REIT funds.

5.4 Minimum Capital Requirement

The minimum equity required to incorporate a company is ILS1 (less than USD1). No minimum equity is required to form a partnership.

5.5 Applicable Governance Requirements

No specific requirements apply to entities that invest in real estate (as opposed to entities investing in other fields). As mentioned previously, there are restrictions and obligations on REIT funds (see **5.3 REITs**).

5.6 Annual Entity Maintenance and Accounting Compliance

Companies and partnerships must file annual statements with the Companies Registrar and with the tax authorities, and must pay a fixed annual fee to the Companies Registrar. The annual cost of all the foregoing starts from ILS6,000 to ILS10,000 (approximately USD2,000 to USD2,500), and increases depending on the scope of activity and level of complexity.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The Leasehold and Borrowing Law, 1971 (the "Leasehold Law") provides the following definition: "[a] leasehold is a right granted, against a consideration… to hold possession and use property for a limited time".

The Land Law, which lists leasehold rights as one of the five property rights, offers a similar definition. Making real property available to others for exclusive use, for a limited time, and against a consideration can only be done through a leasehold. Terms such as "use" or "permission", which are not defined by law, are sometimes used in this respect; they are substantially leaseholds.

There is an obligation to report a leasehold agreement to the tax authorities and to register it in the Land Registry, depending on the term of the leasehold (ten years for registration, 25 years for reporting to the land tax authorities and paying taxes). A long-term lease of more than five years is called *hahira* in Hebrew. If the term exceeds 25 years, it is called *hahira-ledorot* (literally: generations long-term lease).

A status of protected tenancy exists in Israel, protecting tenants who were tenants when the Protected Tenancy Law entered into effect and anyone who rented real property and paid a substantial amount up-front in order to obtain this status. However, hardly any new protected-lease agreements are entered into anymore. There is no longer protected tenancy for commercial property, and protected tenancy is gradually disappearing from the residential lease market as well.

6.2 Types of Commercial Leases

Various mechanisms exist for effecting commercial lease agreements, including advance payment, monthly/quarterly payment, rent calculated on revenue, etc. This does not affect the substantive nature of the engagement as leasehold.

6.3 Regulation of Rents or Lease Terms

Lease terms are freely negotiable as they are not regulated, though they are subject to certain "general" legal restrictions and obligations, such as to negotiate in good faith and to reveal to the tenant known defects in the property.

The Leasehold Law was amended in 2017 and "fair rental" provisions were added, protecting residential tenants (of residential units whose monthly rent does not exceed an amount in

Israeli shekel equivalent to approximately USD5,400).

The law defines obligations governing owners of residential properties, including mandatory contractual disclosures, and stipulates the kinds of payments that the landlord should pay and may not demand from the tenant.

As mentioned, some protected tenancies still exist and the rent for these is limited, though they are gradually disappearing from the market.

6.4 Typical Terms of a Lease

The lease term is usually divided into an initial period of about three to five years, plus one or more options for extension periods which the tenant may exercise. The initial lease term and the option periods will not usually exceed ten years in total.

Standard practice is that the tenant is responsible for ongoing maintenance and the repair of any damage, except for reasonable wear and tear. Commercial properties are often let in "shell and core" condition, and the tenant completes the finishing at their own cost. Triple net leases are less common in Israel and are used mainly when the tenant leases a whole building.

Rent is usually paid every quarter, in advance. Since the COVID-19 pandemic, and following the lessons learned from it, lessors of commercial properties often stipulate in the lease agreements that the tenant is obligated to pay the rent and other payments applicable to them, whether they have used the property or not, for whatever reason.

6.5 Rent Variation

In most cases, rent is linked to the consumer price index, and will also increase at the beginning of every optional extension period if exercised by the tenant, as mentioned in **6.4 Typical Terms of a Lease**.

6.6 Determination of New Rent

The rent increase rate is usually predetermined by the parties in the lease agreement. It is common to determine that in each option period rent goes up by 3% to 5%.

6.7 Payment of VAT

VAT is due on rent, though leasing of residential units is exempted from VAT.

6.8 Costs Payable by a Tenant at the Start of a Lease

In addition to the payment of rent, maintenance fees and other ongoing payments throughout the term of the lease (insurance and local taxes to the municipality, for example), tenants of commercial properties are usually required to submit securities to the lessor prior to the commencement of the lease term, and in some cases to contribute to the lessor's legal fees in connection with the lease agreement.

6.9 Payment of Maintenance and Repair

Common areas in commercial properties, such as lobbies and parking areas, are usually managed by the lessor, directly or through a third-party management company. The cost is usually divided between all tenants, according to the ratio between the area of their leased premises and the total area of all relevant leased premises.

6.10 Payment of Utilities and Telecommunications

For utilities and infrastructure that serve several tenants, the same payment applies – ie, the costs are divided between all the users.

6.11 Insurance Issues

In multi-tenant commercial properties, the lessor usually takes care of the insurance of the building and includes the tenants as additionally insured. In some cases, the tenant is billed separately for this cost. In properties that are let to a single tenant, the building insurance obligation can be passed on to the tenant. Coverage is standard; disputes sometimes arise in connection with the duty to insure against earthquakes or other natural disasters. The Israeli government provides insurance with respect to damage caused by war and terrorism.

Depending on the terms of the insurance, the insurance company can sue the person or entity that caused the damage paid for by the insurance company.

6.12 Restrictions on the Use of Real Estate

Lessors may stipulate provisions regarding the use of the real estate in the lease agreement, such as the purpose (subject, however, to antitrust law in the case of shopping malls and similar properties), operating hours, maintenance, etc. Tenants' use of the property is also subject to regulatory provisions, such as the Business Permits Law, which regulates operating hours, the duty to obtain a business permit, compliance with permitted use in accordance with the city plan and building permit, etc.

6.13 Tenant's Ability to Alter and Improve Real Estate

Standard practice is that the lessor prohibits the tenant from performing any works or changes to the property, unless approved in writing and in advance by the lessor. Lessors will generally prohibit any work that involves changes in construction and infrastructure or any change in the external part of the property.

6.14 Specific Regulations

As mentioned, the Leasehold Law was amended in 2017 and "fair rental" provisions were added, which apply to residential leases of residential units whose monthly rent does not exceed an amount in Israeli shekel equivalent to approximately USD5,400. The purpose of this amendment is to protect residential tenants that are usually the "weaker" party, primarily through imposing certain disclosure duties and liabilities on the lessor. The rent fee is not limited by law.

6.15 Effect of the Tenant's Insolvency

The Insolvency and Financial Rehabilitation Law 2018 (the "Insolvency Law") states that the initiation of insolvency proceedings regarding a corporation or its being insolvent does not lead to the cancellation of an existing agreement and does not grant the lessor a right to cancel it, even if it is stipulated in the contract that the contract will be cancelled under such circumstances.

A trustee appointed to an insolvent tenant may, within a limited timeframe, submit to the court a motion to cancel an agreement even if there is no contractual or legal cause for cancellation. The court may approve the cancellation, or order the cancellation of only part of the agreement, if such cancellation is required for the financial rehabilitation of the corporation or will result in an increase in the debt to be paid to creditors.

Even if there is a cause for cancellation of a lease agreement due to its violation by an insolvent tenant, the court may, at the request of a trustee appointed to an insolvent tenant, order the enforcement of the agreement if it finds it necessary for the economic rehabilitation of the corporation.

The court may approve a transfer of the lease to a third party, even if the agreement prohibits such transfer, provided that it does not badly affect the lessor. The court may determine ways to ensure the fulfilment of the obligations according to an agreement that has been transferred or an agreement that the court ordered to be left in force despite its violation.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The best security for lessors is, of course, a bank guarantee. From a legal point of view, this is "safer" than a cash deposit that a trustee appointed to an insolvent tenant may demand be "returned".

The industry standard is a bank guarantee equal to three to six months' worth of rent (plus VAT), plus management fees. Other securities include deposits, promissory notes and personal guarantees.

6.17 Right to Occupy After Termination or Expiry of a Lease

The tenant has no right to stay on the property after the end of the lease. However, if they do, the lessor is not allowed to take any "self-help" action: they must petition the court through an expedited process, seeking an eviction order.

Another effective measure is to stipulate liquidated damages if the property is not vacated after the end of the lease.

6.18 Right to Assign a Leasehold Interest

The Leasehold and Borrowing Law, 1971 states that the tenant may not transfer their rights and/or obligations under a lease agreement or sublease the leased premises, except with the consent of the lessor. However, if the lessor refuses to consent to the transfer for unreasonable reasons, or conditions their consent with unreasonable terms, the tenant may transfer the lease without the consent of the lessor. In a lease agreement, it is possible to agree differently in this regard.

Usually, commercial lease agreements state that the tenant may not transfer their rights and/or obligations under a lease agreement or sublease the leased premises without the lessor's consent. Usually, when the tenant is a corporation, the agreement stipulates that the transfer of control in the tenant will also be considered a prohibited transfer of rights.

6.19 Right to Terminate a Lease

Lease agreements usually include a (broad) definition of breach that may result in termination of the lease – primarily for non-payment of rent or violation of the purpose of the lease.

The Leasehold Law protects the tenant where the property (for specific reasons related to the property or its access, as opposed to a "general" market situation) cannot be used for the purpose of the lease, allowing the tenant to not pay rent for the period when the use of the property was precluded. However, if the tenant exercises this right, the lessor may, after a reasonable time, terminate the lease (unless the tenant waives their right to not pay).

6.20 Registration Requirements

A lease exceeding five years requires a written document. A lease exceeding ten years requires registration in the Land Registry. There is an obligation to report a leasehold agreement to the tax authorities if the lease period (including optional extension periods) exceeds 25 years. In the event of a leasehold exceeding 25 years,

the lessor will be required to pay appreciation tax (capital gains), and the tenant will bear the purchase tax.

6.21 Forced Eviction

If the lessor terminates the agreement due to breach by the tenant, the lessor may require the tenant to vacate the property; if the tenant does not do so, the lessor may petition the court. This may take several months, and longer if the tenant offers substitutional defence arguments.

6.22 Termination by a Third Party

Termination of a lease by a third party is very rare. This can happen if a building is declared dangerous, or if the property or any part of it is expropriated for use for public needs, as mentioned previously (see **2.9 Condemnation, Expropriation or Compulsory Purchase**).

6.23 Remedies/Damages for Breach

It is customary to stipulate in a commercial lease agreement liquidated damages which the lessor will be entitled to in the event of a breach and termination of the lease, without detracting from the lessor's right to claim actual damages. Actual damages may of course be higher than the unpaid rent.

Usually, lessors of commercial properties continue to hold the collateral given to them by the tenant until a certain (short) period after the lease's end (usually 60 to 90 days) and are allowed to realise such collateral to cover damages.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The consideration in construction contracts is either a pre-agreed fixed sum (allocating the risk to the contractor) or is calculated by measuring the actual quantities of the work performed. Both methods are common.

The developer decides whether to use a single contractor, or to engage different contractors for the different works (structural frame, systems, fit-out work, etc).

7.2 Assigning Responsibility for the Design and Construction of a Project

Developers usually commission planning and design separately from construction. The developer engages planners and consultants (up to between 15 and 20 in a complex project), as well as a project manager that handles management and supervision; later on, the developer also engages one or more contractors.

Architects and planners/consultants usually limit their responsibilities to not exceed the planning fee. Contractors usually take full responsibility.

These alternatives vary in cost, planning flexibility, and legal and contractual liability. A landlord that does not engage a turnkey contractor and uses several different contractors will be responsible for construction performance, including with regard to building safety, even if they retain a project manager and inspector.

7.3 Management of Construction Risk

Developers can stipulate that the contractor will bear the entire liability for construction dates and costs, third-party liability, etc. Criminal liability for which the owner is liable by law cannot be transferred to the contractor. The courts have drawn a distinction in this matter between turnkey contractors (who are considered liable for everything that happens on the site) and a developer who builds with several contractors; the latter cannot disclaim liability.

A developer cannot disclaim liability towards purchasers of part of or all of the project. The developer will be liable directly towards purchasers, regardless of whether they have back-to-back liability against their contractor.

Construction contracts usually impose broad liability on the contractor, who assumes contractual liability and warrants for purchasing insurance, indemnifying the developer if the developer is found responsible or is required to compensate any third party for works for which the contractor is liable according to the construction contract.

7.4 Management of Schedule-Related Risk

It is standard practice for contractors to be contractually liable for the project's timetables. Liquidated damages for delays are also common practice.

In real life, contractors always claim that they are not the cause for the delay, and disputes in this regard are endless.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Contractors usually submit bank guarantees: first, a performance guarantee (the main purpose of which is to guarantee the contractual timetable), and later a warranty guarantee for the quality of the construction and for the handling of defects.

The performance guarantee is usually equal to 5% to 10% of the contractual fee, while the warranty guarantee is usually half the performance guarantee and is sometimes reduced after the first year.

7.6 Liens or Encumbrances in the Event of Non-payment

In most cases, construction contracts prohibit the planners and contractors from pledging their contractual rights against the developer. Subject to the developer's consent, contractors sometimes pledge the right to receive their contractual fee.

7.7 Requirements Before Use or Inhabitation

Once construction is completed, the building permit issuer must obtain a completion certificate before the new building can be used. Several certificates should be obtained as a prerequisite for such completion certificate – namely:

- a certificate confirming that the building is compliant with the building permit;
- confirmation regarding the quality of construction;
- confirmation that the building complies with safety requirements; and
- a certificate confirming that the building complies with the rules regarding access for persons with disabilities, etc.

Use of a building without a completion certificate is a violation of the Criminal Code, both by the owner and by the user.

8. Tax

8.1 VAT and Sales Tax

VAT is payable on any transaction in which the seller or purchaser is registered with the VAT authority as a "business entity" for VAT purposes. The sale and purchase of corporate real estate will always be subject to VAT.

If the seller is a "business entity", it is liable for remitting VAT, and the purchaser will receive an invoice and can offset the VAT against VAT in other transactions (such as payments made to suppliers).

If the seller is an individual who is not a "business entity", the purchaser shall pay VAT through a self-billing invoice, which can also be offset. The VAT rate in Israel is 17%, and is expected to rise to 18% in mid-2024. Transactions in Eilat, in the southern part of Israel, are exempt from VAT.

8.2 Mitigation of Tax Liability

In the past, purchasers have tried to allocate some of the consideration in real estate transactions to assets other than the real property (such as equipment, leasehold rights, etc) in order to reduce their purchase tax obligation. The Supreme Court established various tests for the purposes of determining whether equipment is part of the real estate or not – for example, the effect of its separation from the property.

Purchasers sometimes claim that some of the amount paid was in consideration for reputation. For this to carry, they must prove that the reputation is independent from the real property, and must establish its value.

8.3 Municipal Taxes

Municipal tax is determined by the local authority, in a "Municipal Tax Order", which is updated from time to time, subject to a cap growth stipulated by the government. The amount varies between different properties, depending on (among other things) the use category and subcategory (such as office, banking, movie theatre, store, etc).

Exemptions from municipal tax on usable (as opposed to not used) property are rare, and depend primarily on the user – for example, disabled persons are eligible for discounts on business uses, and senior citizens are eligible for discounts on residential uses. Certain uses that the local authority wishes to encourage in its territory receive reduced municipal tax rates. An example of this is a discount granted to software companies by some local authorities in Israel.

8.4 Income Tax Withholding for Foreign Investors

Payments to foreigners are subject to withholding tax – 30% for individuals, and the applicable corporate rate for corporations (23% in 2024). All such payments are subject to any applicable tax treaty with the investor's country of residence, and depend on the classification of the income.

Rent is taxable according to the classification of the proceeds: corporations will pay corporate income, while individuals will pay their income tax bracket (this could reach 47%, plus 3% "additional" tax).

Tax on rent is paid by the lessor, or by the tenant through tax withholding, subject to exemptions.

Tax breaks exist only for income on residential rent, up to a specific annual amount.

The sale of real property is taxable at a rate that ranges from 23% (for companies) or 25% (for individuals) to 47% on the profit (see **2.10 Taxes Applicable to a Transaction**). Taxable profit can be reduced by offsetting expenses against the income – in addition to the cost of purchase, the seller can deduct improvements such as:

- renovations;
- betterment levy;
- real interest on loans taken to finance the original purchase; and

- ancillary expenses to the purchase and sale of the property (such as broker and attorney fees).

8.5 Tax Benefits

Companies and "business entities" (including individuals that have opened an income tax file) that generate business income on real property can make ongoing deductions to their expenses on the property, and may deduct depreciation of the cost of purchase and improvements they had invested. As mentioned, any deductions made on an ongoing basis will not be recognised as an expense upon the sale of the property.

Trends and Developments

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Arnon, Tadmor-Levy

Arnon, Tadmor-Levy is one of the largest law firms in Israel, and is a leader in its areas of practice. The firm offers diverse legal services and a proven track record of success to its clients, which include many of Israel's largest companies, government and public entities, premier investment funds, and leading multinational corporations. The firm's leading practices include M&A; hi-tech; litigation; real estate, planning and construction; banking and payment systems; competition; project finance and energy; environment; capital markets; regulatory and administrative law; direct, indirect, real estate and municipal taxation; labour and employee matters; healthcare; municipal law; insolvency proceedings and reorganisation; communications and media; transportation; aviation; tender and public procurement; and commercial law. The firm's real estate department is the largest in the firm, and is one of the largest, leading and most established of such departments in Israel. Its lawyers and partners have a wealth of experience and expertise, enabling them to provide a comprehensive service to the firm's clients.

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General

The real estate market in Israel has experienced changes in recent years, some global (such as the global economic crisis) and some local (mainly, the actions of the coalition parties in the Israeli Parliament to try and change the judicial system in Israel, and the significant public protests that arose as a result of such actions), as well as the war in October 2023.

All these have plunged the real estate market in Israel, and the Israeli economy as a whole, into instability, with a resulting decrease in business activity and a rise in prices.

The Israeli economy as a whole (and in particular the Israeli high-tech industry) as well as the Israeli real estate market stand on strong bases, and therefore the intensity of these changes has not been great. Assuming it will not take too long before Israel reaches internal political and regional stabilisation, this period should not have long-term effects.

Residential Market

The slowdown trend in the housing market (due to the increase in interest rates that began in 2022) and the increase in prices of residential units after the COVID-19 crisis continued in 2023.

According to the Bank of Israel Annual Report for 2023, in the third quarter of 2023 there was a recovery in the volume of transactions in the residential market and a decline in residential units' prices, particularly in the prices of new residential units. At the beginning of the fourth quarter of 2023, after the outbreak of the October war, the recovery in the residential market was halted and there was a sharp decline in the number of residential units' sale transactions, due to the broad recruitment of civilians to their reserve duty and the continuation of the war.

According to the Bank of Israel Report, 2023 was the first year since 2018 in which residential prices declined by 0.6%. The areas of demand that are central Israel in general and Tel Aviv in particular "led" in the decline in prices. The main cause of the decline in prices was the accumulation of the new unsold residential units.

In November and December 2023, the index of residential prices increased again. It is possible that the increase in prices was caused by demand for new residential units, with the expectation that in light of the war there will be a slowdown in the number of residential units for sale, and the expectation that the shortage of new residential units will continue for more than the short-term.

According to the review published by the Chief Economist at the Ministry of Finance of the State of Israel, in January 2024 there was a significant recovery in the number of residential units' sale transactions, particularly in the new residential units' market, with an increase of 14% in the number of transactions (new and second-hand), compared to January 2023. In February 2024, there was a 19% increase in the number of residential units' sales transactions compared to February 2023. These figures are still among the lowest figures for February since 2000.

Long-Term Leases

"Affordable housing" is defined in Israeli law as one of the following:

- rental at a reduced price; and
- long-term rental.

The need to establish long-term institutional rental projects, which currently almost does not exist in Israel, is aimed to allow Israelies stability in their place of residence, even if they are unable to pay the cost of a residential unit.

Since the middle of the previous decade, a regulatory structure was established designed to incentivise and regulate the institutional market for long-term residential rentals. The inventory of such market in Israel is very low, and is in fact negligible.

According to the Bank of Israel Annual Report for 2023, the rapid increase in the interest rate since April 2022, as well as the market players' assessment that the interest rate will remain high for a relatively long period, deterred developers from participating in tenders for marketing land for long-term rental projects, and affected the economic viability of these projects. Also contributing to this was the change in the Encouragement of Capital Investments Law, such that the rental duration required to enjoy the benefits under the Law is at least 15 years on average out of the 18 years following the end of construction of a project.

In 2021, the Israel Land Authority (the governmental authority handling land owned by the State, and leased) succeeded in marketing 97% of the land for the construction of long-term rental residential units. In 2022, the Israel Land Authority managed to market only 46% of the land for the construction of long-term rental residential units. In 2023, the Israel Land Authority managed to market only 53% of the land for the construction of long-term rental residential units.

In other words, despite the State of Israel's actions in recent years to promote long-term institutional rentals (including the provision of tax incentives to developers) and the great interest in this new field from various institutional entities in recent years (mainly insurance companies and equity funds), long-term institutional rental is still negligible in scope and not significant in the real estate market in Israel.

The Office Market

The actions of the coalition parties in the Israeli Parliament to try and change the judicial system, the global economic crisis, and the increase in interest rates worldwide and in Israel contributed to the decline in rents of office space in 2023.

By the end of 2019, the office market in Israel was growing. In the second half of 2020, and in light of the COVID-19 pandemic, there was a slowdown in demand for office space in Israel, and there was a moderate decline in rents in the central business district of Tel Aviv and nearby cities. In 2021, due to high demand (mainly from high-tech companies), rents in these areas

increased compared to rents in the pre-COVID-19 period. This trend continued throughout 2021, and towards the end of 2021 reached new highs. In the second half of 2022, there was a slowdown in demand for office space, which led to slight declines in rents in some of these areas.

Downgrading of Credit Rating

In February 2024, Moody's announced the downgrading of Israel's credit rating from 1A to 2A.

A well-known Israeli economist believes that the effects of this rare event will influence all players in the real estate industry in Israel.

For entrepreneurs, the high price of money will affect the profitability of investments, and may put them in financing difficulties due to the high interest rate. Those who wish to purchase residential units will see the impact on their very ability to purchase them. In recent years, there has been a decline in the ability of the Israeli public to purchase residential units. In other words, it will be harder to both build residential units and to buy them.

In April 2024, S&P also announced the downgrading of Israel from AA to A+.

Loans and Credit in the Real Estate Market

In 2023, the Bank of Israel continued to raise the interest rate in the Israeli market, from 3.25% at the end of 2022 to 4.75% in June 2023. In January 2024, the Bank of Israel lowered the interest rate to 4.5%.

Due to the increase in the cost of credit and the increase in the burden of credit repayment, the growth rate of the residential credit market has been particularly low compared to previous years. In addition, the number of transactions for the purchasing of residential units declined.

The increase in the interest rate since April 2022 was accompanied by a prolonged decline in the volume of new residential loans – from a peak of NIS12.3 billion in March 2022 to NIS5.6 billion in April 2023. The volume of residential loans stabilised from May 2023, and even increased slightly before declining again following the outbreak of the October war.

According to data from the Central Bureau of Statistics, credit in the construction industry constitutes 38% of business bank credit and 44% of total tradable debt in the economy. An examination of the 25 largest public companies in the construction industry shows that these companies have bank credit totaling NIS36 million, out of NIS118 billion of bank credit to large businesses.

The impact of the October war on the activity of the construction and real estate industries is significant. According to a survey by the Central Bureau of Statistics published at the end of November 2023, a quarter of companies in the construction industry reported very significant reduction in their activity, and nearly half the companies reported a negative impact of over 50% of their revenues.

In projects where construction has already begun, the decline in the activity of construction companies increases the need for credit in order to cope with the decline in cash flow from sales (which are on a downward trend) and to finance construction expenses. The flow of payments from buyers who have already signed purchase contracts may also be adversely affected by the halt in construction progress at some sites.

In projects where construction has not yet begun, companies are required to pay financing expenses for land they have already purchased. The difficulty is greater if the land was purchased at higher prices and with higher credit leverage.

According to Israeli banks' reports, at the end of the third quarter of 2023, NIS98 billion (representing 34.5% of the construction and real estate sectors' credit) was granted to projects secured on land where the construction process has not yet begun. NIS48 billion (representing 17%) is in projects under construction.

If the stagnation in the construction industry continues, the ability to receive revenue to pay their debts will be impaired for companies managing projects that are in early stages.

Transactions on Vacant Land

According to the Bank of Israel Annual Report for 2023, based on Israel Land Authority data, the land marketing period is very long, with some land tenders published by the Israel Land Authority being signed three years after their publication.

In light of the increase in interest rates in the economy in 2022, the prices of winning land tenders have declined, and the success rate of tenders and land marketing is low. The decline in demand for residential units led to a decrease in demand for land. The interest of developers in land tenders has decreased.

General

As is sometimes the case, the current situation in the Israeli real estate market is an opportunity for certain companies and entities, both in order to direct their activities towards growth and profitable channels as well as to identify market opportunities for expansion.

Strong companies in the Israeli economy, which have stable revenues and are less reliant on credit, see this period as an opportunity, and are taking advantage of the opportunities to improve their operations.

The foregoing numerical data is from reports and reviews of the Central Bank of Israel, and from reviews published by the Chief Economist of the Ministry of Finance of the State of Israel.

ITALY



Law and Practice

Contributed by:
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SI – Studio Inzaghi

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SI – Studio Inzaghi was established in 2024 as a firm focused on real estate and offers a full range of legal and tax services for the real estate sector. Its professionals are renowned among both Italian and international clients for their expertise in real estate transactions, with particular focus on investment transactions, urban planning leases, real estate alternative investment funds, sale and leaseback, public and private tenders, environmental law, and court and out-of-court real estate disputes. The firm boasts a team of over 25 qualified professionals with extensive knowledge across all asset classes. Its focus on the real estate business affords the firm a comprehensive view of the legal and tax aspects of this sector. They stay ahead of the curve by closely monitoring and adapting to new trends and market developments, such as logistics, residential, student housing, data centres, and senior living. The firm's professionals have been involved in landmark transactions (the sale and leaseback of Fedrigoni Group and WPC, with an overall value of EUR280 million), development projects, such as the redevelopment of the former Romana railway yard, including the Olympics Village, Falk, the biggest regeneration project in Europe, and several acquisitions of buildings for conversion into residential, purpose-built student accommodation (PBSA), hotels, and the development of logistics and data centres across Italy.

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Studio Inzaghi
The legal side of real estate

1. General

1.1 Main Sources of Law

The Italian Civil Code is the main source of real estate law for civil aspects. Commercial leases are governed by Law No 392/1878 (the Tenancy Law), while residential leases are governed by Law No 431/1998.

Zoning and planning aspects are mainly regulated by several national, regional and municipal laws and regulations. In this regard, the main national sources are Urban Planning Law No 1150/1942, which disciplines planning aspects, and D.P.R. 380/2001, regulating construction aspects.

The main sources of the real estate finance law are:

- Legislative Decree No 385 of 1 September 1993 (TUB), on banking and lending matters;
- Law No 130 of 30 April 1999 on securitisation transactions;
- Legislative Decree No 170 of 21 May 2004, on financial security agreements; and
- Directive 2011/61/EU on alternative investment fund managers.

The real estate market is also facing the potential challenges of complying with complex new ESG regulations. Initiatives that closely involve the real estate market are Regulation (EU) 2019/2088 on sustainability-related disclosure in the financial services sector (SFDR) and Regulation (EU) 2020/852 of 18 June 2020 ("EU Taxonomy").

The SFDR aims to bring greater transparency on social and environmental responsibility for financial markets, and to limit so-called "greenwashing". It also aims to ensure comparability of products and direct the flow of private capital toward more sustainable investments.

The EU Taxonomy identifies a set of criteria for determining what is green and sustainable and what is not, and identifies all those economic activities that make a substantial contribution to achieving at least one of the six environmental objectives identified by the European Commission.

1.2 Main Market Trends and Deals

The total investment volume for commercial real estate in Italy in 2023 was approximately EUR6.6 billion, decreasing by almost 45% compared to 2022 (although Q4 2023 saw more growth than the previous quarter, reaching approximately EUR2.9 billion, which was a 17% increase compared to the same period in the previous year).

The contraction in real estate purchases and sales can be attributed to various factors:

- High interest rates: High rates were caused by the constant increases made by the ECB to counter high inflation.
- Increased difficulty in accessing credit: Rising rates caused interest rates on variable mortgages to soar and prompted banks to tighten lending conditions.
- Russia-Ukraine conflict: In addition to socio-economic instability, the war has also affected the procurement of energy resources, leading to higher utility bills and increased housing construction costs.
- New post-pandemic housing needs: Restrictions due to the COVID-19 pandemic and the increased use of smart working have focused buyers' attention on housing solutions with larger spaces and in suburban areas.
- Increased focus on energy class: Italians are increasingly focusing on the energy class of

their home and are looking for properties with low energy consumption, while the supply of homes with high energy classes is still too scarce to cover demand.

Despite the slowdown in price inflation bolstering the prospect of monetary policy normalisation, the repricing process observed since the second half of 2022 has not yet fully ended and will likely continue to be an obstacle to closing new investments during the first half of 2024.

Logistics maintained its significance, representing around 26% of total investments, driven by strong leasing demand, low vacancy rates and rising rents.

The demand for technological facilities and healthcare assets continued and the "alternatives" sector registered a volume of around EUR900 million. Notably, investments in healthcare assets surged, reaching approximately EUR600 million – more than double the amount seen in 2022.

The hospitality sector retained strong investment volumes, experiencing the least contraction compared to 2022 in terms of capital invested, with a total of EUR1.1 billion.

Investments were mainly concentrated in Milan, but Rome and secondary cities such as Florence and Bologna also confirmed their attractiveness, particularly in the student housing segment, which recorded numerous transactions in such cities, also thanks to funds made available by the National Recovery and Resilience Plan.

The most significant deals in 2023 included:

- The Fedrigoni Group monetised most of its European industrial production portfolio (over 400,000 square metres of built surfaces and mostly composed of industrial spaces, with associated logistics and office areas), with the majority of the assets located in Italy (85%), specifically Lombardy, Veneto, Trentino Alto-Adige, Friuli-Venezia Giulia and Marche, with the remaining 15% divided between Spain and Germany.
- The 5-star luxury hotel Six Senses in Rome, the brand's first urban hotel, was sold by Orion Capital Managers to the Statuto Group, which already owns some of Italy's most prestigious hotels, for a record EUR245 million.
- Palazzo San Fedele in Milan was sold by COIMA SGR to an investment vehicle underwritten by Union Investment Real Estate GmbH for the establishment of Bottega Veneta's (Kering Group's) headquarters following a sustainable redevelopment of the building coordinated with the Superintendency of Milan.

Start-ups and venture capitalists are focusing on improving the "tokenisation" of real estate assets, driven by the need to increase the liquidity of the market, and the fragmentation of investments. These technologies are still to be fully implemented but they have all the necessary attributes to emerge as a viable alternative market for small/medium projects accessible to retail and institutional investors.

Italy continues to be a major player in European real estate crowdfunding, ranking fourth in the continent. This data comes from the sixth Real Estate Crowdfunding Report, drawn up by the research group of the Crowdinvesting Observatory created by the Polytechnic of Milan and financed by Walliance.

Between July 2022 and June 2023, Polytechnic of Milan recorded 500 successfully closed

campaigns, of which only 27 were in equity. The remainder was financed by lending.

Within Italy, Lombardy emerged as the clear leader in real estate crowdfunding activity, accounting for 42% of total projects (Milan alone accounted for 21% of projects).

1.3 Proposals for Reform

Italy is undergoing a broad tax reform, including changes affecting VAT on real estate transactions, particularly for residential properties. These changes are driven by Law 111/2023, which empowers the government to reform the tax system.

The Budget Law 2024 introduces, inter alia, specific measures for short leases. Landlords can now choose a flat tax rate of 26% under the "*Cedolare Secca*" tax regime in lieu of income tax and related surcharges, as well as registration taxes on the lease. The "*Cedolare Secca*" tax regime is a distinct taxation framework characterised by a flat-rate tax, offering an alternative to standard income tax (*Imposta sui redditi delle persone fisiche,* IRPEF) applied to rental income.

For those declaring income from short leases related to a single unit, the tax rate stands at 21%.

Law 111/2023 also opens the door for extending the "*Cedolare Secca*" regime to non-residential properties. This would allow landlords of commercial or professional spaces to potentially benefit from the flat tax system.

2. Sale and Purchase

2.1 Categories of Property Rights

The categories of property rights that can be acquired are as follows:

- absolute freehold or full ownership (*piena proprietà*) – the right to fully enjoy and dispose of the property;
- right to build or surface right (*diritto di superficie*) – the surface right is either the right to build on a third party's property and, subsequently, to purchase the property of the building built, or the right to sell the existing building separately from the land itself;
- beneficial interest (*diritto di usufrutto*) – the right to enjoy a third party's real estate for a specific (and limited) period of time;
- right of use (*diritto d'uso e di abitazione*) – the right to use real estate in order to meet the needs of the person holding the right and those of their immediate family; and
- long lease (*diritto di enfiteusi*) – the right to enjoy a property owned by a third party, similar to those granted to a full owner.

Standard Italian transactions refer to sale and purchase or absolute freehold/full ownership.

2.2 Laws Applicable to Transfer of Title

The Italian Civil Code governs the transfer of title, along with tax, zoning/planning and cadastral regulations.

2.3 Effecting Lawful and Proper Transfer of Title

A deed transferring a real estate asset shall be in writing and executed before an Italian notary, who has the duty to authenticate it. Preliminary sale and purchase agreements shall take the same form as the final deed and therefore must be made in writing.

The parties can freely negotiate the content of the notarial deed, except for the following requirements, which must be included according to the applicable law:

- the price and means of payment;
- the cadastral data of the real estate asset and declaration of compliance of the cadastral plans (*planimetrie catastali*) filed with the competent Building Cadastre with the actual status of the real estate asset;
- a list of building permits issued to build the real estate asset;
- the rules allocating the risks and benefits of the real estate asset; and
- details of the real estate broker involved (if any) and the relevant fee paid to the broker.

Once executed, the notary files the deed with the Real Estate Register (*Conservatoria dei Registri Immobiliari*); this is not a requirement for the validity of the notarial deed but it is necessary to avoid conflicts with third parties and future buyers.

Because the Italian legal system gives the buyer a certain level of assurance in terms of title to the property, title insurance might not be necessary.

After the COVID-19 pandemic and the issuance of European Directive 1151/2019, which was implemented in Italy through the European Delegation Law 2019–2020, there was a significant expansion of the use of digital tools in the legal field, enabling the remote execution of computerised notarial acts.

This novelty is part of the regulatory trend that, since 2013, has legitimised the use of so-called digital public deeds, where parties electronically sign a digital version of the deed instead of paper documents.

2.4 Real Estate Due Diligence

A potential purchaser should build up a team of legal, tax, commercial and technical advisers.

Areas of investigation are the following:

- title to property (in this respect, it is fundamental to obtain a 20-year notarial report, including an investigation into third-party rights, registered prejudicial liens and the seller's title to the property);
- leases and contracts relating to the property;
- third-party rights and encumbrances affecting the property;
- zoning/planning permits (including agreements entered into with municipalities authorising the construction of the property);
- litigation; and
- analysis of all technical aspects of the property (eg, plants, fire prevention system and certificate).

Usually, technical and commercial analysis requires specific site visits. Because of the pandemic-related travel restrictions, many due diligence exercises were divided into a "documental phase", where the advisers assess the documents in a dedicated virtual data room, followed by a second phase with site visits if there is a positive outcome from the first phase.

2.5 Typical Representations and Warranties

According to statutory law, the seller has to guarantee the following:

- the title to the property;
- the property is free from any third-party rights, except those reported in the deed (if any);

- the factual cadastral situation of the property complies with that registered with the relevant cadastre; and
- the list of the building titles.

According to the Italian Civil Code, the purchaser has to notify the seller of any breach of the warranties within eight days from the relevant discovery. A one-year statute of limitations applies from the date the purchaser takes possession of the property. These provisions may lead to the termination of the purchase agreement, and to a full refund of the purchase price.

According to current market practice, the parties usually negotiate and include additional representations and warranties, and agree to depart expressly from the set of rules included in the Italian Civil Code in relation to warranty defects, thus derogating to the above-mentioned time limitations.

Additional representations and warranties are usually included in sale and purchase agreements.

Parties usually include contractual remedies or special indemnities to cure any breach of the representations and warranties preventing the termination of a sale and purchase agreement once the transfer of title has been executed.

The representations and warranties generally last for a certain amount of time (the "survival period") following the execution of the sale and purchase agreement, and the buyer will not be able to cover claims that arise following the end of the applicable survival period.

The survival period usually ranges from six months to two years, although representations and warranties covering the seller's title to the property and tax matters usually remain valid until the statutory terms provided by law have elapsed.

Warranty and indemnity insurance policies providing cover for losses arising from breaches of the representations and warranties are being used with increasing frequency, particularly when one of the parties (often a real estate investment fund) is to be liquidated upon completion of the relevant transaction. Usually, the policy is underwritten by the purchaser, and payment of the insurance premium is divided between the parties.

2.6 Important Areas of Law for Investors

Investors should carefully evaluate all tax aspects of the investment. Other areas to be taken into account would vary depending on the type of investment to be carried out. In relation to core investment, a detailed evaluation of leases in place would be required, while for value-add investments – where the goal is to increase/create value – planning and zoning aspects should be evaluated in detail, with the same approach to be applied as to the acquisition of development projects.

2.7 Soil Pollution or Environmental Contamination

Italy applies the "polluter pays" principle, which means that an owner who is not responsible for the pollution/contamination is not obliged to carry out the relevant remediation works. If the owner does not carry out remediation works, the owner would not be entitled to carry out construction works and, in the worst-case scenario, the public authorities may carry out the remediation works at the expense of the owner. In this case, upon the sale of the area, the public authorities should return to the owner the excess price obtained through the sale compared to the

costs borne by the public authorities to carry out the remediation works.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The permitted use of an asset is set forth in the general town planning scheme of the city but, in the case of existing buildings, the construction history of each asset should also be taken into account, since it could affect the establishment of a specific use.

A buyer may ascertain the permitted use under the town planning rules in force by requesting a zoning certificate (*certificato di destinazione urbanistica*), from which it is also possible to discover any urban planning restrictions that apply to the asset.

2.9 Condemnation, Expropriation or Compulsory Purchase

Private ownership might be subject to an expropriation procedure if there is a supervening public interest, such as the realisation of public works or works of public interest. In this event, an indemnification shall be paid to the owner of the property/land. It should be noted that the indemnification is at the market price of the property/land subject to expropriation.

2.10 Taxes Applicable to a Transaction

Non-residential Property

The sale of a non-residential property by one VAT entity to another VAT entity is generally VAT-exempt, other than in the following circumstances:

- if the seller was also either the developer of a newly constructed property or the entity that carried out renovation works on an existing property, provided that the sale is performed within five years of the date when the construction or renovations works are completed (mandatory VAT); or
- when the above requirements are not met, if the seller exercises the option to apply VAT to the sale and purchase transaction, and the exercise of this option is properly set out in the deed providing for the sale and purchase of the real asset.

In either of these cases, one of the following two mechanisms will respectively apply:

- the ordinary regime in the first case, which provides that the seller must issue an invoice in connection with the sale charging the VAT; or
- the reverse charge mechanism in the second case (ie, when the seller opts for VAT to apply), which provides that the seller will not charge VAT in the invoice, and the purchaser then "writes in" the rate and amount of applicable VAT in the invoice, and then registers the invoice and the VAT in its input VAT register and its output VAT register; consequently, the sale and purchase transaction will be VAT-neutral (and no cash-out for VAT).

The applicable VAT rate is either 22% or the reduced rate of 10% if the real property sold underwent material renovation works.

The following taxes will be payable in any sale and purchase of non-residential real assets:

- cadastral tax at 1% of the sale price;
- mortgage tax at 3% of the sale price; and
- registration tax of EUR200.

Mortgage and cadastral taxes can be reduced to an aggregate 2% rate if one of the parties to the transaction is an Italian real estate investment fund (REIF) or if the property is acquired

by an Italian listed real estate investment company (*Società di Investimento Immobiliare Quotata*, SIIQ). The tax authority may verify within two years if the sale price is in line with the fair market value.

Generally speaking, VAT can be offset against output VAT, offset against other taxes, or recovered through a refund by the tax authority under certain circumstances.

Residential Property

The sale of residential property by a VAT entity to another VAT entity is generally VAT-exempt, except where:

- the seller was also the developer of a new property or is the company that carried out renovation works, the developer of a newly constructed property or the entity that carried out renovation works on an existing property, provided that the sale is performed within five years from the date when the construction or renovations works are completed; or
- the sale and purchase transaction takes place more than five years after the works are completed, and the seller is the developer or entity that performed the renovation works on the real property, and exercises the option to apply VAT; in these circumstances, VAT would be applied under the reverse charge mechanism.

The following taxes apply on sales of residential properties that are VAT-exempt:

- cadastral tax of EUR50;
- mortgage tax of EUR50; and
- registration tax at 9% of the sale price (the tax authority may verify within two years if the price is in line with the fair market value).

Otherwise, the registration tax, mortgage tax and cadastral tax will each be due at EUR200.

The sale of a real property whose VAT was not totally deducted by the seller VAT entity when it purchased the property is always VAT-exempt (and liable to proportional registration, cadastral and mortgage taxes).

Typically, the purchaser will pay the transfer tax and the fees for the notary. Brokerage fees typically range from 1% to 3% of the sale price.

If the transfer of the asset is the result of the acquisition of the entity that owns the asset, then the transfer transaction is VAT-exempt and a registration tax of EUR200 will be due, regardless of which percentage of ownership in the entity is purchased, and no stamp duty will be due in connection with the transaction. However, a financial transaction tax (also called a Tobin Tax) will be due on a purchase of any number of shares representing the corporate capital of a joint stock company (but not in the case of quotas in a limited liability company or participation in a real estate fund) that is an Italian resident company for tax purposes, regardless of whether the purchaser or the seller is an Italian resident. This financial transaction tax is equal to 0.2% of the sale price.

2.11 Legal Restrictions on Foreign Investors

In principle, there are no restrictions on foreign investors acquiring real estate. However, it shall be verified whether or not investors come from countries that are affected by international sanctions or where rights are limited or restricted, in which case the so-called reciprocity principle (ie, whether the country of the investor grants a similar right to Italy) or the investment screening regulations at the European level might apply.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Commercial real estate purchases are generally financed through bank loans, although the number of real estate financings granted by non-banking institutions has increased significantly.

In the real estate market, investors can participate in commercial real estate through contractual vehicles like real estate investment funds (REIFs) or corporate vehicles like SICAVs and SICAFs (joint stock companies with variable or fixed capital).

An additional financing scheme is represented by real estate securitisations. Special purpose vehicles meeting certain requirements can carry out securitisation of proceeds arising from the ownership of real estate and registered movable assets as well as other rights in rem or personal rights over such assets.

In recent years, some provisions have entered into force in Italy introducing new alternative lending (ie, entities can operate in the Italian market without requiring a banking license).

There are two types of alternative lending: (i) the European alternative investment funds (EU AIFs) can carry out investment activities in receivables in Italy; while (ii) the special purpose vehicle (SPV) can grant financing to certain borrowers under conditions provided by Law No 130 of 30 April 1999.

3.2 Typical Security Created by Commercial Investors

Italian real estate finance transactions are assisted by an extensive security package that includes:

- the mortgage;
- the assignment of rental receivables;
- the assignment of due diligence report receivables;
- the assignment of construction contracts receivables;
- the assignment of hedging agreements receivables;
- the pledge over the corporate capital of the borrower;
- the pledge over the shares of the borrower;
- the pledge over the units of the borrower;
- the pledge over the borrower's bank accounts;
- the assignment of receivables under other contracts or of insurance proceeds;
- the loss payee clause in connection with any insurance policy (other than covering third-party risks);
- the equity commitment agreement; and
- the subordination agreement.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are different restrictions on granting securities in the context of a real estate financing transaction.

If a company enters into a financing transaction, it needs to receive some corporate benefits.

Such transaction must be considered on its merits and the corporate benefit in granting the security must be assessed in the context of that transaction.

To ensure that any guarantee or third-party security is valid, the lender needs to identify any concerns regarding corporate benefit and ensure that the situation is properly addressed.

The fund's units may be pledged in accordance with Article 2784 of the Italian Civil Code.

For registered notes, an entry in the issuer's register of unit holders, held by the management company, is necessary.

A pledge over dematerialised units is also allowed.

Pursuant to Article 2358 of the Italian Civile Code, a joint stock company may not, directly or indirectly, obtain loans or provide securities for the purchase or subscription of its shares, except under certain conditions.

Limited liability companies are subject to stricter rules, as detailed in **3.5 Legal Requirements Before an Entity Can Give Valid Security**.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Pursuant to Presidential Decree No 601 of 29 September 1973 (Decree 601/1973), some loans and related securities granted can be exempt from the ordinary taxation regime.

The borrower can pay a substitute tax, which is an all-inclusive tax at a rate of 0.25% of the principal amount of the loan.

In the cases mentioned in **3.10 Taxes on Loans**, the parties can expressly exercise the option of applying the substitute tax regime to securities.

If the parties do not exercise this option, the security package will be subject to the ordinary taxation regime, including:

- notary fees (in case of notarial securities);
- stamp duty;
- cadastral tax;
- registration tax;
- mortgage tax; and
- governmental duties.

The deed of pledge over quota granted by a third person other than the debtor, bears registration tax at the rate of 0.5%, which is calculated on the taxable base represented by the amount secured by the pledge.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The granting of security on own assets in favour of third parties – within a group of companies – is always subject to the existence of a corporate benefit, and to certain restrictions in financial assistance situations.

Corporate benefit should exist, and be verified, on a case-by-case basis.

In the case of joint stock companies, financial assistance is generally prohibited, but it is possible to provide security over own assets subject to compliance with certain steps, formalities and restrictions (see **3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders**).

Limited liability companies are subject to stricter rules. In particular, Article 2474 of the Italian Civil Code regulates transactions on their quotas, preventing companies from making transactions to purchase their quotas or provide securities for their purchase or subscription.

3.6 Formalities When a Borrower Is in Default

In case of borrower default, the acceleration of the loan and enforceability of the securities are regulated by the provisions of the Italian Civil Code, the Legislative Decree No 170 of 21 May 2004 (as the case may be), as supplemented

by the facility agreement and the security documents.

The lender shall notify the borrower that an event of default has occurred.

The lender may withdraw from the facility agreement and/or accelerate the payment obligations of the borrower, and/or terminate the facility agreement.

Upon withdrawal, acceleration of the payment obligations or termination, all outstanding amounts will be immediately due and payable (save for any grace period permitted by law).

The lender may be entitled to enforce the relevant securities.

3.7 Subordinating Existing Debt to Newly Created Debt

Banks and companies' shareholders (or funds' unit holders), can enter into a subordination agreement.

A subordination agreement establishes one debt as ranking behind another in priority for collecting repayment from a borrower. A second-in-line creditor collects only if and when the priority creditor has been fully paid.

When a lender accepts a subordination agreement, it acknowledges that another party's claim or interest will take precedence over its own in the insolvency, winding-up or liquidation of the borrower.

3.8 Lenders' Liability Under Environmental Laws

Lenders are not juridically liable in relation to environmental issues affecting borrowers.

3.9 Effects of a Borrower Becoming Insolvent

Legislative Decree No 14 of 12 January 2019 (the "Insolvency Law") regulates the crisis and insolvency situations of the borrower.

The asset and financial imbalance of mutual funds, and in particular liquidation in cases of insolvency, is regulated by Article 57 paragraphs 6-bis and 6-bis.1 of Legislative Decree No 58 of 24 February 1998 (TUF).

Article 57 paragraph 6-bis of the TUF provides that if the assets are insufficient to satisfy the fund's obligations, and there is no reasonable prospect that this situation can be overcome, the creditors or the management company can request the fund's judicial liquidation.

In order to protect the holders of financial instruments issued in securitisation transactions, Article 4 of Law No 130 of 30 April 1999 expressly excludes from the application of the bankruptcy claw-back action, pursuant to the Insolvency Law, payments made by the assigned debtors in favour of the assignee company. The borrower's insolvency is one of the cases of an event of default and it could lead to the acceleration of the loan.

3.10 Taxes on Loans

Pursuant to Decree 601/1973, some loans can be exempt from registration tax, stamp duty, mortgage and cadastral taxes and taxes on government concessions (otherwise applicable to the loan and the security package).

The parties can expressly exercise the option of applying the substitute tax regime (0.25% of the principal amount of the loan) instead of the ordinary taxation regime to the facility agreement.

The substitute tax applies, upon option, to:

- transactions related to medium- and long-term financing (more than 18 months carried out by banks);
- financing transactions, the duration of which are more than 18 months, set up by securitisation special purpose vehicles, EU insurance companies and by EU UCITSs; and
- securities of any kind, by anyone and at any time given in connection with financing transactions structured as issues of bonds or bond-like securities.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Town planning rules are set forth by each municipality at a local level by means of the general town planning scheme.

The local rules must be in compliance with national and regional legislation (indeed, zoning is a shared competence between the state and the region), and with higher-ranking plans (such as the regional and provincial plans).

The regional authorities must also check each local town planning scheme and have the authority to require any necessary changes to the rules to ensure compliance with the higher-ranking plans.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The regulation of the design, appearance and method of construction of new buildings, and the refurbishment of existing buildings, is set forth principally at a national level. However, certain aspects of design and appearance may be further detailed locally, through the building regulation of the municipalities.

4.3 Regulatory Authorities

The municipality is responsible for authorising and controlling the development of individual parcels of real estate.

If the asset is affected by specific restrictions, the authority competent over the constraint must issue its prior approval.

In any case, development projects must comply with town planning, building, hygiene, health and safety, structural stabilityand fire prevention regulations, as well as any specific constraint (hydrogeological, cultural, landscape, etc) affecting the asset.

4.4 Obtaining Entitlements to Develop a New Project

The entitlement procedure and specific building title depend on the type of building works to be carried out, and they are mainly regulated by national legislation.

For certain works, the developer must submit a prior certified notice to the Municipality (a Start Works Notice or SCIA – *Segnalazione Certificata di Inizio Attività*), which is checked by the relevant municipal offices.

Significant works are subject to the issuance of a building title (building permit) on the part of the municipality.

The general town scheme may – at a local level – provide for the necessity to approve a prior implementation plan or to enter into a town planning agreement.

Building permits expire if the developer fails to carry out the works within given timeframes.

4.5 Right of Appeal Against an Authority's Decision

An operator who requested and was denied a building permit may challenge such denial before an administrative regional court.

Third parties may challenge an existing title (before the administrative courts) if they have legal standing and interest to sue (ie, they can prove they have a direct interest in the development project and are affected by it).

4.6 Agreements With Local or Governmental Authorities

Through town planning agreements, the municipality and the developer regulate various aspects of the development, such as the transfer of areas to the municipality for public use and the realisation of urbanisation works (roads, squares, parks, etc). The execution of urbanisation projects follows the guidelines set out in the Public Procurement Code, which has recently been entirely revised (Legislative Decree No 36/2023).

4.7 Enforcement of Restrictions on Development and Designated Use

Any building works carried out in violation of building or town planning regulations may be subject to a suspension order, a demolition order and/or an order to re-establish the legitimate status of the building. The developer may also incur administrative and/or criminal liability. In certain cases set forth by the Building Law, it is also possible to apply to the municipality for a regularisation procedure to address any building abuses or non-compliance.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Real estate investments in Italy are mainly carried out via one of the following types of investment vehicles, or a combination thereof.

Companies

Real estate companies are special purpose vehicles carrying out the purchase/sale, management, leasing and building of real estate assets. Real estate companies are generally formed as limited liability companies (*società a responsabilità limitata* – S.r.l.) or joint stock companies (*società per azion* i – S.p.A.), and are usually not listed on an exchange (with few exceptions).

REIFs

REIFs are undertakings for collective investments, and are generally used to invest in a variety of real estate assets.

REIFs must be managed by licensed Italian managers (so-called SGR), or alternatively by non-domestic EU managers under the freedom to provide services regime (management passport), or by establishing an Italian branch.

REIFs must invest at least two-thirds of their assets into real estate assets (including rights in rem on such assets, equity interests in real estate companies, and units of other REIFs). The remaining third may be invested in listed or non-listed financial instruments.

REIFs may not directly own business activities, which are deferred to affiliates indirectly owned by the REIF.

SIIQs

Listed real estate investment companies are Italian investment vehicles that have the following features:

- SIIQs must be formed as joint stock companies, and their shares must be listed on a regulated stock exchange of an EU member state or a European Economic Area member state, and must be resident for income tax purposes in the same area.
- No shareholder can own, directly or indirectly, more than 60% of the voting rights nor have the right to more than 60% of the company's profits.
- At least 25% of the shares must be owned by shareholders who do not own, directly or indirectly, more than 2% of the voting rights nor have the right to more than 2% of the company's profits.
- SIIQs' main business must be the leasing of real estate assets.

Real Estate SICAFs

A Real Estate SICAF is an Italian joint stock company with fixed corporate capital that has its registered office and headquarters in Italy. A Real Estate SICAF raises capital by offering its shares or other equity instruments, and invests the capital raised into real estate assets.

The considerations that apply to REIF investments also apply, mutatis mutandis, to Real Estate SICAF investments.

The recent Law No 21/2024 introduced measures aimed at simplifying the regulation of SICAVS and SICAFS through the introduction of a distinction between SICAVs and SICAFs that directly manage their own assets (so-called self-managed) and those that entrust the management of their assets to licensed intermediaries (so-called hetero-managed SICAVsS/SICAFs), and also eliminated the unnecessary requirements imposed on hetero-managed SICAVs/SICAFs by the current Article 38 of the TUF, aligning their regulatory provisions with those applicable to OICR.

Real Estate Securitisation Vehicle

The real estate securitisation scheme was introduced in Italy in 2019, so that a securitisation vehicle may now purchase real estate assets and benefit from the tax and regulatory regime applicable to the securitisation vehicles.

In a real estate securitisation, the real estate assets are transferred to a securitisation vehicle, which issues securitisation notes to finance the payment of the assets' price.

The securitisation vehicle is a bankruptcy remote vehicle and, on the basis of the principle of fiscal neutrality, the proceeds deriving from the securitised real estate assets are not subject to direct taxes.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited liability companies have a corporate capital divided into quotas with no face value.

Joint stock companies have a corporate capital divided into shares with the same face value.

Limited liability companies and joint stock companies are subject to ordinary corporate income tax of 24% (*Imposta sul reddito delle società*, IRES) and regional tax on productive activities of approximately 3.9% (*Imposta regionale sulle attività produttive*, IRAP). Special rules are provided for the tax deduction of certain interest expenses. Starting from 1 January 2024, there are no tax incentives for equity injections.

Capital gains from the sale of participation in such companies may benefit from the participation exemption regime (effective tax rate of 1.2%) if certain requirements are met.

The new property-rich companies rule introduced in 2023 should be considered in cross-border investment structure, with reference to the capital gains on the disposal of the participation (exit phase).

REIFs and Real Estate SICAFs are exempt from corporate income tax and regional tax on productive activities. Regional tax on productive activities may apply to SICAFs in limited cases.

Investors in REIFs and Real Estate SICAFs may benefit from a withholding tax exemption on profits distributed by the REIF/Real Estate SICAF if certain requirements are met: for example, in case of foreign pension funds or foreign investment funds having certain features (both in case of direct or indirect investment into REIFs and Real Estate SICAFs). Generally, foreign investors may also benefit from a tax exemption on capital gains from the sale of participation in REIFs and Real Estate SICAFs.

The Real Estate Securitisation Vehicle is not subject to corporate income tax or regional tax on productive activities on the profits realised during the securitisation transaction since it does not own such profits for tax purposes. This is because the profits must be used for the repayment of the notes issued by the vehicle for the financing of the property acquisition.

The non-resident noteholders may benefit from a withholding tax exemption on proceeds paid under the notes.

5.3 REITs

REITs have been implemented in the Italian jurisdiction pursuant to Law 296/2006, as subsequently amended.

Liquidity and diversification are among the main features of these instruments. The tax regime providing for SIIQs is an optional regime intended for listed joint stock companies whose main activity is real estate leasing and which meet certain financial and equity requirements. This regime provides an advantage for direct tax purposes consisting in the exemption of business income from leasing activities from corporate income tax of 24% and regional tax on business activities of approximately 3.9%. However, taxation occurs at the investor level, with the SIIQ obligated to make periodic distributions. On the other hand, income from activities other than real estate remains subject to ordinary income taxation for the SIIQ.

The option for such regime can also be exercised by unlisted joint stock companies that are primarily engaged in real estate leasing activities and in which a SIIQ owns a certain percentage of participation in profits and voting rights (ie, more than 50%).

In case of foreign investors, such regime is available by establishing a branch in Italy which would opt for the SIIQ regime, if certain requirements are met.

There are currently few SIIQs in Italy, and the number has actually decreased in recent years.

5.4 Minimum Capital Requirement

The minimum capital required is EUR10,000 (or EUR1 under certain conditions) for limited liability companies, and EUR50,000 for joint stock companies.

The minimum share capital for SGRs, as set by the Bank of Italy, is EUR1 million, even though SGRs with reduced capital (not lower than EUR50,000) are allowed under certain circumstances.

SICAFs' minimum share capital is also EUR1 million (the minimum capital is reduced to EUR500,000 for SICAFs reserved to professional investors). For SICAFs entirely managed by external managers, the minimum capital is EUR50,000.

5.5 Applicable Governance Requirements

A limited liability company is characterised by greater flexibility, and quota-holders have wider autonomy in shaping the company according to their needs through the provision of different rules within the by-laws, while a joint stock company is governed by a large number of mandatory provisions.

See **5.1 Types of Entities Available to Investors to Hold Real Estate Assets** regarding the governance principles that apply to REIFs, SIIQs and SICAFs.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual entity maintenance and accounting compliance costs depend on the amount of activities to be carried out. On average, for both types of company, costs range from EUR10,000 to EUR20,000. Auditors' costs will be added.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Italian law recognises two types of leases:

- property leases; and
- business leases.

Property Leases

A property lease concerns non-residential properties (eg, office, retail and hotel) and residential properties. Property leases are mainly regulated by the Italian Civil Code, Law No 392/78 (in relation to non-residential properties) and Law No 431/98 (in relation to residential properties).

The Italian tenancy law on non-residential properties was amended on 11 November 2014, allowing the parties to freely negotiate the terms and conditions of a lease if the lease provides for an annual rent higher than EUR250,000 and the building does not have historical value – so-called "large leases".

Business Leases

A business lease covers a "going concern" or a business (*ramo d'azienda* or *azienda*) that might include a property. In this case, the lease is only regulated by certain provisions of the Italian Civil Code, so the parties are granted wider freedom to negotiate the terms and conditions of the lease.

6.2 Types of Commercial Leases

The Italian tenancy law on non-residential properties regulates leases concerning offices, retail properties and hotels.

6.3 Regulation of Rents or Lease Terms

The parties are free to determine rent amounts.

Italian laws set a minimum term for leases (see **6.4 Typical Terms of a Lease**), and the parties can freely fix the term in large leases.

6.4 Typical Terms of a Lease

The Italian tenancy law provides for fixed minimum terms for non-residential leases of six years for office/retail properties and nine years for hotel properties. Temporary leases can be entered into based on certain objective reasons. In large leases, the parties can agree on a different term. The Italian Civil Code provides for a maximum lease term of 30 years.

The lease automatically renews upon the expiry of the first period, unless either party gives notice not to renew at least 12 months prior to the expiry term, or 18 months for hotels.

A residential lease has a fixed/minimum term of four years. Upon the expiry of the initial term, the lease automatically renews for a further period of four years, unless the parties agree otherwise.

The Italian Civil Code distinguishes between ordinary and extraordinary maintenance works, and tenants are generally responsible only for ordinary maintenance; however, parties can deviate from this principle.

The frequency of rent payments can be freely agreed between the parties.

6.5 Rent Variation

Parties are free to determine the rent, but once fixed it is subject only to an annual review based on 75% of the ISTAT consumer price index (or 100%, depending on the duration of the lease). Since November 2014, parties in large leases can freely negotiate and determine a mechanism to review and update the rent; however, current market practice still provides for the update of the rent based on the ISTAT consumer price index.

Turnover rents, stepped rents and free rent periods are also permitted, with certain limitations provided by case law.

6.6 Determination of New Rent

See **6.5 Rent Variation**.

6.7 Payment of VAT

Residential Leases

The general rule is that such leases are VAT exempt. However, landlords can opt for the VAT regime to be applied (at a 22% rate) exclusively in the following cases:

- leases executed by (i) companies that built the leased building and (ii) companies that have performed, including through contractors, the interventions referred to in Article 3, co. 1, lett. c), d) and f) of Presidential Decree No 380/2001; and
- leases of social housing also carried out by other companies (not necessarily construction or reinstatement).

Non-residential Leases

The general rule is that such leases are VAT exempt. However, landlords can opt for the VAT regime to be applied (at a 22% rate). The VAT option must be clearly stated in the agreement.

6.8 Costs Payable by a Tenant at the Start of a Lease

No costs should be paid by the tenant other than rent (and ancillary charges, if any), unless there are fit-out works to be carried out within the property. If this is the case, the parties shall define which works are for the benefit of the tenant and which are for the benefit of the landlord.

6.9 Payment of Maintenance and Repair

Maintenance costs for common parts of the property are borne by the landlord and reimbursed by tenants on a pro rata basis.

6.10 Payment of Utilities and Telecommunications

Tenants pay for utilities and telecommunication costs.

6.11 Insurance Issues

Tenants are required to take out policies covering any damage caused to third parties or to the property as a result of the activities carried out by the tenants within the premises.

Landlords are usually required to take out insurance policies covering the building where the leased premises are located.

6.12 Restrictions on the Use of Real Estate

Real estate must be used in compliance with zoning and planning provisions. Lease agreements expressly provide for the use of the property and the tenant is not allowed to change such intended use; doing so would result in the termination of the lease.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant is usually allowed to alter/improve the property, subject to the landlord's consent. Upon the expiry of the lease agreement, the landlord may require the tenant to remove all alterations and improvements, or may decide to acquire all alterations and improvements for free.

6.14 Specific Regulations

Law No 392/78 regulates commercial leases (eg, office, retail and hotel), while Law No 431/98 regulates residential leases. The Italian Civil Code applies to all leases.

6.15 Effect of the Tenant's Insolvency

Landlords are not allowed to terminate lease agreements in the event of a tenant's insolvency; instead, a specific procedure set up by the court-appointed receiver will take place.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A cash deposit of up to three months' rent is usually provided by tenants to landlords in order to secure the latter against a failure by the tenant to meet its obligations. Bank guarantees/insurance policies can cover higher amounts. Corporate guarantees are even delivered by the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

Upon the expiry date, the tenant shall vacate the property. Failure to do so may result in holdover indemnities being paid to the landlord for a specified period. Upon the expiry of this grace period (if agreed), the landlord may seek a court injunction and the restoration of damages.

6.18 Right to Assign a Leasehold Interest

Per current market practice, a tenant might be allowed to assign the lease, subject to the landlord's consent. Exceptions might apply to intra-group assignments. A sub-lease term must not be longer than the term of the lease.

These provisions can be freely determined by the parties and are subject to negotiations.

Italian tenancy law provides that, if a tenant transfers the business along with the lease, the landlord can only oppose such transfer on justi-

fied grounds. Large leases can deviate from this provision.

6.19 Right to Terminate a Lease

Leases include a specific termination clause listing all events pursuant to which a landlord can demand termination. In any case, a tenant's non-fulfilment of its obligations might allow the landlord to terminate the lease.

A tenant has the right (according to the final paragraph of Article 27 of Law 392/78) to withdraw at any time from the lease agreement on the basis of "serious grounds" (*gravi motivi*) with six months prior notice. This provision can be derogated by the parties only in large leases.

6.20 Registration Requirements

All leases have to be registered with the tax authority, and an annual registration fee equal to 1% of the passing rent must be paid. The registration fee is usually paid equally by the landlord and the tenant.

Certain leases that have a first term longer than nine years should be executed before a notary and registered with the Land Register so that they can be opposed to all third parties.

6.21 Forced Eviction

If the tenant does not comply with the obligations arising from lease, the landlord can terminate the lease and seek eviction. This is a court process, the duration of which changes on a court-by-court basis.

6.22 Termination by a Third Party

A lease can be terminated by a third party only in cases of compulsory procedure, and an indemnity is payable.

6.23 Remedies/Damages for Breach

In the event of a tenant breach and termination of the lease, landlords may hold the cash deposit (which, save for large leases, cannot be higher than three monthly instalments of rents) and/or enforce the guarantee.

In addition, landlords may seek for further damages (eg, loss of profit and reputational damages) to be ascertained before a court and/or provide in the lease agreement for specific penalties.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structures are as follows:

- a guaranteed maximum price to be determined based on an open book approach, except for variations;
- a price determined on the basis of separate prices for certain works, and the overall final price is determined upon the completion of works; or
- a cost plus fee basis, where the price is determined on an open book basis plus a pre-agreed fee.

7.2 Assigning Responsibility for the Design and Construction of a Project

Landlords might decide to enter into separate agreements for design and construction, and relevant liabilities will remain with the appointed contractor, except in the case of any necessary variations.

7.3 Management of Construction Risk

It is market practice to insert penalties to be paid by the contractor in case of delay. Regarding the

feasibility of the project, the construction agreement usually includes proper representations and warranties. Contractors are even required to deliver performance bonds.

7.4 Management of Schedule-Related Risk

Construction agreements usually provide for penalties to be paid in case of delay.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Contractors are required to deliver a performance bond and, upon completion of the works, to give a warranty bond and a ten-year insurance policy (*decennale postuma*) covering material defects of the building.

7.6 Liens or Encumbrances in the Event of Non-payment

In case of a landlord's default, there might be a possibility for contractors/designers to encumber the property and enforce the sale in order to recover their outstanding debts. This would imply a judicial proceeding in court.

7.7 Requirements Before Use or Inhabitation

The law requires buildings to be fit for use before they can be inhabited.

According to the regulations currently in force, the fitness for use is self-declared by the developer through a certified technical assessment using a specific form, which confirms that the works comply with the submitted project and the regulations on hygiene, health and safety, plants and systems, and fire prevention.

8. Tax

8.1 VAT and Sales Tax

See **2.10 Taxes Applicable to a Transaction**.

8.2 Mitigation of Tax Liability

Where non-residential real assets are purchased by a REIF or a SIIQ, the applicable cadastral tax and mortgage tax are halved to 0.5% and 1.5%, respectively.

The contribution of multiple real assets, primarily leased, performed by a VAT-registered entity to a REIF or SIIQ is not subject to VAT. Instead, it is subject to fixed cadastral tax, mortgage tax, and stamp duty.

8.3 Municipal Taxes

An owner of real property is generally liable for the payment of the local property tax (*Imposta Municipale Unica*, IMU). The taxable basis is equal to the cadastral income (including a 5% increase), multiplied by a figure depending on the kind of property.

Each year the local municipality approves the rates (from 0% to 1.14%).

The user of a property is also subject to the waste removal tax (*tassa sui rifiuti,* TARI).

8.4 Income Tax Withholding for Foreign Investors

An investor may derive lease income from owned real properties, either directly or by means of dividends or distributions made by a corporate vehicle or fund. Tax on rental income may vary substantially, depending on the structure of the investment.

Where the property is held by an Italian corporate vehicle, if the real estate is leased to ten-

ants, any rental income generated is subject to corporate income tax (IRES) at a rate of 24% and to regional tax on productive activities (IRAP) at the ordinary rate of 3.9% (or more, depending on the relevant region).

The taxable income of a real estate company for IRES purposes is the net revenue after the deduction of costs, as shown in the annual profit and loss account. Roughly all costs relating to the activities of a company can be deducted, including depreciation (excluding land) and interest (as long as this exceeds interest receivable), up to an amount equal to 30% of tax EBITDA in each fiscal year. Interest due on loans aimed at purchasing real estate properties for "letting" that are secured by mortgages over the same properties is fully deductible.

The taxable income of a real estate company in relation to the leasing of residential real properties for IRES purposes is represented by the rent minus maintenance expenses and interest up to the above limits. No other costs are deductible.

Interest is not deductible from an IRAP standpoint.

The taxation of dividends distributed to shareholders depends on the nature of the shareholder.

Dividends in favour of a foreign individual are generally subject to a withholding tax of 26%. Withholding tax rates can be reduced by any double tax treaty signed by Italy with the country of residence of the foreign investor.

Dividends distributed to a company that is resident in the EU or EEA and subject to corporate income tax therein are liable to a 1.2% withholding tax (to avoid discrimination with dividends received by Italian resident companies). Exemption from Italian withholding tax under the Parent-Subsidiary Directive may apply.

Dividends paid by an Italian resident company to foreign undertakings for collective investments (UCIs) are exempt from withholding tax if the following conditions are met (EU UCIs):

- UCIs are established in the EU or EEA; and
- UCIs are compliant with Directive 2009/65/EC (UCITS) or are alternative investment funds managed by managers subject to regulatory supervision in the country where they are established, pursuant to Directive 2011/61/EU (AIFMD).

In the case of direct investment performed by a foreign company (without a permanent establishment in Italy, noting that ownership of Italian real estate does not automatically give rise to a permanent establishment in Italy), the income derived from letting property is subject to IRES, payable at a rate of 24%. 95% of the gross income derived from letting is taxable and no depreciation or other costs can be deducted.

Italian REIFs are not subject to IRES or IRAP and foreign investors may benefit from a withholding tax exemption if certain requirements are met.

Tax on capital gains deriving from the sale of real estate properties may vary according to the structure of the investments.

Profits on the sale of a property realised by an Italian corporate vehicle are subject to IRES and IRAP at the aggregate rate of 27.9%, regardless of how much time has lapsed since acquisition. The profit is represented by the difference between the agreed purchase price and the net tax value of the property at the time of the sale.

In some cases, it is possible to spread the liability for tax on capital gains over a period of five years.

In a sale of the participation into an Italian vehicle, the capital gain is subject to Italian income tax at a rate of 26%.

Capital gains from the sale of real estate directly owned by a foreign investor without a permanent establishment in Italy are not subject to IRES if the property is sold more than five years after its acquisition. If the sale occurs within five years, IRES applies at a rate of 24%. The taxable income is represented by the difference between the price agreed for the sale of the property and its acquisition cost.

Starting from 1 January 2023, Italy introduced a so-called property-rich companies rule, in line with the OECD Model Tax Convention, which regards capital gains realised by foreign investors from the direct or indirect sale of a participation in an Italian vehicle owning certain real estate assets. Such gains may be subject to Italian income tax, including in case of the sale of participations in a foreign vehicle owning a participation in an Italian real estate company.

Financial transactions tax (Tobin Tax) is payable (at a rate of 0.2% on the agreed price) by the purchaser of shares in an Italian resident joint stock company, even if the purchaser and the seller are not Italian residents.

8.5 Tax Benefits

Italian corporate vehicles are allowed to deduct real estate depreciation and interest on real estate financing, while direct investment from abroad is not eligible for any deduction. No benefits are allowed for residential real estate properties that are rented by Italian companies.

JAPAN



Law and Practice

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1. General

1.1 Main Sources of Law

The Civil Code provides the general legal framework for real property and real estate transactions, including ownership, co-ownership, superficies, easement and security interests, and for sale and purchase and leasing transactions.

In addition to the Civil Code, the Law on Unit Ownership of Buildings governs unit ownership (*kubun shoyu ken*) and the relationship among the unit owners of a multi-unit building, while the Land Lease and Building Lease Law applies to leases of buildings and leasehold interests or superficies in land for the purposes of owning a building on a parcel of land. Since this law was enacted to enhance protection of the tenant's interest, some provisions are mandatory and cannot be circumvented by the parties to a land lease or building lease. Also, there are court rulings relating to land leases and building leases which have established legal doctrines that generally restrict the lessor's rights and protect the tenants.

1.2 Main Market Trends and Deals

The Japanese real estate market has been active of late, especially attracting attention from abroad due to low interest rates and the depreciation of the yen. In 2023, there have been several large-scale transactions where hotel assets were sold to foreign real estate funds, indicating the strong appetite of foreign funds for Japanese hotels and the recent trend of traditional Japanese companies turning to asset-light strategies. Another trend is rising inflation stimulating investments in inflation-resistant real estate, such as residential, hotel, and retail properties. In contrast, new large-scare development projects have somewhat stalled due to the rising cost of materials and labour.

Security token offerings, a new type of real estate fund, have also been increasing over the past few years and will attract more attention going forward.

For more information on market trends, see our Chambers article Japan: An Introduction to Real Estate.

1.3 Proposals for Reform

New legislation concerning real estate transactions for national security purposes became effective on 20 September 2022. The Act on Investigation and Regulation on Use of Properties in the vicinity of Significant Facilities and Border Remote Islands will authorise the Japanese government to:

- designate Close Monitoring Areas and Enhanced Close Monitoring Areas;
- investigate persons using the properties located within such areas and the use of such properties; and
- issue recommendations and orders to take remedial measures if such persons are found to be disturbing the functions of Significant Facilities, such as defence facilities and sensitive infrastructure, and Border Remote Islands, or if there is an evident threat that such persons will do so.

In addition, parties to a real estate purchase agreement will be required to submit a notice of certain prescribed matters (eg, identity of the parties and purpose of use) prior to the execution of the agreement if the real estate is located within the Enhanced Close Monitoring Area.

In 2024, the draft revision of the Act on Building Unit Ownership, etc. is under discussion. The proposed revisions include the relaxation of the majority requirement for resolutions for reconstruction from four-fifths to three-fourths. If the revised bill is submitted and passed, it is expected that the reconstruction of deteriorated condominiums will progress.

2. Sale and Purchase

2.1 Categories of Property Rights

In the current Japanese market, the most common subject properties or interests for investment purposes are:

- ownership (equivalent of fee simple absolute) of the land or the building, or both;
- a combination of the right to use the land (leasehold interest or superficies) and fee simple ownership of the building;
- co-ownership (*kyo-yu*) of the land or the building, or both; and
- a combination of co-ownership of the land and unit ownership of private units in a multi-unit building.

Co-ownership refers to a type of ownership where one person owns a certain percentage interest in the entire property and other owners own the remaining percentage interests.

Unit ownership is a type of ownership recognised for a multi-unit building under the Law on Unit Ownership of Buildings. A unit owner is entitled to own exclusive private units in the building, to own and use common areas (such as the entrance hall of the building) jointly with other unit owners, and to use the underlying land in the form of co-ownership, leasehold interests or superficies.

In addition, many real properties are held under trust arrangements, in which case the investor would acquire a trust beneficial interest (TBI) in respect of the entrusted real property. Under a trust arrangement, the real property is owned by the trustee (usually, a licensed trust bank in Japan) as part of the assets of the trust, and the investor becomes a beneficiary of the trust by acquiring the TBI.

2.2 Laws Applicable to Transfer of Title

The Civil Code generally governs the transfer of title. Other laws may also be relevant, depending on the ownership structure. For example, the Law on Unit Ownership of Buildings provides for certain rules on the transfer of unit ownership.

Specific restrictions may apply to specific types of real estate. One such restriction is the requirement under the Agricultural Land Law that the acquisition of agricultural land is subject to governmental permission.

2.3 Effecting Lawful and Proper Transfer of Title

How to Effect a Title Transfer

A transfer of title to real estate is effected pursuant to an agreement between the seller and the buyer. Most sale and purchase agreements provide that the transfer of title takes effect upon the full payment of the purchase price by the buyer.

Registration of Title to Real Estate

Japan has a real estate registration (*toki*) system where title to and certain other interests (such as mortgages) on real estate are registered. In practice, parties to a real estate transaction usually rely on the real estate registration because it is generally the best indication of the true owner of or holder of interest on a real property.

Registration of a Title Transfer

A transfer must be registered pursuant to the real estate registration system in order for it to be perfected. If a transfer of real property is not registered, the buyer cannot assert its title against a third party.

Applications for registration of title transfer can be completed online, but the use of registered seals to execute the documents required for registration is still the prevalent practice. In Japan, the pandemic caused no major delays or other disruptions in real estate registration procedures.

Title Insurance

Title insurance is not commonly used in the Japanese real estate market.

2.4 Real Estate Due Diligence

A real estate due diligence process usually involves some or all of the following elements.

- Document review – documents to be reviewed include publicly available materials such as a certified copy of the real estate registration, as well as the contracts that have been entered into in respect of the subject property. An "explanation sheet of important matters" (*juyo jiko setsumei sho*) prepared by a broker or the seller is usually one of the major documents that should be reviewed, as it is supposed to provide an orderly overview of the property (including pre-closing or post-closing requirements under public laws applicable to the transfer of the property) and highlight issues relating to the property.
- On-site inspection – the buyer often retains, and brings to on-site inspections, an appraiser and a property inspector, who will prepare the necessary third-party reports.
- Question-and-answer sessions – these are conducted in writing, through email, telephone or online meeting software, or at face-to-face meetings.
- Third-party reports – for commercial real estate, the buyer often arranges for professional service providers to prepare a real estate appraisal report and an engineering report.

2.5 Typical Representations and Warranties

Under the Civil Code, the seller is liable for any defect in the subject property. This defect liability may be limited by agreement on the scope, duration or amount of liability. This defect liability is referred to as "non-conformity liability" in the Reformed Civil Code. Aside from such statutory liability, the seller and the buyer often agree on contractual representations and warranties regarding the subject property. The scope and duration of the seller's property representations and warranties vary from deal to deal. It is not necessarily common in Japan for representations and warranties in purchase and sale agreements to address issues relating to the COVID-19 pandemic.

The primary remedies for statutory liability and seller's misrepresentations are termination of the purchase agreement and compensation for damages (or indemnity). It is not common in Japan for the parties to use representation and warranty insurance for real estate transactions.

2.6 Important Areas of Law for Investors

The primary laws relating to real estate transactions include the following:

- the laws governing private parties' rights and obligations are the Civil Code, the Law on Unit Ownership of Buildings, the Land Lease and Building Lease Law, and the Real Estate Registration Law;

- the laws regarding regulations and public policy are the City Planning Law, the Construction Standards Law, the Soil Contamination Countermeasures Law, the Real Estate Transaction Business Law, and local government ordinances;
- the laws related to trusts and TBI transactions are the Trust Law, the Trust Business Law, and the Financial Instruments and Exchange Law; and
- the Foreign Exchange and Foreign Trade Law relates to foreign investments.

2.7 Soil Pollution or Environmental Contamination

The buyer may be responsible for soil pollution or the environmental contamination of a property. If the soil contamination is likely to harm human health, the land will be designated as an area requiring action (*yo sochi kuiki*) under the Soil Contamination Countermeasures Law, and the landowner is required to take the necessary measures to remedy the contamination; such measures depend on the class of hazardous substances found on the land, and on the state and degree of contamination. In practice, the removal of contaminated soil is the prevailing remedial method.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The City Planning Law is the main source of zoning regulations. An "explanation sheet of important matters" prepared by a broker or the seller would address the zoning restrictions applicable to the subject property under the City Planning Law. A buyer may also consult with relevant governmental bodies to ascertain the applicable local or specific zoning or planning regulations.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Land Expropriation Law provides the requirements and procedure for the expropriation of privately owned real estate by governmental bodies. Owners of expropriated assets are generally entitled to reasonable compensation. The two major elements of the whole process are a confirmation that the project necessitating the expropriation serves the public interest, and the determination of the amount of compensation.

2.10 Taxes Applicable to a Transaction

Asset Deal

The outright transfer of real property (asset deal) is subject to real estate acquisition tax (*fudosan shutoku zei*), registration and licence tax (*toroku menkyo zei*), consumption tax (*shohi-zei*) and stamp duty. Depending on the type of real property and the timing of the transactions, and subject to some exceptions, the tax rates are as follows:

- registration and licence tax – 1.5% to 2% of the Taxable Base of the property, which is the property value recorded in the tax rolls for purposes of fixed assets tax;
- real estate acquisition tax – 3% to 4% of the Taxable Base;
- consumption tax – 10% of the purchase price of the building; and
- stamp duty – up to JPY600,000 (or up to JPY480,000 under the current special tax treatment).

Corporation tax is also imposed on net income if the seller is a corporation.

Share Deal

In a share deal, corporate sellers are subject to corporation tax but not consumption tax, real estate acquisition tax or registration and licence

tax. Moreover, the share purchase agreement is basically not subject to stamp duty.

Allocation of Responsibilities for Taxes

Typically, the real estate acquisition tax, the registration and licence tax and the consumption tax are borne by the buyer, and the corporation tax is borne by the seller. The responsibility for the stamp duty is allocated based on agreement between the buyer and the seller.

Special Methods to Mitigate Tax Liability

For tax treatments that can be accomplished by using a trust structure or a tokutei mokuteki kaisha (TMK), please see **8.2 Mitigation of Tax Liability**.

2.11 Legal Restrictions on Foreign Investors

There are no legal restrictions on the acquisition of real property in Japan by non-residents, except that such buyers are required to make a post-transaction filing pursuant to the Foreign Exchange and Foreign Trade Law.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Please see **5.1 Types of Entities Available to Investors to Hold Real Estate Assets**.

3.2 Typical Security Created by Commercial Investors

A mortgage is the most typical security interest created by a borrower who holds outright ownership of real estate. If the borrower and the lender intend to enter into financing transactions on a continual basis, a revolving mortgage may be created instead. If the borrower holds an interest in real estate in the form of a TBI, a pledge over the TBI is the principal security interest in place of a mortgage. Some lenders may require pledges over insurance claims.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no special restrictions on granting security over real estate to foreign lenders. However, a licensing requirement applies if a foreign financial institution lends money in Japan as part of its money lending business, unless the institution is a licensed bank in its home country and has a Japanese branch.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Formal (ie, non-provisional) registration of a mortgage is subject to a registration and licence tax, at a rate of 0.4% of the secured amount. Because this tax can be substantial depending on the secured obligation, some lenders permit the borrower to make a provisional registration only, which costs JPY1,000 for each real property. Once the mortgage is formally registered based on the provisional registration, the mortgagee enjoys priority over other mortgagees who register their mortgages after the provisional registration.

Judicial foreclosure of a mortgage involves various costs. The applicant has to prepay up to JPY2 million (in the case of the Tokyo District Court) to a competent court, which will be credited to the court's expenses.

3.5 Legal Requirements Before an Entity Can Give Valid Security

If there are minority shareholders in a company that is providing security to secure a debt owed by its parent company, the directors of the security provider usually obtain the consent of said minority shareholders to ensure that the direc-

tors are not deemed to be in breach of their fiduciary duty and duty of care.

3.6 Formalities When a Borrower Is in Default

In the case of a borrower's default, a mortgagee would typically accelerate the entire outstanding debt pursuant to the credit agreement. After the secured obligation becomes due, the mortgagee may judicially enforce the mortgage by submitting the real estate registration certificate on which the mortgage is registered. The priority of the mortgage vis-à-vis other mortgages is determined based on the order of mortgage registration. There have been no specific governmental measures taken in response to the COVID-19 pandemic to restrict a lender's ability to foreclose or realise collateral in real estate lending.

3.7 Subordinating Existing Debt to Newly Created Debt

Unless the existing lenders with perfected security interest agree, they do not become subordinated to any newly created non-preferred debt.

3.8 Lenders' Liability Under Environmental Laws

Because a financer such as a lender is not an "owner" for purposes of the Soil Contamination Countermeasures Law, a lender is not responsible for soil contamination investigations and countermeasures, unless it acquires the land from the borrower in default through the enforcement of a security.

According to a notice issued by the Ministry of Environment, even if the borrower assigns its land to a lender for the purpose of security (*joto-tampo*), the borrower but not the lender is deemed to be the "owner" of the land and will be responsible for any investigations and countermeasures under the Soil Contamination Countermeasures Law.

3.9 Effects of a Borrower Becoming Insolvent

The creation of a security interest by a financially distressed borrower may be invalidated (by the insolvency trustee or the debtor-in-possession under the theory of bankruptcy avoidance) if the security interest was created to secure existing debt after the filing of an insolvency petition with respect to the borrower.

The perfection of a security interest may also be avoided even where the creation of a security interest itself may not be avoided, pursuant to the criteria set out above. The requirements of such avoidance include the perfection being made after the suspension of payments or the filing of an insolvency petition, and not being made within 15 days of the creation of the security interest.

3.10 Taxes on Loans

In Japan, there are no recording or similar taxes in connection with mortgage loans or mezzanine loans related to real estate. Regarding the registration and licence tax required for registration of a mortgage, please see **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The City Planning Law is the main source of planning and zoning regulations. Local ordinances are also relevant.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Construction Standards Law is the primary law regulating the construction of new buildings and the refurbishment of existing buildings. The law establishes minimum standards concerning building sites, structures, equipment and building use.

4.3 Regulatory Authorities

Under the Construction Standards Law, the confirmation of authorised entities regarding the details of construction or refurbishment must be obtained for the construction of new buildings or any major refurbishment of existing buildings. Authorised entities include local governments such as cities, towns and villages, and private building agencies accredited by the government.

4.4 Obtaining Entitlements to Develop a New Project

A building developer or building owner must apply for confirmation from the relevant local governments or government-accredited private building agencies. The detailed requirements for such confirmation, including the steps to be taken vis-à-vis third parties, may differ under the relevant local ordinances.

4.5 Right of Appeal Against an Authority's Decision

Theoretically, it is not impossible to litigate against an authority's decision, although such litigation is not commonly seen in practice.

4.6 Agreements With Local or Governmental Authorities

Unless the development project involves a property or facility that is currently or was previously owned by a governmental body, it is not common to enter into agreements with governmental bodies to facilitate a development project.

4.7 Enforcement of Restrictions on Development and Designated Use

The contractor of a building under construction in violation of the Construction Standards Law or the City Planning Law, or the owner of a building that has been thus constructed, may be ordered to suspend the construction or to demolish or refurbish the building, or otherwise to ensure compliance of the building with legal requirements.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Generally speaking, real property tends to be owned directly by joint stock companies (*kabushiki kaisha* or KK), which is the most popular form of corporate entity available under the Companies Law.

When it comes to real estate investment, there are three typical investment structures, each of which uses a different type of entity to acquire property:

- the GK-TK structure;
- the TMK structure; and
- the J-REIT structure.

Of these three structures, the GK-TK structure and the TMK structure are primarily used to acquire a specific asset or portfolio identified at the outset. The TMK structure is more often preferred by non-Japanese investors.

However, the J-REIT is used as a going-concern vehicle for real estate investment, the asset port-

folio for which can be continually expanded or replaced with new assets.

The main features of each structure are discussed below.

GK-TK Structure

A GK-TK structure usually involves three types of vehicles:

- the fund is formed as a limited liability company (*godo kaisha* or GK);
- the GK is to acquire and hold one or more TBIs in a real estate trust (Property Trust); and
- the GK obtains quasi-equity investment from a TK investor under a TK agreement, and takes out a loan from a third-party financial institution.

A GK is one of the ordinary corporate forms available under the Companies Law, with all equity holders (members) of the GK bearing limited liability.

For tax and other regulatory or practical reasons, real property is often traded under trust arrangements in Japan – ie, property is acquired in the form of a TBI rather than an outright purchase of the property. In that case, the real property is owned by the trustee of the Property Trust (usually, a licensed trust bank in Japan) for the benefit of the GK as beneficiary.

A TK is one of the forms of partnership available under the Commercial Code, and is formed by an agreement between the GK as operator and a TK investor. As a legal matter, the funds contributed by the TK investor belong to the GK as operator, and all acts of the TK business are done in the name of the GK.

TMK Structure

A *tokutei mokuteki kaisha* (TMK) structure involves a specified purpose company, which is a corporate entity specifically designed to acquire a specific asset (such as real estate assets) by issuing asset-backed securities under the Asset Liquidation Law.

The best feature of a TMK is that, by fulfilling certain requirements, it will be eligible for special favourable tax treatment that is not available to a KK or a GK. The downside is the imposition of various regulatory requirements and special restrictions under the Asset Liquidation Law.

In most cases, a TMK finances the acquisition of real estate assets (which can be actual real properties or TBIs) by issuing preferred shares and obtaining third-party debt.

The TMK's equity consists of "specified shares" and "preferred shares". Specified shares are similar to ordinary voting shares of a KK. The amount of specified shares is nominal and is not supposed to be used for the acquisition of real estate assets, and the preferred shares comprise most of the TMK's equity.

The third-party debt is usually obtained in the form of "specified bonds" or "specified loans".

J-REIT Structure

Please see **5.3 REITs**.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Please see **5.1 Types of Entities Available to Investors to Hold Real Estate Assets**.

5.3 REITs

A J-REIT is a type of investment fund in corporate form under the Investment Trust and Invest-

ment Corporation Law, which is set up to acquire real estate assets (whether actual real properties or TBIs). Similar to a TMK, a J-REIT can be eligible for special favourable tax treatment that is not available to a KK or a GK, but it is subject to various regulatory requirements and restrictions under the Investment Trust and Investment Corporation Law.

A J-REIT's equity is issued in the form of investment units, and the investment units of a J-REIT can be listed and traded on a stock exchange. As of 1 March 2024, there were 58 publicly listed J-REITs in Japan.

In general, the Foreign Exchange and Foreign Trade Law allows non-residents of Japan to acquire units of listed J-REITs from Japanese residents without any restriction. On the other hand, units of non-listed J-REITs are usually offered and held only by certain types of institutional investors due to securities regulation and tax considerations.

5.4 Minimum Capital Requirement

There are no minimum capital requirements on KKs, GKs and TMKs, whereas J-REITs have a minimum equity requirement of JPY100 million.

5.5 Applicable Governance Requirements

Governance requirements vary, depending on the structure.

GK-TK Structure

The governance of a GK is simpler and more flexible than a KK, and the characteristics of the operations and governance of a GK are intended to be more similar to those of a limited partnership. In most cases, a GK is incorporated with one corporate entity being the sole managing member representing the GK, and such managing member appoints an individual (operating manager or *shokumu shikkosha*) to act as its representative and perform the duties of a managing member.

In a GK-TK structure, the GK is structured as a special purpose company that has no human resources. Thus, it is intended for the GK to retain an asset manager, who takes a lead role in the GK's activities. Such asset manager must be a registered investment adviser or manager under the Financial Instruments and Exchange Law.

TMK Structure

A TMK must always have at least one director and one statutory auditor. In addition, one accounting auditor is usually required to be appointed, who must be either a certified public accountant or an auditing firm.

Certain fundamental matters with respect to a TMK require the approval of its shareholders (in the form of a resolution). In general, only specified shareholders have voting rights at shareholders' meetings.

The management and disposal of the real estate assets owned by the TMK must be subcontracted to a third party, which must be a trust company or certain other service provider experienced in asset management and permitted under the Asset Liquidation Law. In practice, there are two types of asset management, depending on whether the TMK acquires actual real properties or TBIs:

- actual real properties – the TMK needs to retain an asset manager who is licensed to engage in a real estate transaction business under the Real Estate Transaction Business Law; or

- TBIs – the trustee of a Property Trust is responsible for the management and disposal of the real estate assets, and the TMK needs to retain an asset manager who is a registered investment adviser or manager under the Financial Instruments and Exchange Law.

J-REIT Structure

A J-REIT must have at least one corporate officer, supervisory officers outnumbering the directors (by at least one person), a board of officers and an accounting auditor, which must be either a certified public accountant or an auditing firm.

The fundamental matters with respect to a J-REIT are quite limited, and require the approval of its unitholders (in the form of a resolution).

Pursuant to the Investment Trust and Investment Corporation Law, a J-REIT must retain the following:

- an asset manager who is a registered investment manager under the Financial Instruments and Exchange Law and a licensed real estate transaction business provider with a discretionary agency permit under the Real Estate Transaction Business Law;
- an asset custodian; and
- an administrative agent.

5.6 Annual Entity Maintenance and Accounting Compliance

Maintenance costs vary significantly on a case-by-case basis. However, generally speaking, the following applies:

- the cost to maintain a TMK structure is higher than for a GK-TK structure;
- the cost to maintain a J-REIT structure is significantly higher than for a GK-TK structure or a TMK structure; and
- the cost to maintain a publicly listed J-REIT is higher than for a private J-REIT.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Leases are the most common arrangements by which to use another person's land or building, but superficies (*chijo-ken*) is a common alternative.

The purpose of a lease is not limited, and leases are available for both land and buildings. In contrast, superficies is available only for land to own buildings or trees.

In general, holders of superficies are in a stronger position than leaseholders against the landowner, as they are holders of a "real right". For instance, the landowner owes the superficies holder a duty to co-operate in the registration of the superficies that is required for perfection, but the lessor does not owe such a duty to the tenant.

6.2 Types of Commercial Leases

There are two types of land or building leases based on the lease term – namely, a general lease and a fixed-term lease.

A general lease is subject to renewal, which the lessor is entitled to refuse only when there is a justifiable reason, taking into account the lessor's and the tenant's respective needs to use the property, the history of the lease, the present use of the property, and the amount of compensation being offered by the lessor to the tenant to vacate the property.

A fixed-term lease allows for three alternative arrangements for land leases (each a "Fixed-Term Land Lease"), as outlined below.

- Land leases relating to land on which a building is built for business or residential purposes and that have a term of at least 50 years are not renewable, and must be executed in writing.
- Land leases relating to land on which a building used only for business purposes (ie, not for residential purposes) is built and that have a term of at least 30 years but under 50 years are not renewable, and must be executed by way of notarial deeds.
- Land leases relating to land on which a building used only for business purposes (ie, not for residential purposes) is built and that have a term of at least ten years but under 30 years are not renewable, and must be executed by way of notarial deeds (a "Category 3 Fixed-Term Land Lease").

A "Fixed-Term Building Lease" is also available. This lease must be in writing, is not renewable and will terminate upon the expiry of the lease term.

6.3 Regulation of Rents or Lease Terms

General Lease

In a general lease for land or buildings, lease terms that are contrary to or reduce certain statutory protections or rights granted to the tenant under the Land Lease and Building Lease Law are void. Several of these statutory protections and rights are outlined below.

- The lessor must have a justifiable reason to refuse a renewal of the lease.
- The tenant may demand that the rent be decreased in response to market conditions, and cannot be deprived of the right to demand a decrease of the rent even if they explicitly agree not to exercise that right.
- In the case of a land lease only, the leasehold interest in the land is perfected without registration if the land tenant owns a registered building on the leased land.
- In the case of a land lease only, the land tenant has the right to request the landlord to purchase the building upon the termination of the land lease.
- In the case of a building lease, the leasehold interest in the building is perfected without need of registration if the leased building is delivered to the tenant.

Otherwise, the rent and other terms of a general lease are freely negotiable and not regulated or subject to a voluntary code.

Fixed-Term Lease

The tenant may be deprived of the protections and rights under the first and fourth items listed above under a Fixed-Term Land Lease, and of the protections and rights under the first and second items under a Fixed-Term Building Lease.

COVID-19 Pandemic Legislation

On 27 January 2023, the Japanese government formally decided to downgrade the legal status of COVID-19 to "Class 5", the same category as common infectious diseases such as seasonal influenza, with effect from 8 May 2023. With the downgrade, COVID-19 is no longer subject to quarantine, and other measures are to be terminated or relaxed, which is expected to normalise social and economic activities in Japan.

6.4 Typical Terms of a Lease

The initial term of a land lease for owning a building is required by law to be at least 30 years, and tends to range from 30 years to 50 years, except

where the land lease is a Category 3 Fixed-Term Land Lease.

Building leases are typically for a much shorter term. Office space leases are often for a short term (most commonly two to five years), while building leases for retail or commercial facilities tend to be longer, for ten to 20 years.

The maintenance and repair of the premises actually occupied by the tenant are typically the responsibility of the tenant. However, if certain renovation works are required by the tenant before it can start using the premises, the allocation of the responsibility and the cost for such works is negotiated before entering into the lease agreement.

Monthly payment is the most typical payment term.

It is not common in Japan for lease agreements to address issues relating to the COVID-19 pandemic or other future pandemics, except in cases where parties have agreed on special treatment for these events, such as expanding the definition of force majeure to include the COVID-19 pandemic.

6.5 Rent Variation

Lease agreements usually schedule a regular rent review, which is conducted every three to five years in many cases. During a rent review, the parties will negotiate an increase or decrease in the rent for the next three to five years.

Aside from a contractual rent review, the Land Lease and Building Lease Law entitles either party to a lease to demand that the rent be increased or decreased in response to market conditions. If the parties cannot come to an agreement, a court may order an adjustment after considering the following:

- any change in tax or other liabilities imposed on the leased real estate (or the underlying land in the case of a building lease);
- the value of the leased real estate (or the underlying land in the case of a building lease), and other relevant economic conditions; and
- rents in neighbouring areas.

If the lessor and tenant specifically agree not to increase the rent for a certain period, the lessor cannot exercise its right to demand an increase in the rent but, with respect to a land lease and a general building lease, the tenant cannot be deprived of the right to demand a decrease in the rent, even if it has explicitly agreed not to exercise that right under the lease.

However, a different rule applies to a Fixed-Term Building Lease, under which the lessor and the tenant may exclude the application of the rule on rent adjustment described above by setting forth express provisions on rent revisions.

6.6 Determination of New Rent

Please see **6.5 Rent Variation**.

6.7 Payment of VAT

Consumption tax (which is equivalent to VAT) is payable on the rent on building leases other than for residential purposes. The rent on land leases is exempted from consumption tax.

6.8 Costs Payable by a Tenant at the Start of a Lease

Typical costs payable by a tenant at the start of a lease include a deposit (often calculated by a multiple of the monthly rent, depending on the type of lease and the real estate), brokerage

fees, insurance premiums and other expenses, such as for replacement of the keys. In addition, it is market practice for the tenant to pay a renewal fee (a multiple of the monthly rent) for each renewal of the lease term.

6.9 Payment of Maintenance and Repair

The maintenance and repair costs of common areas are paid by the building owner, primarily from the money paid by tenants as common area fees.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications serving a property occupied by several tenants are paid for by the building owner, primarily from the money paid by tenants as common area fees.

6.11 Insurance Issues

Typically, a tenant pays for insurance covering damage caused by accidents occurring in the real estate and by fire and, in some cases, earthquake and flood. Conventional business interruption insurance did not cover rent payments or other costs in the event of a business interruption due to COVID-19, but since the outbreak of the COVID-19 pandemic, a new type of insurance has appeared, which covers damages resulting from business interruption caused by the pandemic.

6.12 Restrictions on the Use of Real Estate

There may be contractual restrictions on how a tenant uses the real estate, restrictions on the use of common areas, and prohibitions on the handling of hazardous materials or explosives.

6.13 Tenant's Ability to Alter and Improve Real Estate

The extent to and the conditions under which the tenant is permitted to alter or improve the real estate are entirely up to the agreement between the lessor and the tenant.

6.14 Specific Regulations

In principle, there are no specific regulations or laws that apply to leases of particular categories of real estate.

6.15 Effect of the Tenant's Insolvency

In the case of a bankruptcy procedure (*hasan tetsuzuki*) or a corporate reorganisation procedure (*kaisha kousei tetsuzuki*), a bankruptcy trustee – or a debtor in possession in the case of a civil rehabilitation procedure (*minji saisei tetsuzuki*) – has a statutory right to determine whether to terminate the lease agreement or to continue the lease by performing its obligations.

If the bankruptcy trustee of the tenant or the tenant as debtor in possession opts for the termination of the lease, the treatment of the unpaid rents depends on when the due date arose: unpaid rents accruing before the commencement of the relevant insolvency procedure are treated, in principle, as general insolvency claims and are therefore subject to the insolvency procedure and subordinated to preferential claims, while rents that become due after the commencement of the insolvency procedure are paid from the insolvency estate in preference to other general insolvency claims, and are not subject to the insolvency procedure.

If continuation of the lease is chosen instead, unpaid rents accruing before the commencement of the relevant insolvency procedure would be treated as general insolvency claims, although there is a different academic view that

treats such unpaid rents as preferential claims. Furthermore, if the lease is continued, the rents that are due on or after the commencement of the relevant insolvency procedure are paid from the insolvency estate in preference to other general insolvency claims.

In practice, lease agreements often provide for the lessor's right to terminate the lease upon the commencement of an insolvency procedure on the part of the tenant. However, there are a few legal precedents that reject such a contractual provision, so the validity thereof remains arguable.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Typically, a tenant is required to pay a deposit at the start of the lease as security for any failure to pay in the future. A typical lease agreement contains a provision that allows the landlord to utilise the deposit to cover any outstanding obligation of the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant is obliged to vacate and return the leased property on or before the expiration or termination of the lease term if the lease is not renewed.

Generally, the lessor does not have to do anything to ensure that the tenant vacates the property on time, as long as the lease duly expires or terminates. However, there is a special requirement in a Fixed-Term Building Lease that the lessor must provide written notice of the expiry of the lease term from one year to six months prior to the expiry date in order to oblige the tenant to vacate the leased property by the end of the lease term.

6.18 Right to Assign a Leasehold Interest

A tenant may assign its leasehold interest in the lease or sublease all or a portion of the leased premises if it is able to obtain the owner's approval.

6.19 Right to Terminate a Lease

Typically, lease agreements provide that the following events give the landlord a right to terminate the lease:

- a breach of obligation by the tenant, such as failure to pay rent;
- the commencement of an insolvency procedure by the tenant;
- the occurrence of events that constitute grounds for the commencement of an insolvency procedure, such as being "unable to pay" (ie, unable to pay debts generally when they fall due); and
- the issuance of an order for compulsory execution, petition for auction sale or compulsory disposition for delinquent public charges.

Having said this, the court takes the view that the lessor is entitled to terminate the lease only if the tenant's breach amounts to a destruction of the relationship of trust between the lessor and the tenant, regardless of any provision in the lease agreement.

A statutory right to terminate in the case of the tenant's insolvency is discussed in **6.15 Effect of the Tenant's Insolvency**.

6.20 Registration Requirements

A Fixed-Term Land Lease and a Fixed-Term Building Lease must be made in writing (see **6.2 Types of Commercial Leases**).

A leasehold interest in the land must be registered pursuant to the real estate registration system in order for it to be perfected. However, if the lessee owns a building standing on the land, the lessee may perfect its leasehold interest in the land by registering its ownership of the building.

A leasehold interest in a building could also be perfected by either registering it pursuant to the real estate registration system or upon the delivery of the subject building by the landlord to the tenant, in which case the tenant can assert its leasehold interest against any person who acquires the building after delivery.

Registration of a leasehold interest is subject to a registration and licence tax at the rate of 0.4% of the Taxable Base of the property.

6.21 Forced Eviction

In order to force a tenant to leave, the lessor must first obtain a court judgment ordering the tenant to vacate the leased property on the basis of the termination of the lease. If the tenant does not comply with the judgment, the lessor will need to file a petition for compulsory enforcement against the tenant to compel it to surrender the leased property.

The length of time necessary to obtain such a judgment and to complete a compulsory enforcement largely depends on the tenant's response in court hearings and the tenant's reaction to the requirement to surrender, and varies from a few months to one year.

6.22 Termination by a Third Party

Leases cannot be terminated by any third party, including central government or municipal authorities.

6.23 Remedies/Damages for Breach

In principle, there are no specific regulations or laws that limit the damages a landlord may collect, or remedies a landlord may pursue. However, even if a lease agreement provides that the tenant will have to pay rent for the remaining lease term as a penalty in case of early termination by the tenant without cause, the court may determine that the provision is against public order and morals and thus void because it allows the landlord to obtain an excessive amount of damages.

Upon the execution of a lease agreement, the tenant is usually required to pay a deposit in cash as security for the payment of rent and other tenant obligations, although there are rare cases where the landlord may allow the tenant to provide a letter of credit in lieu of a cash deposit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most typical construction price structure is the fixed price arrangement, whereby the parties agree on the price at the signing of the construction contract, taking into account estimated costs and expenses as well as the contractor's profit. For a large construction project, the price adjustment mechanism may be implemented to reflect fluctuating procurement prices of materials or services linked to the cost element of the construction price.

7.2 Assigning Responsibility for the Design and Construction of a Project

Typically, design and construction works are provided under separate independent agreements – ie, the owner tends to enter into a design contract with a design company and a construc-

tion contract with a construction company. Each contract's terms and conditions are usually prepared and negotiated based on general terms and conditions made available as templates by the pertinent industry associations in Japan.

7.3 Management of Construction Risk

The general terms and conditions of a typical construction contract that are made available jointly by the pertinent industry associations (the "Form Terms and Conditions for Construction Contracts") provide for the construction contractor's obligation to take out insurance, and for defect liability.

With respect to insurance, the Form Terms and Conditions for Construction Contracts require the contractor to purchase and maintain fire insurance or contractor's all risk insurance for the completed portion of the work, materials and building equipment and other materials delivered to the construction site. The details of the insurance coverage are left for the parties to agree.

With respect to defect liability, the Form Terms and Conditions for Construction Contracts provide that the owner may demand that the contractor repairs the defect, reduces construction fees and/or pays damages. In principle, the contractor's liability is subject to a time limitation of one to two years, depending on the construction materials (such as wood, stone, metal or concrete). However, in the case of a newly constructed residential building, the defect liability period for certain major structural works is mandatorily set at ten years after the delivery of the building, pursuant to the Housing Quality Assurance Law, a special law to ensure the quality of residential buildings.

7.4 Management of Schedule-Related Risk

Schedule-related risks can be managed by the payment of liquidated damages by the contractor. Such contractual arrangements are allowed under Japanese law, and the courts are bound by the amount of liquidated damages agreed, without having to ascertain the actual damages incurred.

In particular, the Form Terms and Conditions for Construction Contracts provide that if the contractor fails to deliver the completed work by the due date for any reason attributable to the contractor, the owner may claim liquidated damages calculated at 10% per annum of the agreed construction price (minus a portion of the construction price equivalent to the part of the work already completed and delivered), calculated on the basis of the number of days delayed.

On the other hand, the Form Terms and Conditions for Construction Contracts allow the contractor to seek an extension of the due date if there is any justifiable reason, such as a force majeure event or a need for adjustment of the works. If the delay is caused by any reason not attributable to the contractor and the owner agrees to extend the due date, the owner is not entitled to liquidated damages.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

For domestic construction projects, additional forms of security such as performance bonds or parent guarantees are not common. Normally, it is difficult to get major construction companies to provide additional security.

7.6 Liens or Encumbrances in the Event of Non-payment

The law grants contractors the right to retain (*ryuchi ken*) or refuse to deliver the completed building in the event of non-payment, as long as the contractor has possession of the building. This right to retain does not require any registration.

Construction contracts typically provide for the payment of the last instalment of the construction price in exchange for the delivery of the completed building.

7.7 Requirements Before Use or Inhabitation

The Construction Standards Law requires the owner to obtain an inspection certificate (*kensa zumi shou*) before it is allowed to use a newly constructed building. The process is as follows:

- the owner must apply for inspection by the relevant local government or government-accredited private building agency within four days of the completion of the construction;
- the inspection will be carried out within seven days of the application being accepted; and
- if it is confirmed that the construction and the site comply with relevant laws and regulations, the inspection certificate will be issued.

8. Tax

8.1 VAT and Sales Tax

The sale of a building is subject to consumption tax (equivalent to VAT) at the rate of 10% of the purchase price of the building. The sale of land is not subject to consumption tax.

Although the seller is liable for the consumption tax under tax law, in practice the buyer is contractually obliged to pay an amount equivalent to the consumption tax on top of the purchase price of the building.

In general, sellers whose taxable sales did not exceed JPY10 million in the penultimate taxable year are exempt from consumption tax.

8.2 Mitigation of Tax Liability

The most common method to mitigate tax liability is to use a trust structure where the investor purchases the TBI in a Property Trust rather than the outright ownership of the real property itself. Please also see **2.1 Categories of Property Rights** and **5.1 Types of Entities Available to Investors to Hold Real Estate Assets**.

In doing so, generally:

- the registration and licence tax for the establishment of a Property Trust is reduced from 1.5% (for land) or 2% (for buildings) of the Taxable Base of the property (which is applicable in an outright purchase of real property) to 0.3% (for land) or 0.4% (for buildings) of the Taxable Base of the property; in addition, JPY1,000 is paid for each TBI transfer; and
- the real estate acquisition tax is reduced from 1.5% (for building land), 3% (for non-building land and residential buildings) or 4% (for non-residential buildings) of the Taxable Base of the property (which is applicable in an outright transfer of real estate) to zero.

Alternatively, by using a TMK as an acquisition vehicle, the registration and licence tax is reduced to 1.3% of the Taxable Base of the property, and the real estate acquisition tax is effectively reduced to 0.6% (for building land), 1.2% (for non-building land and residential buildings) or 1.6% (for non-residential buildings) of the Taxable Base of the property because, in

computing real estate acquisition tax, the TMK is allowed to reduce the Taxable Base of the property to 40% of the regular taxable base.

8.3 Municipal Taxes

In Japan, no universal municipal taxes are paid on the occupation of business premises, except in certain major cities, where taxes (of a relatively low amount) are imposed on the basis of the size of the taxpayer's premises or the amount of salaries paid.

The main municipal taxes paid on real estate per se are a fixed asset tax (*kotei shisan zei*) and a city planning tax (*toshi keikaku zei*), which are imposed on every owner of real estate, regardless of its purpose. However, there are limited exemptions for the above municipal taxes in certain designated areas where the municipal government is promoting certain industry sectors.

8.4 Income Tax Withholding for Foreign Investors

Income Tax Withholding for Foreign Investors

There is income tax withholding for non-resident individuals and foreign corporations.

Taxation on Rental Income

Rental income from real estate is subject to corporation tax if the lessor is a foreign corporation, or to income tax if the lessor is a non-resident individual. In 2022, the applicable corporation tax rate is 15% (for small income of a small enterprise) or 23.2% (in other cases), plus a local corporation tax of 10.3% of the amount of the corporation tax and a special corporation enterprise tax of various rates, while the applicable progressive income tax rates range from 5% to 45%, plus a special income tax for reconstruction, at 2.1% of the amount of the income tax.

If the lessor is a non-resident individual or foreign corporation, the tenant is required to withhold 20.42% of the rent, payable to the tax authority no later than the tenth day of the month following the date of the payment of the rent. Withholding is not required if the tenant is a natural person using the property as a residence for themself or their relatives. Any amount withheld by the tenant from the rent can be used as a deduction for corporation or income tax.

There is no exemption for taxation on rental income from real property in Japan.

Taxation on Gains from the Disposition of Real Property

Capital gains from the disposition of real property in Japan are subject to corporation or income tax in the same manner as rental income, as described above.

If the owner of the real property to be sold is a non-resident individual or foreign corporation, the buyer is required to withhold 10.21% of the purchase price, payable to the tax authority no later than the tenth day of the month following the date of payment of the purchase price. Withholding is not required if the purchase price does not exceed JPY100 million and the buyer will use the property as a residence for themself or their relatives. Any amount withheld by the buyer from the purchase price can be used as a deduction for corporation or income tax.

There is no exemption for taxation on capital gains from the disposition of real property in Japan.

8.5 Tax Benefits

A depreciation deduction is available for a person who owns a building. The depreciation expense is allocated to each taxation year

equally or by a declining rate for the life of the building as prescribed by law, depending on the structure and purpose of the building. Land is not a depreciable asset.

Trends and Developments

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Nishimura & Asahi (Gaikokuho Kyodo Jigyo) has substantial experience in a wide array of real estate securitisations in domestic and cross-border transactions. The firm's real estate finance team has a proven track record in advising lenders and borrowers alike in finance transactions throughout the real estate industry and offers expert assistance to clients in all stages of their transactions. Since the early 2000s, the firm's lawyers have played a significant role in advising publicly traded REITs, private REITs, and real estate operating and finance companies in all stages of their life cycles – from REIT formation, roll-up transactions and initial public offerings to secondary debt and equity offerings, and REIT transactions. Nishimura & Asahi (GKJ) also specialises in environmental law, providing risk analysis and settling disputes on soil pollution, asbestos and other environmental law issues that arise regarding real estate. The firm's expertise extends to environmental law-related issues to be complied with by business entities and covers Corporate Social Responsibility (CSR).

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REITs

REIT market overview

The REIT market has generally shown steady growth. As of the end of 2023, the total value of real estate held by REITs, including private REITs, has reached approximately JPY28.7 trillion (on the basis of acquisition price), and the aggregate market capitalisation of listed J-REITs was about JPY15.4 trillion.

The growth of private REITs has played a role in the Japanese REIT market, with private REITs holding properties valued at about JPY6 trillion (based on acquisition price) in December 2023. As of the end of 2023, there are 54 private REITs, ranging from diversified REITs (ie, those diversifying their portfolio in multiple asset types) to sector-specific REITs (eg, focused on residential, hotel or logistic properties). Sponsors from various business fields have initiated private REITs. Railroad companies, electric power and gas companies, financial institutions (including insurance companies and banks), and other industries are also engaging in the management of REITs or are interested in doing so.

No IPO of a listed J-REIT has occurred since 2021, although more than 22 public offerings (totalling approximately JPY313 billion) have been executed through 2023. The market value of listed J-REITs has softened, and the ratio of REIT market price to REIT net asset value is below 1.0 in many J-REITs. Influenced by changes in the investment environment due to COVID-19 and other factors, there is some movement in the J-REIT market, including mergers of REITs, and portfolio rebalancing that has reduced returns for office portfolios and in contrast, increased returns for portfolios of other assets classes.

Hostile takeovers

Hostile takeovers of J-REITs are among the key trends in the current REIT market. There were some M&A transactions between J-REITs before 2019; however, they were all friendly mergers conducted through agreements between all relevant parties (including the sponsors). Many were carried out between J-REITs under the same sponsors or affiliated sponsors in an effort to increase their assets under management (AUM), expand the types of their assets, and/or streamline their business.

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The first hostile REIT M&A transaction was completed in 2020. A minor shareholder called a shareholders' meeting of a target REIT with the financial bureau's permission. At the shareholder's meeting, the existing management agreement was terminated, a new officer nominated by the minor shareholder was selected, and a management agreement with a new sponsor was executed. After the meeting, a merger was conducted between the REIT managed by the new sponsor and the target REIT.

Another contemplated hostile transaction was a hostile bid to take over a listed office J-REIT's shares, which resulted in the delisting of the REIT through a counter-bid and squeeze-out of minority shareholders by its sponsor. A REIT has relatively limited defensive measures against a hostile takeover bid compared with a company incorporated under the Companies Act. For example, "poison pills" and specially designed shares are not permitted under the Act on Investment Trusts and Investment Corporations, which regulates REITs.

The types of REIT M&A transactions are generally as follows:

- mergers between two REITs (via a consolidation-type merger or an absorption-type merger);
- the acquisition of J-REIT shares and the replacement of an asset management company; and
- the acquisition of all portfolio assets held by a REIT by the acquiring REIT.

These types of transactions are subject to approval from the shareholders of the REIT to be acquired, so there are hurdles to implementing hostile REIT M&A transactions. Even so, REIT asset management companies cannot overlook the possibility of such transactions, considering that a shareholder holding 3% or more of the issued shares for the preceding six-month period can request that a shareholders' meeting is held to consider such transactions. Under these circumstances, it is becoming more important for REIT asset management companies to regularly provide sufficient reports to shareholders and ensure that they understand the advantages of having such companies managing REIT assets in addition to reports on their investment policies and investment records.

Furthermore, under the Act on Investment Trusts and Investment Corporations, a J-REIT may provide in its certificate of incorporation that shareholders who do not attend a shareholders' meeting or exercise their voting rights will be deemed to agree to the proposal(s) submitted at that meeting (this is known as a "Deemed Votes in Favour Provision"). Shareholders of J-REITs include many individual or corporate investors who are mainly focusing on returns and, therefore, are less concerned about attending shareholders' meetings or exercising their voting rights. As a result, most J-REIT asset management companies provide Deemed Votes in Favour Provisions in their REIT certificates of incorporation in order to constitute a quorum and pass necessary resolutions at shareholders' meetings. As a general rule, however, a Deemed Votes in Favour Provision can also apply to important proposals such as those for the replacement of management companies or the above-mentioned hostile takeover – thereby making such transactions easier. In response to this, several REITs have amended their certificate of incorporation in such a way that Deemed Votes in Favour Provisions do not apply to certain important agenda items (such as dismissal of officers, termination of a management agreement, and dissolution).

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Current restructuring

In the wake of the COVID-19 pandemic's impact on the investment landscape, REIT mergers have been carried out in 2023. These mergers are driven by a desire for sustained growth and enhanced market presence, etc. These mergers have been conducted among those who would like to shift from sector-specific REITs to diversified REITs, which makes it easier to replace or rebalance asset portfolios and to increase AUM to grow faster. Enlargement of market capitalisation by a merger also serves as a useful way of reducing the likelihood of hostile REIT M&A proposals. The decrease of sector-specific REITs, however, may have less appeal in the eyes of investors if they are looking for unique specialisation.

In addition to REIT mergers, the delisting of an infrastructure REIT (a REIT focused on investments in solar power facilities) initiated by its sponsor has been conducted in recent years. Legal concerns exist regarding the squeeze-out of REIT minority shareholders, but several transactions demonstrate the legality of delisting a REIT by consolidating shares until the shares held by minority shareholders are less than one share. This trend suggests potential for future REIT market restructuring, including M&A and delistings.

Security Token Offerings

A Security Token Offering (STO) is an attempt to issue a security that is managed and transferred using distributed ledger technology (ie, blockchain). STOs are expected to reduce management costs for real estate funds and provide investors (including individual investors) in new small-lot real estate investments with middle-risk middle returns in Japan. Amendments to the FIEA and the Payment Service Act on 1 May 2020 established regulations for STOs. Following this, several real estate funds successfully raised funds through STOs. There have been large-size STO transactions where security tokens of more than JPY10 billion were issued.

One of the leading methods for structuring STOs backed by real estate is to use a Trust with Certificates of Beneficial Interest. Unlike other types of equity instruments (eg, equity investments via TK interests), which generally require written documents with a certified date in order to be transferred and perfected, a beneficial interest in the trust can be transferred and perfected by agreement between the parties without a document with a certified date. This is because the transfer of a beneficial interest of the trust can be perfected by an entry or record in the beneficial interest register if the trust deed indicates that no beneficiary certificate is issued. Therefore, this beneficial interest registry may be directly linked with a blockchain and nothing other than the registration would be required to complete a transfer (including perfection).

Furthermore, under the Industrial Competitiveness Enhancement Act (which was amended on 16 June 2021), a transfer of TK interests may be perfected against the debtor and third parties if a notice or consent to the transfer has been conducted through a certified business operator that uses information systems with certain features.

One of the upcoming issues for STOs is the development of secondary markets. Under the current FIEA, providing an online platform to trade securities is regulated as a Proprietary Trading System (PTS) and requires the Prime Minister's authorisation. Given the current situation, in which there is no PTS operator dealing tokenised securities, there are discussions and

legislative movement to relax the regulation on PTS operators dealing non-listed securities.

Redevelopment Projects

Urban redevelopment projects

A large number of redevelopment projects have been undertaken in metropolitan areas in accordance with the Urban Redevelopment Act (the "Act"), including large-scale redevelopments in major metropolitan areas in Tokyo (Roppongi, Azabu, Shibuya, etc). The purpose of the Act is to promote greater use of urban land and to facilitate the renewal of urban functions. The Act has the unique features of (i) enabling the participation of developers who are development professionals and (ii) covering project costs by selling the rights in surplus portions obtained from such redevelopment or allocating such rights to developers who do not have rights to the property before redevelopment.

Without the Act, it would be difficult to proceed with redevelopment projects due to the challenge of aligning the interests of various rights holders for small-scale land and buildings in project areas while also covering project costs. Although individuals, redevelopment associations, and local governments can be entities who carry out urban redevelopment projects, redevelopment associations are used in many cases, and the procedures generally involve (i) an urban planning decision, (ii) preparation and approval of a project plan, and (iii) rights conversion, which is the main procedure for redevelopment projects and is a process of converting existing rights in existing real property into rights in newly redeveloped real property.

Use of SPC

In recent years, as the total development costs of large-scale redevelopment projects have increased, there has been a trend toward an increasing number of projects that not only involve the participation of professional contractors or developers but also use a real estate securitisation structure, such as a TK-GK structure or TMK structure, to finance part of the project costs. There are several ways in which an SPC can be involved in a redevelopment project, including the SPC becoming a participant in a redevelopment association or the SPC becoming an acquirer of surplus floor space after redevelopment. In this case, the difficulty is high because both knowledge of real estate liquidation schemes and knowledge of redevelopment projects are required. TK-GK and TMK structures are regulated by the Financial Instruments and Exchange Act or the Asset Securitization Act, respectively, neither of which is directly related to development-related laws and regulations. For example, at the time of approval of a business plan, the authorities may require that an SPC submit a letter of support from a sponsor in terms of the SPC's credibility to be involved in the project for a long period of time.

Issues in relation to increased development costs

In addition to the increased scale of development projects, there are various other factors that increase development costs. The main factors are considered to be the soaring cost of construction materials due to the post COVID-19 increases in prices and the weakened yen, as well as the difficulty in securing human resources. The fact that the employment regulations, such as the overtime limit, which were initiated as part of the work-style reform, will apply from 1 April 2024, after a five-year grace period for the construction industry, which has a chronic shortage of human resources, an ageing workforce, and long working hours, is another factor contributing to the difficulty in securing human resources. Those factors also seem to make it

difficult to set up long-term business plans for redevelopment projects.

Market in Each Type of Asset

Hotels

With the COVID-19 outbreak subsiding, hotel assets appear to be recovering significantly as an investment target due to the increased willingness of domestic travellers to travel as well as the recovery of the number of inbound visitors. The hotel market is booming as hotel demand recovers, especially in Tokyo, Osaka, Hokkaido, and Okinawa.

According to the Nikkei's real estate market information, two of the top ten real estate transactions (by deal size) in Japan in 2023 were hotel investment projects, although none were ranked in 2022.

Office properties

Although it does not appear to be depressed to the point of being negative, investment in this asset class appears to have stagnated somewhat in 2023, as it did in 2022, due in part to rising vacancy rates. Nonetheless, while office building prices in Europe and the United States have plummeted due to rising interest rates and the establishment of telecommuting, office building prices in Japan have remained relatively stable, which appears to be one of the reasons why a certain level of investment has been maintained.

Logistics

Investment in logistics facilities remained strong in 2023, with a number of funds being newly launched. In the first half of 2023, the largest supply has been provided in the Tokyo area, and transactions aimed at strengthening supply chains, such as base consolidation and investment in logistics systems, are attracting attention.

Data centres

With the growing demand for cloud computing, data centres are being developed in Japan, and investment in this asset class is also on the rise. For data centres, there are hurdles to obtaining non-recourse financing at the land leasehold stage without income generated from a property, and therefore the development of data centres may be conducted through other schemes, such as joint ventures.

Renewable Energy

Even after the global COVID-19 pandemic exerted considerable pressure on economic activity in Japan, domestic and foreign investors have actively and consistently invested in Japanese renewable energy businesses.

After the Japanese Feed-in-Tariff regime (the FIT Regime) came into effect in July 2012, the proportion of renewable energy in Japan's power generation mix increased from approximately 9% to 18%.

As the next step, for the independence of renewable energy, a major amendment to the Japanese Renewable Energy Act (Act No 108 of 2011) was promulgated into law in June 2020 and came into force in April 2022, and the Japanese Feed-in-Premium regime (the FIP Regime) has been introduced, shifting away from the FIT Regime.

Under its Green Growth Strategy towards 2050 Carbon Neutrality, published in December 2020, the Japanese government plans to achieve around 50% to 60% of total power generation through renewable energy by 2050, with offshore wind power considered a high-growth potential sector. In response to the legislation anticipated

under this strategy, investments and developments in the renewable energy section will be continuously stimulated over the next few decades.

ESG

ESG factors have gained attention in the real estate market, in line with other investment sectors.

To create a sustainable environment, it is generally understood that real estate, as a basic component of society, should follow global policy, such as contributing to Sustainable Development Goals (SDG). The real estate industry is thought to have significant potential to play an important role in meeting SDG targets, especially with respect to the environment. There have been developments of buildings that achieve high environmental performance to reduce energy consumption. Buildings with environmental performance certificates appear to attract more investments than those without such certificates.

In line with the promotion of ESG, the number of Japanese participants in GRESB Real Estate Assessment has been increasing, with the participation rate of Listed J-REITs in the Assessment reported to have been approximately 90% (on the basis of market capitalisation) in 2019. GRESB Real Estate Assessment is the global ESG benchmark capturing information on ESG performance and sustainability best practices for real estate, and gives rating results. It appears that more and more investors have referred to, or are considering, GRESB Real Estate Assessment for their investment decisions.

The Japanese government is also actively promoting ESG/SDG through a number of policies related to this field, such as:

- SDG Action Plan 2020;
- Financial Administration and SDG;
- the interim report for the promotion of ESG investment in real estate;
- the interim report of the study group on real estate-specific joint ventures based on ESG investment; and
- Guidance for responding to “Proposals of Task Force on Climate-Related Financial Information Disclosure” in the real estate field.

The idea of a green lease is part of the government’s strategy to improve environmental performance in the real estate sector, which the Japanese government is also suggesting through its Green Lease Guidelines. In a green lease, the owner and tenant share the costs for environmental improvements of the leased building.

Also, public funds, together with private funds, have been flowing into investments to redevelop old buildings and remodel them to have improved seismic capacity and environmental efficiency. The green bonds market is also growing and collecting funds to be spent on eco-friendly businesses.

KENYA



Law and Practice

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DLA Piper Africa, Kenya (IKM) is a leading full-service commercial law firm that has been providing legal services in Kenya for over 35 years. The firm's multidisciplinary team of lawyers is internationally recognised and has in-depth knowledge of the Kenyan market and its legal, economic, cultural and social dynamics, bringing significant scale and expertise to matters through DLA Piper Africa, with an unrivalled presence in over 20 African countries. The firm advises a wide range of clients, including buyers, developers, entrepreneurs, hotels, investors, lenders, property-owners, schools, sellers and tenants. The team has extensive experience in working with both the public and private sectors, enabling it to understand issues on both sides of the negotiating table. The firm assists in the full spectrum of real estate transactions, from acquisition to disposal, and facilitates the preparation and review of leases, the extension of leasehold terms, subdivision, changes of use and the amalgamation of properties.

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1. General

1.1 Main Sources of Law

The main sources of real estate law in Kenya are as follows:

- the Constitution of Kenya, 2010 (Constitution) is the supreme law prescribing land rights and policies in Kenya;
- the Land Act 2012 (LA) is the principal statute on the administration and management of land and land-based resources;
- the Land Registration Act 2012 (LRA) governs the registration of interests in public, private and community land;
- the Community Land Act 2016 governs community land;
- the National Land Commission Act, 2012 prescribes the functions of the National Land Commission (NLC);
- the Land Control Act, 1967 (LCA) governs dealings in agricultural land;
- the Landlord and Tenant (Hotels, Shops and Catering Establishments) Act, 1972 (LTA) governs controlled tenancies related to business premises;
- the Distress for Rent Act relates to distress for rent;
- the Physical and Land Use Planning Act, 2019 (Physical Planning Act) governs the planning, use and development of land;
- the Sectional Properties Act, 2020 (SPA) governs the registration and management of sectional properties;
- the Law of Contract Act, 1961 prescribes the formal requirements for contracts related to dealings in land;
- the National Construction Authority Act, 2011 (NCA Act) establishes the National Construction Authority and prescribes its functions;
- the Environmental and Land Court Act, 2011 establishes the Environment and Land Court (ELC) to hear and determine disputes relating to the environment and land;
- the Environmental Management and Co-ordination Act, 1999 (EMCA) is the framework environmental law;
- the Special Economic Zones Act, 2015 (SEZ Act) establishes special economic zones;
- the Housing Act, 1953 to provide for loans and grants of public moneys for the construction of residential dwellings;
- the Affordable Housing Act 2024 establishes a framework for development of affordable housing and institutional housing; and

- the Climate Change Act 2023 establishes a regulatory framework for enhanced response to climate change for purposes of achieving a low carbon climate development.

1.2 Main Market Trends and Deals

Sustainable Real Estate Finance

Sustainable real estate finance continues to gain popularity in Kenya, with notable developments including the following:

- the Central Bank of Kenya has published the draft Kenya Green Finance Taxonomy;
- adoption of the Green Economy Strategy Implementation Plan 2016-2030 to accelerate a transition towards a low carbon economy;
- adoption of the Kenya Sovereign Green Bond Framework to mobilise green sustainable financing;
- ongoing development of the Green Fiscal Incentives Policy Framework for Kenya to steer Kenya's economy into a low-carbon climate-resilient green development pathway;
- establishment of the Kenya Green Bond Programme in 2017 to develop a domestic green bond market, with the first green bond to raise capital for a real estate project being issued by Acorn Holdings in 2019;
- a partnership between KCB Bank Kenya and the International Finance Corporation to expand KCB's Green Climate Fund, which provides financing to businesses addressing climate change; and
- partnership between the European Investment Bank and the Central Bank of Kenya to launch a climate finance best practice initiative.

Affordable Housing Scheme (AHS)

The President of Kenya aims to deliver 200,000 affordable housing units each year. The Affordable Housing Act, 2024 has been enacted into law to provide financing for the AHS by imposing a housing levy and creating an Affordable Housing Fund. The latest AHS projects include Kings Orchid and the Mabera Affordable Housing Project. An affordable unit should cost no more than KES3 million (approximately USD22,640). The Kenya Mortgage Refinance Company was incorporated in 2018 to provide affordable long-term financing to primary mortgage lenders (eg, banks) for the onward provision of affordable mortgage products to Kenyans.

Private developers are also investing in affordable housing products independent of the AHS, including TSAVO and Acorn Holding Limited.

Smart Cities and Green Buildings

Key projects and deals include:

- various Kenyan buildings and developments being certified as green including Britam Tower, Garden City, the Aga Khan University Hospital, ALP North Logistics Park, Strathmore Business School, Pope Paul VI Learning Resource Centre at the Catholic University of East Africa, Sandalwood Waterfront and UNEP Nairobi building;
- a partnership between Africa Logistics Properties and the IFC to promote voluntary green building certification programmes;
- the Nairobi Railway City, a proposed mixed-use sustainable development on 425 acres of land located within the Nairobi Central Business District;
- Konza Technopolis (Konza City), a smart city located in Machakos County;
- Tatu City, a 5,000 acre mixed-use development located in Kiambu county;
- Tilisi Development, a 400-acre master-planned and mixed-use development located in Kiambu county; and

- the Qwetu Student Residences, modern purpose-built affordable student hostels in Nairobi.

Impact of inflation and increases in interest rates

Rising inflation and increasing interest rates have affected real estate transactions in the following ways:

- investors have been risk averse, leading to low demand for real estate products and low uptake of loans;
- financial products, including mortgages, have been increasingly costly, due to rising interest rates and the weakening Kenyan shilling;
- the high cost of living has prompted rent and loan payment defaults and forfeitures;
- construction materials remain expensive; and
- there has been a greater appetite for affordable housing solutions.

Impact of Disruptive Technologies

The following digital solutions have been adopted:

- the digitisation of courts, including the ELC;
- the digitisation of land records and the launch of the Ardhi Sasa platform by the Ministry of Lands and Physical Planning (the Ardhi Sasa platform is progressively improving, albeit with some technical challenges);
- the digitisation of the collateral registry of security rights over movable assets under the Movable Property Security Rights Act;
- the Business Laws (Amendment) Act, 2020 (Business Laws Act) to enable the digital execution of land-related documents is yet to be fully implemented;
- mobile money payment is available for land transactions;
- proptech solutions such as Airbnb, xPodd, virtual reality site visits and smart homes are popular in Kenya; and
- 3D printing building technology.

These technologies will have the following effects:

- the cost of real estate transactions will be reduced;
- land transactions will be easier;
- construction will be more efficient; and
- there will be reduced reliance on intermediaries in real estate transactions.

1.3 Proposals for Reform

The Land Laws (Amendment) Bill, 2023 seeks to amend various land statutes. Key proposed changes include the transfer of the NLC's power to undertake compulsory acquisition of land to the Cabinet Secretary responsible for land matters.

The Local Content Bill, 2023 seeks to create a comprehensive legal framework for the development and adoption of local content through ownership, control and financing of activities connected with the exploitation of gas, oil and other petroleum resources.

The Natural Resources (Benefit Sharing) Bill 2022 seeks to establish a system of benefit sharing in natural resource exploitation between resource exploiters, the national government, county governments and local communities.

The Land Control Bill, 2022 seeks to rationalise the law on dealings in agricultural land with the provisions of the Constitution, the Environmental and Land Court Act, the LA and the LRA. The Bill proposes to introduce Land Control Committees, which will regulate dealings in agricultural

land in accordance with the law and traditions, customs and the way of life in the community of the controlled area.

The Landlord and Tenant Bill, 2021 seeks to consolidate the laws relating to the renting of business and residential premises, and to regulate the relationship between landlords and tenants to promote stability in the rental sector.

2. Sale and Purchase

2.1 Categories of Property Rights

There are two main categories of property rights:

- leasehold tenure – a lease interest in immovable property for a specific period, subject to the payment of a lease premium or rent to the owner; and
- freehold tenure – an absolute ownership interest in immovable property, subject only to the provisions of law.

2.2 Laws Applicable to Transfer of Title

The LA and LRA are the primary statutes that apply to the transfer of real estate title, be it residential, retail, industrial, business or hotels. For community land, the Community Land Act also applies.

The SPA is the primary statute governing the transfer of sectional titles.

2.3 Effecting Lawful and Proper Transfer of Title

Conducting Due Diligence

Transfer of title begins with due diligence being performed by the purchaser; see **2.4 Real Estate Due Diligence**.

Preparation of an Agreement for Sale

Agreements for sale must generally meet the requirements under Section 38 of the LA and Section 3 of the Law of Contract Act, and therefore must:

- be in writing;
- be signed by all the parties to the contract; and
- have the signature of each party attested by a witness.

The agreement is prepared by the seller's advocates.

Obtaining Completion Documents

The seller's advocate obtains the completion documents, which include the title document, the signed transfer document and land control board consent (where applicable). The transfer is drafted by the purchaser's advocates.

Transfer of Title

Upon payment of the full purchase price to the seller or the issuance of suitable undertakings to the seller's advocates for payment of the financed balance of the purchase price (if any), the seller's advocates release the completion documents to the purchaser's advocates. Thereafter, the transfer is lodged at the land registry for valuation of the property for purposes of assessing the stamp duty payable. Subsequently, the purchaser pays stamp duty and files the transfer at the land registry for registration.

If the transfer is to be effected through the Ardhi Sasa platform, the parties will be required to have Ardhi Sasa accounts. The transfer is initiated on the platform and signed by the parties electronically. Valuation of the property will be initiated online and payment of stamp duty done via ardhi pay. When the transfer is registered,

the original title and registered documents are collected from the land registry.

The law does not require landowners to insure their titles. Title insurance is not common in Kenya.

2.4 Real Estate Due Diligence

Purchasers' advocates conduct due diligence as follows:

- review the title document to confirm the landowner and property details;
- conduct a title search at the land registry to confirm the property details, including existing encumbrances;
- undertake a search at the survey department to confirm the boundaries and permitted use of the property – the purchaser may also appoint a surveyor to identify the property on the ground and confirm the boundaries and size;
- peruse the report by the Commission of Inquiry into the Illegal/Irregular Allocation of Public Land, 2003 to confirm if the property is adversely mentioned;
- peruse all notices published by the NLC to confirm if the title is due for revocation due to any illegalities in acquisition;
- peruse the gazette notices published by the Ministry of Lands and Physical Planning to confirm if the property is listed for conversion;
- confirm if the property falls under the SPA and if applicable, whether sectional titles have been or will be obtained for units of the property;
- physically inspect the property to confirm the existence of squatters, suitability for purpose and compliance with environmental laws; and
- perform searches on the seller to confirm identity and capacity to contract – this may include a company search, where applicable.

2.5 Typical Representations and Warranties

Representations and Warranties

On the purchaser's insistence, the seller may issue representations and warranties to the effect that:

- the seller is the legal owner of the property;
- the seller has full authority to enter into the contract for sale;
- the property is not situated on public land or in a buffer zone or road reserve;
- the seller is not engaged in any litigation relating to the property;
- there are no notices issued by any governmental authority for compulsory acquisition of the property; and
- the seller is not in breach of environmental laws.

Representations warranties and their survival period are not prescribed by law; they are negotiated by the parties. A seller may cap their liability as at the date of the agreement for sale, while a purchaser may negotiate to extend the seller's liability until the date of transfer or a reasonable period after the date of transfer. A seller may also cap their financial liability to the purchase price amount.

Enforcement of Representations and Warranties

The agreement for sale gives the purchaser the option to:

- terminate the agreement in the event of material misrepresentation or breach of a warranty; or
- claim damages if the breach is not material.

Representation and warranty insurance is not common in Kenya.

2.6 Important Areas of Law for Investors

In addition to those discussed in **1.1 Main Sources of Law**, the following laws are also significant:

- the Stamp Duty Act prescribes stamp duty payable on the purchase of immovable property;
- the Urban Areas and Cities Act provides for the classification, governance and management of urban areas and cities;
- county by-laws; and
- the laws governing investors' real estate investment vehicles, including the Companies Act 2015 governing operations of companies, and the Limited Liability Partnership Act 2011 governing limited liability partnerships.

2.7 Soil Pollution or Environmental Contamination

A buyer is deemed responsible for soil pollution or environmental contamination on their property. Accordingly, it is critical for a buyer to physically inspect the property to confirm its compliance with environmental laws before purchase.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Permitted Use

The Physical Planning Act and county laws govern zoning and planning at the national and county level, respectively. The use or development of land must be in accordance with the National and County Physical and Land Use Development Plans. The permitted use of a parcel of land is usually indicated on the title document. Where this is not the case, the permitted use can be confirmed by a search at the land registry or survey department.

Development Agreements

It is possible to enter into development agreements with relevant public authorities in order to facilitate a project; see **4.6 Agreements With Local or Governmental Authorities.**

2.9 Condemnation, Expropriation or Compulsory Purchase

Compulsory Acquisition

Article 40 (3) (b) of the Constitution allows the state to compulsorily acquire land for a public purpose, subject to the fair and prompt compensation of the interested persons. Section 107 of the LA prescribes the process of compulsory acquisition, which takes place in four stages as follows.

The pre-inquiry stage

- The Cabinet Secretary or the County Executive Committee Member of the national or county state agency that wishes to compulsorily acquire the land submits a request for acquisition to the NLC.
- The NLC requests a verification meeting with the state agency, which provides a list of the affected parcels of land and the respective owners, title search details, cadastral maps of the affected areas, a resettlement action plan and a list of persons affected by the acquisition.
- The NLC may reject the request if the constitutional requirements are not met. If the request is approved, the NLC maps out and values the land.
- The NLC then publishes a notice of intent in the Kenya Gazette and the County Gazette, and delivers a copy of the notice to the land registrar and any person interested in the land.
- On receipt of the notice, the land registrar makes an order restricting further dealings on the affected land until it vests in the state

agency. The land registrar also makes an entry in the register of the intended acquisition.

The inquiry stage

- At least 30 days after publishing the above notice, the NLC publishes another notice in the Kenya Gazette announcing the date of an inquiry to be conducted by the NLC.
- Before the date of the inquiry, the interested persons submit their written claims for compensation to the NLC.
- On the hearing date, the NLC examines the interested persons to confirm their proprietary interests in the land and hears claims for compensation.

The post-inquiry stage

- After the inquiry, the NLC prepares a written award in favour of the interested persons and serves a notice of the award on each interested person.
- Upon acceptance of the award, the NLC promptly pays compensation to the entitled persons within one year of taking possession of the land. Compensation may be monetary or otherwise, including land swaps.

Possession and vesting

- After an award has been made, the NLC may take possession of the land by serving a notice to each interested person and the land registrar, specifying the day of possession. The title then vests in the national or county government (as the case may be).
- Upon taking possession and payment of just compensation in full, the land vests in the national or county governments, free from encumbrances.
- The landowner is required to deliver the title documents to the land registrar for cancellation if the whole land has been acquired, or for registration of the resultant parcels and issue of their titles if only a portion of the land is acquired.

2.10 Taxes Applicable to a Transaction

Taxes in Direct Sale of Real Estate

Capital Gains Tax (CGT) and stamp duty are applicable in real estate transactions. CGT is paid by the seller at the rate of 15% of the net gains received upon sale of the immovable property. The seller will also pay CGT at the rate of 15% on the transfer of shares where the shares or comparable interest derive more than 20% of their value directly or indirectly from immovable property in Kenya. Stamp duty is paid by the purchaser at the rate of 2% of the value of the property if located in a rural area, or 4% of the value of the property if located in an urban area.

The Income Tax Act prescribes transfers exempted from CGT, including the transfer of property to a registered family trust. Similarly, the Stamp Duty Act prescribes transfers that are exempt from stamp duty, including transfers to first-time homeowners under the AHS.

Taxes in Sale of Real Estate by Way of Shares

Where real estate is purchased by way of the acquisition of shares in a land holding company, stamp duty will be paid by the purchaser at the rate of 1% of the value of the acquired shares. This also applies in the event of the subsequent acquisition of the shares of the company. Furthermore, CGT will be charged at the rate of 15% of the net gain on the sale of the shares by the seller.

Transaction Costs

The transaction costs typically borne by the seller are:

- the costs of the subdivision or change of use of the land, if required (unless otherwise agreed);
- the cost of obtaining relevant consents, including the land control board consent in the case of agricultural land;
- CGT; and
- legal fees (unless otherwise agreed).

The transaction costs typically borne by the purchaser are:

- costs for valuation of the property;
- stamp duty;
- registration fees for the transfer; and
- legal fees.

2.11 Legal Restrictions on Foreign Investors

Foreign Ownership of Land

Article 65 of the Constitution prohibits foreigners from owning freehold land. Foreigners may own land based on a leasehold tenure only, and such leases are for a maximum period of 99 years. Any freehold land or lease for a term exceeding 99 years held by a foreigner is deemed to be a lease of a maximum period of 99 years from 27 August 2010.

Under the Constitution, a body corporate is regarded as a Kenyan citizen only if it is wholly owned by Kenyan citizens. Where the property is held in trust, the property is regarded as being held by a Kenyan citizen if all its beneficiaries are Kenyan citizens.

Dealings in Agricultural Land

Sections 6 (1) (a) and (c) as read with Section 9 (1) (c) of the LCA prohibit land control boards from approving:

- the sale, transfer, lease, mortgage, exchange, partition or other disposal of or dealing with any agricultural land situated within a land control area where the beneficiary is not a citizen of Kenya; and
- the issue, sale, transfer, mortgage or any other disposal of or dealing with any share in a private company or co-operative society that, for the time being, owns agricultural land situated within a land control area in favour of a person that is not a citizen of Kenya.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The acquisition of commercial real estate is usually financed as follows:

- by borrowing from financial institutions, including commercial banks and Savings and Credit Co-operatives;
- through REITs; or
- through joint ventures.

Where the government is involved, acquisition may be financed by the government itself or by public-private partnerships.

3.2 Typical Security Created by Commercial Investors

A commercial real estate investor who is borrowing funds to acquire or develop real estate will typically create the following security:

- a legal charge over the real estate in favour of the lender;
- assignment of receivables: during the development the receivables will include insurance proceeds; rights in project bank accounts; and/or rights and interest to contracts and agreements relevant to the project. After the development, the receivables will typically be rental income;
- (if required by certain lenders) direct agreements with respect to key construction contracts.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders, nor on making repayments to a foreign lender under a security document or loan agreement. However, like citizens and Kenyan corporations, a foreign lender or foreign security trustee would be required to have an Ardhi Sasa account in order for security over immovable property, which is registrable on Ardhi Sasa, to be created in their favour. For security over movable assets, the foreign lender would need to appoint a Kenyan agent (typically, Kenyan counsel) to register relevant notices at the Collateral Registry on their behalf.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

When granting security, the borrower will be responsible for the following costs:

- stamp duty at the rate of 0.1% of the borrowed amount for registrable securities such as legal charges;
- the legal fees of the borrower's and lender's advocates, as prescribed by the Advocates Remuneration Order based on the amount secured; and
- nominal registration fees charged by the relevant registries.

In addition, the borrower is usually responsible for the lender's enforcement costs, including legal fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The following requirements must be met.

- The borrower must have the capacity to give the security under its constitutive documents.
- A corporate guarantor must derive commercial benefit from giving security over its real estate assets, even where the borrower is a related company. Where there is no commercial benefit, the borrower and guarantor must enter into a commercial benefit agreement for the payment of agreed fees to the guarantor as consideration for guaranteeing the facility to the borrower.
- Financial assistance for the acquisition of real estate assets is not prohibited.

3.6 Formalities When a Borrower Is in Default

Enforcement of a Legal Charge

Section 90 of the LA prescribes the formalities for the enforcement of a legal charge in the event of default by the borrower. If the borrower is in default for one month, the lender issues a notice of the default to the borrower, requiring the borrower to remedy the default within the notice period (at least three months if the default relates to non-payment). If the borrower fails to do so and the lender opts to exercise statutory power of sale, the lender issues another 40-day notice. Upon lapse of the notice period, the property is valued and sold. The time taken to sell the property would vary according to market

demand and could range from a month to more than a year.

The LA also provides additional remedies available to the lender: appointment of a receiver, suing the chargor, leasing the property and taking possession of the property. Enforcement of these remedies may take longer than exercising the statutory power of sale, especially if the matter is contentious.

Priority of Legal Charges

According to Section 81 of the LA, charges rank according to the order in which they are registered, unless the charge instrument (with the prior written consent of a prior security holder) states otherwise.

3.7 Subordinating Existing Debt to Newly Created Debt

According to Section 81 of the LA, charges rank according to the order in which they are registered. However, existing legal charges may be subordinated to newly created legal charges by agreement between the lenders. The holder of the prior registered charge would typically sign a consent form on the subsequent charge, consenting to the creation of the subsequent security and confirming that its security ranks subsequent to the new charge. Lenders can also enter into an intercreditor agreement.

3.8 Lenders' Liability Under Environmental Laws

Kenyan courts apply the polluter pays principle under which the person responsible for environmental damage is liable for it.

A lender is not liable for non-compliance with environmental laws since a legal charge does not constitute a transfer of the property. However, when enforcing the security by the appointment of a receiver or the leasing or taking possession of the charged property, a lender qualifies as an "owner" under the EMCA and will therefore be liable for non-compliance with environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

A borrower's insolvency does not affect a lender's security interest. Insolvency is usually an event of default in the charge instrument that would trigger enforcement by the lender. Where an administrator has been appointed, the consent of the appointed administrator or approval of a court of competent jurisdiction would need to be obtained in order to enforce security. Under Section 590 of the Insolvency Act, the administrator of an insolvent person's estate is prohibited from interfering with a secured creditor's right to enforce its security.

3.10 Taxes on Loans

The following taxes apply to loans.

- Withholding tax at the rate of 15% is payable on interest income earned by resident and non-resident persons.
- Section 12 B of ITA imposes a fringe benefit tax at the rate of 30% on loans provided by employers to an employee, director or their relatives at an interest rate that is lower than the market rate. The applicable rate is the difference between the market interest rate and the actual interest paid on the loan. Market interest rate means the average 91-day treasury bill rate of interest for the previous quarter. The rate at time of publication (May 2024) is 16%.
- Section 5 (2 A) of ITA imposes a low interest benefit tax at the rate of 30% on loans received by an employee, director or their relatives from an unregistered pension or

provident fund at an interest rate that is lower than the prescribed rate of interest. The applicable rate is the difference between the interest rate prescribed by the Commissioner for Domestic Taxes and the actual interest paid on the loan. The rate at time of publication (May 2024) is 14%.
- Section 10 1 (c) of ITA imposes deemed interest tax. Deemed interest is an amount of interest equal to the average 91-day treasury bill rate which is deemed to be payable by a resident person or a person having a permanent establishment in Kenya in respect of any outstanding interest-free loan provided or secured by the non-resident. Withholding tax is also applicable to such deemed interest. The Commissioner for Domestic Taxes determines the deemed interest rate and withholding tax rate. The rate at time of publication (May 2024) is 16% and the withholding tax rate is 15%. Banks and other financial institutions licensed under the Banking Act are exempted from paying taxes on deemed interest.
- Excise duty at the rate of 20% is imposed on fees charged by financial institutions. This does not apply to interest on loans or returns on loans.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Under the Fourth Schedule of the Constitution, the national government is responsible for developing planning policies and co-ordinating planning by the county governments, and the county governments are responsible for county planning and development.

The principal laws for strategic planning and zoning in Kenya are the Constitution, the Physical Planning Act, the Urban Areas and Cities Act and county legislation.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Physical Planning Act requires development permission to be obtained prior to the improvement of land, which entails the submission of building plans prepared by a qualified planner. The development permit will be issued only if the development complies with zoning laws. The permit may also prescribe conditions for undertaking the development. It is rare for the permit to prescribe requirements on the appearance of the development or method of construction. However, the methods and standards of construction are regulated under the NCA Act.

4.3 Regulatory Authorities

The following authorities regulate the use and development of real estate in Kenya.

- The NLC manages public land on behalf of the national and county governments, and oversees land use planning and development in accordance with the Constitution and the NLC Act.
- The county governments regulate zoning and planning pursuant to the Physical Planning Act and county legislation. Land use must comply with National and County Physical and Land Use Development Plans. A development permit is also required from the county government prior to development.
- The National Construction Authority (NCA) regulates contractors and construction in Kenya, in accordance with the NCA Act. Construction projects must be registered with the NCA.

- Dealings in agricultural land are regulated by Land Control Boards (LCB) in accordance with the LCA. LCB consent is required for the development of agricultural land.
- The EMCA establishes the National Environment Management Authority (NEMA), which is responsible for the general supervision and co-ordination of all matters relating to the environment, including the development of land.

4.4 Obtaining Entitlements to Develop a New Project

The Physical Planning Act requires the developer to apply to the relevant county government for development permission. Upon receipt, the county government circulates the application to the relevant state agencies, including the Director of Survey, the NLC and NEMA, for their comments. The state agencies may object to the issuance of the development permit if the development does not comply with the law. The county government also publishes a notice in the Kenya Gazette and newspapers circulated nationwide, inviting public participation in the proposed development. After considering the comments by the state agencies and the general public, the county government may reject the application or issue the development permit.

In addition, the following approvals are required, among others.

- The developer must conduct an environment impact assessment (EIA) of the project and apply to NEMA for an EIA licence. NEMA is required to consult with the relevant state agencies and allow for public participation before the EIA licence is issued.
- The project must be registered with the NCA.
- If the land is agricultural, LCB consent is required. Public participation is not required for this.
- If a borehole is to be drilled, a Water Resources Authority permit.
- The consent of the Kenya Railway Authority is required if the development is adjacent to a railway line.
- The consent of the Kenya Forest Service is required if the development may affect conservation areas or wildlife.
- The consent of the Kenya Civil Aviation Authority is required if the development may affect the airspace in any manner.

4.5 Right of Appeal Against an Authority's Decision

A developer may appeal a county government's decision not to grant development permission before the National or County Liaison Committee (as applicable). The developer may lodge a further appeal against the decision of a County Liaison Committee to the National Liaison Committee. Thereafter, an appeal against a decision of the National Liaison Committee may be made to the ELC.

If NEMA declines to grant the EIA licence or revokes it, the developer may appeal such decision at the National Environment Tribunal (NET) within 60 days. A further appeal may be made to the ELC against the decision of the NET.

If the LCB declines to consent to the development of agricultural land, the developer may appeal to the Provincial Land Control Appeals Board within 30 days of the decision being delivered. A further appeal may be made to the Central Land Control Appeals Board. If the developer is not successful, they can consider effecting a change of use of the land to avoid the need to obtain the LCB consent for the development.

If the NCA declines to register a construction project, the developer may appeal to the Appeals Board established under the NCA Act.

4.6 Agreements With Local or Governmental Authorities

Development agreements may be concluded with county or national government authorities in compliance with the law to facilitate large projects. Development agreements may be aimed at facilitating the issuance of statutory approvals, the development of infrastructure, local content requirements and the provision of social amenities, among others.

Agreements may also be entered into with utility providers, such as Kenya Power and Lighting Company, to facilitate utility provision on the development.

4.7 Enforcement of Restrictions on Development and Designated Use

Physical Planning Laws

Section 72 of the Physical Planning Act enables the County Executive Committee Member for Physical and Land Use Planning to issue an enforcement notice to an owner, occupier, agent or developer of land (Recipient) if a developer commences development without a development permit or if any conditions of the development permit are not complied with. The enforcement notice will prescribe the remedial action to be taken by the Recipient, who will face imprisonment and/or be subject to fines if they do not comply with the notice.

Environmental Laws

Section 108 of the EMCA enables NEMA to issue environmental restoration orders prescribing remedial action to be taken by the Recipient to refrain from causing harm to the environment and/or restore the environment to its original state. The order may also impose fines against persons contravening environmental laws, or may award compensation to those affected by environmental degradation or pollution. The ELC may also issue environmental restoration orders.

Section 112 of the EMCA allows courts to grant environmental easements and conservation orders to preserve environmental resources.

Furthermore, part XIII of the EMCA spells out environmental offences. The consequences of committing environmental offences include revocation of the relevant licences, imprisonment and hefty fines.

Construction Laws

Rule 28 of the National Construction Authority Regulations, 2014 empowers the NCA to set up a committee to investigate complaints against contractors and any developments if they are suspected of contravening the law. The committee may recommend the deregistration of a contractor or the revocation or suspension of their licence. Where a contractor is deregistered, all construction contracts being executed by that contractor will be terminated immediately.

Dealings in Agricultural Land

Failure to obtain LCB consent for the development of agricultural land may render all related transactions void.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The main vehicles for investment in real estate are limited liability companies (LLCs), limited liability partnerships (LLPs) and Real Estate Investment Trusts (REITs). LLCs are the most common

and preferred investment vehicles, but LLPs are beginning to gain traction.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

LLCs

LLCs are the most common and preferred investment vehicles, and are regulated by the Companies Act 2015. LLCs have corporate personality, and the liability of the members is limited. Given this, an LLC may own property, enter into contracts and sue and be sued in the name of the company.

LLCs may be private or public. A private LLC has one to 50 members and a minimum of one director, who must be a natural person. The shares of a private LLC may not be transferred to the public. A public LLC has a minimum of one member and no restriction on the maximum number of members. It is also required to have a minimum of two directors, one of whom must be a natural person. The shares of a public LLC may be transferred to the public.

LLCs are tax residents in Kenya and are subjected to tax at the rate of 30%. The taxable income is computed as the gross revenue less allowable expenses which were wholly and exclusively used in the production of income. Subsequent distribution of dividends by an LLC would be subject to withholding tax (WHT) at the rates indicated below.

A resident (or non-resident entity with a branch/permanent establishment in Kenya) will pay:

- 5% WHT on dividends from shares representing up to 12.5% of voting power;
- no WHT on dividends from any further shares; and
- 15% WHT on interest.

A non-resident will pay 15% WHT on all dividend and interest income.

LLPs

LLPs have gained traction as the real estate investment vehicles of choice, and are regulated by the LLP Act 2011. LLPs have legal personality, and the liability of the partners is limited. LLPs may also own property, enter into contracts and sue and be sued in the name of the LLP.

An LLP has a minimum of two partners and at least one manager, who must be a natural person.

An LLP is not recognised as a distinct person for the purposes of income tax even though it has legal personality. Accordingly, tax on income accrued in or derived from Kenya is accounted for by the partners individually and not by the LLP. Each partner will therefore pay taxes on their share of the profit earned from the LLP based on the applicable income tax rates.

REITs

Following the enactment of the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations (2013), REITs have gained traction as the premier vehicle for collective investment in real estate in Kenya. They are licensed and regulated by the Capital Markets Authority (CMA). A REIT is structured as an unincorporated common law trust divided into units and established by way of a trust deed. REITs must have a licensed independent REIT trustee who holds the REIT assets on behalf of the investors and a licensed REIT manager who manages the day-to-day affairs of the REIT.

A REIT scheme may be structured as follows.

- In a development REIT (D-REIT), investors pool resources for the purposes of acquiring eligible real estate for development and construction. Upon the completion of construction, the D-REIT may be converted to an income REIT (I-REIT).
- In an I-REIT, investors pool resources for the purposes of acquiring long-term income-generating real estate. The capital gain and rental income are distributed amongst the unit holders.
- An Islamic REIT is a pool for investment in income-producing Sharia-compliant real estate products.

REITs are beneficial to investors because they are professionally managed and there is minimal capital risk, despite the variety of real estate products available.

REITs also enjoy tax exemptions (see **8.5 Tax Benefits**).

5.3 REITs

REITs are available in Kenya (see **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**). They may be unlisted or listed on the Nairobi Securities Exchange. Foreigners are allowed to set up and invest in REITs provided that they comply with the applicable laws. In order to register a REIT, the prescribed minimum capital requirements (see **5.4 Minimum Capital Requirement**) must be met, and the CMA must declare the REIT to be an authorised scheme.

The advantages of REITs are that:

- they enable low capital investors to invest in real estate, which is typically capital intensive;
- they are a source of capital for real estate development and investment;
- they allow investors to diversify their real estate portfolio based on the schemes' pool of assets;
- if listed, they create liquidity by allowing easy and quick investment in real estate;
- they can, in the case of income REITS (I-REITS), provide consistent income, since they are required to pay out at least 80% of its taxable income to unitholders in the form of dividends;
- since they are regulated entities, they benefit from transparency and professionalism in their management and operation; and
- they enjoy tax exemptions (see **8.5 Tax Benefits**).

Despite the benefits, there is still a low uptake of investment in REITs in Kenya for various reasons including low investor awareness, market volatility and high set-up costs.

5.4 Minimum Capital Requirement

There are no minimum capital requirements for LLPs and private LLCs.

A public LLC must have a minimum capital requirement of KES6,750,000 (approximately USD50,945).

REITs must have:

- a REIT trustee, who is required to have a minimum paid up capital of KES100 million (approximately USD754,720); and
- a REIT manager, who is required to have a minimum paid up capital of KES10 million (approximately USD75,470).

5.5 Applicable Governance Requirements

Private LLCs

A private LLC is required to:

- convene one annual general meeting;
- file annual returns at the companies registry;
- procure an annual audit of its accounts;
- remit and file tax returns annually with the Kenya Revenue Authority, and pay and file tax returns monthly for taxes due on a monthly basis; and
- maintain registers of its members, directors and charges at its registered place of business.

Public LLCs (Listed and Non-listed)

Listed public LLCs are those listed on the Nairobi Stock Exchange. In addition to the governance requirements listed above in respect of private LLCs, public LLCs are required to obtain a trading certificate for their operations. Furthermore, listed public LLCs must comply with the Capital Markets Act and relevant regulations applicable to listed companies.

LLPs

LLPs are required to:

- file an annual declaration of solvency;
- maintain a register of partners, nominee partners and a register of beneficial owners; and
- maintain accounting records pertaining to the LLP's business, such as invoices.

Unless required under their partnership agreements, LLPs are not obliged to convene any meetings, nor to procure an audit on their accounts except during the winding-up and dissolution of the partnership. LLPs are also not required to file tax returns.

REITs

A REIT is required to:

- maintain a register of REIT security holders;
- convene an annual meeting of REIT security holders between 14 and 28 days after the circulation of the annual report;
- procure an annual audit of its accounts;
- remit and file tax returns in respect of withholding tax deductions on the payments to investors; and
- submit a copy of the first half financial year reports and accounts, the REIT's annual report and audited accounts to the CMA.

The REIT trustee and the REIT manager are responsible for maintaining proper records in respect of the fund, the scheme and the REIT.

5.6 Annual Entity Maintenance and Accounting Compliance

Nominal fees for annual entity maintenance are payable at the companies registry and the LLP registry for LLCs and LLPs, and at the land registry for trusts licensed as REITs. For REITs, additional compliance costs are incurred towards the renewal of the licences of the REIT trustee and REIT manager, and approval fees for any public offerings. The fees are paid to the CMA.

For accounting compliance, the costs will depend on the terms of engagement negotiated with the retained accounting firm.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Leases

Leases for a term of less than 21 years grant the tenant the right to the exclusive use and quiet enjoyment of the leased premises for the lease term. The same is true for leases that have longer terms but do not confer ownership.

Licences

A licence is a permit granted to the licensee to do some act in relation to the real estate (on a non-exclusive basis) that would otherwise constitute trespass.

Easements

An easement is a non-possessory interest in another's land that allows the holder to use the land (or a portion of it) to a particular extent or requires the owner to undertake or refrain from undertaking an act relating to the land.

Public Rights of Way

This could be a wayleave or a communal right of way.

The NLC may authorise a wayleave for the benefit of the national or county government, a public authority or any corporate body to enable them to carry out their functions in relation to the land.

The NLC may also authorise a communal right of way for the benefit of the public upon application by a county government, an association or any group of persons.

6.2 Types of Commercial Leases

The LA provides for the following types of leases.

Short-Term Leases

The LA defines a short-term lease as a lease for a term of two years or less without an option for renewal. A short-term lease is also a periodic lease.

Periodic Leases

The following are periodic leases:

- leases of an unspecified term with no provision for the giving of notice to terminate the tenancy;
- leases whose term is from week to week, month to month or year to year, or is any other periodic basis to which the rent is payable;
- where a tenant remains in possession of land with the consent of the landlord after the term of the lease has expired, unless the parties agree otherwise; or
- where an owner allows exclusive occupation of their land or part thereof for rent but without there being any agreement in writing.

Long-Term Leases

A lease is long term if it is for a period over two years.

Leases of a period of 21 years and above may confer an ownership interest to the lessee.

Future Leases

Future leases are leases for a term that is to begin on a future date not being later than 21 years after the date on which the lease is executed. A future lease for a period above five years must be registered.

6.3 Regulation of Rents or Lease Terms

The terms of a lease, including the rent amount, are negotiated by the parties. However, Sections

65 and 66 of the LA impose some covenants on landlords and tenants, including:

- the tenant's right to peaceful and quiet possession and enjoyment of the leased premises;
- the tenant's obligation to pay rent;
- the landlord's obligation to pay statutory charges; and
- the landlord's responsibility to ensure the leased dwelling premises are fit for human habitation.

The LTA further regulates the revision of rent of the following controlled tenancies:

- commercial leases that are not in writing;
- written commercial leases of a period below five years or which contain termination provisions other than for breach of covenant within five years of commencement of the lease; or
- leases over business premises gazetted as controlled tenancies.

6.4 Typical Terms of a Lease

The terms of a lease are contractual, except for the implied covenants under Sections 65 and 66 of the LA (see **6.3 Regulation of Rents or Lease Terms**).

Length of Lease Term

The law does not prescribe the term of a lease, which is contractually agreed by the parties.

For commercial leases, the term is typically above five years to avoid creating a controlled tenancy under the LTA.

Furthermore, where the term of the lease is not specified and no provision is made for the giving of notice to terminate a tenancy, the lease is deemed to be a periodic lease pursuant to Section 57 (1) (a) of the LA. In this case, the term of the periodic lease will be the period by reference to which rent is paid.

Finally, where the lease is terminated or the term lapses and the landlord accepts rent and allows the tenant to occupy the premises for at least two subsequent months, a periodic lease from month to month is deemed to have come into force, pursuant to Section 60 (2) of the LA.

Maintenance and Repair Provisions

Sections 65 (1) (c) and (d) of the LA impose an obligation on landlords to keep the exterior parts of leased premises in a proper state of repair, and to ensure dwelling houses are fit for human habitation.

Sections 66 (1) (c) and (e) of the LA impose an obligation on tenants to keep the interior parts of leased premises and boundary marks of land in a reasonable state of repair. Tenants are also required to yield up the leased premises in the same condition they were in when the term of the lease began (subject to fair wear and tear).

The parties can agree to further terms.

Frequency of Rent Payments

The law does not regulate the frequency of rent payments, which is contractually agreed by the parties.

COVID-19 Pandemic Provisions

See **6.21 Forced Eviction.**

6.5 Rent Variation

The law does not regulate rent variation, except in the case of commercial leases governed by the LTA, which sets out elaborate notice requirements and allows the tenant to challenge the

proposed variation before the Business Premises Rent Tribunal (BPRT).

If the lease is silent on rent variation, this can only be done by agreement between the parties.

6.6 Determination of New Rent

Rent is varied based on a pre-agreed escalation rate indicated in the lease. The frequency of escalation is also indicated in the lease.

6.7 Payment of VAT

VAT is payable on rental income from non-residential premises at the rate of 16%. Rental income obtained from residential premises is exempted from VAT payment under part II of the First Schedule of the Value Added Tax Act 2013 (VAT Act).

6.8 Costs Payable by a Tenant at the Start of a Lease

The tenant bears the following costs:

- the cost of fitting out the premises;
- the security deposit on the rent and the service charge;
- the initial service charge;
- the stamp duty payable on the lease, which is charged at 2% of the average annual rent;
- nominal fees for registration of the lease; and
- the tenant's legal fees and the landlord's legal fees (as may be agreed by the parties).

6.9 Payment of Maintenance and Repair

The maintenance and repair costs for common areas are paid by the landlord or the management company from the service charge paid by the tenants. These costs are apportioned amongst the tenants.

6.10 Payment of Utilities and Telecommunications

Each tenant bears the cost of installing individual utility meters (water, electricity, etc) for the leased premises, and pays utility costs directly to the utility providers.

For shared utilities, the landlord or management company will apportion the costs to the tenants, who will pay the landlord or management company in the form of service charges for onward payment to the utility providers.

6.11 Insurance Issues

The landlord insures the building while the tenant insures the contents in the leased premises, including the assets of the tenant within the premises. The lease indicates the insured risks, which may include fire, burglary and natural disasters. In recent times, insurers have offered cover for losses suffered due to the COVID-19 pandemic. There is no data on the uptake of these types of cover or recovery rates for pandemic-related losses.

6.12 Restrictions on the Use of Real Estate

The landlord may contractually restrict the use of the leased premises by a tenant if such restrictions are permitted by law.

Furthermore, the law imposes user restrictions on tenants, with the Physical Planning Act and county legislation regulating the use and development of land in Kenya. These restrictions may be indicated on the title document. The LA also implies covenants on the use of leased premises by tenants.

6.13 Tenant's Ability to Alter and Improve Real Estate

Section 67 (2) (e) of the LA restricts tenants from developing the leased premises beyond what is permitted in the lease. The landlord's consent would be required for restricted developments, and is granted on the following conditions:

- the tenant complies with the applicable laws, including obtaining all development approvals;
- the tenant engages the relevant qualified professionals, such as architects; and
- the tenant restores the leased premises to its original state (subject to reasonable wear and tear) at the expiry of the lease (unless otherwise agreed).

6.14 Specific Regulations

The LA applies to all leases, whether residential, industrial or commercial. The following categories of leases are governed by specific laws.

Controlled Tenancies Under the LTA

The LTA regulates controlled tenancies (see **6.3 Regulation of Rents or Lease Terms**) over business premises to protect tenants from exploitation, including arbitrary rent revisions and illegal evictions.

Leases of Dwelling Houses Under the Rent Restriction Act (Rent Act)

The Rent Act regulates tenancies relating to dwelling houses of a standard rent of below KES2,500, to protect tenants from exploitation by landlords.

Leases Over Agricultural Land

The LCA regulates dealings in agricultural land, with the aim of advancing agricultural activities and restricting ownership by foreigners.

There has been no legislation regulating leases during the COVID-19 pandemic period.

6.15 Effect of the Tenant's Insolvency

Under Section 73 (1) of the LA, the landlord has the right to terminate the lease if the tenant is declared bankrupt or goes into liquidation.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A landlord can ensure performance of the tenant's obligations through holding a security deposit throughout the term of the lease, which will be forfeited in the event of default. Some landlords may also accept bank guarantees or parent company guarantees as security.

6.17 Right to Occupy After Termination or Expiry of a Lease

The tenant has no right to occupy the leased premises upon the expiry of the commercial lease. The landlord should call for the yielding up of the premises by the tenant, and should issue eviction notices if necessary. Thereafter, the landlord may evict the tenant; see **6.21 Forced Eviction**.

6.18 Right to Assign a Leasehold Interest

The lease would typically prohibit the assignment of the lease or permit assignment subject to the landlord's consent. If permitted, a tenant may assign its rights over all or part of the leased premises on the following conditions:

- the parties execute and stamp the deed of assignment;
- the assignee is restricted from further assigning their rights under the lease; and
- the tenant settles all obligations due to the landlord as at the date of assignment.

6.19 Right to Terminate a Lease

Section 73 of the LA allows the landlord to terminate a lease if the tenant:

- commits a breach of its express or implied obligations under the lease; or
- declared bankrupt or goes into liquidation.

The lease may also allow for early termination by the parties giving reasonable notice. Termination may also be permitted in the event of the occurrence of a force majeure event.

Controlled tenancies (see **6.3 Regulation of Rents or Lease Terms**) may only be terminated in accordance with the LTA, which requires the other party's consent to be obtained. The aggrieved party can challenge termination at the BPRT. In this case, termination of the lease will be subject to BPRT's orders.

The termination of commercial leases can also be challenging, since these leases do not contain termination provisions so as to avoid creating controlled tenancies under the LTA. In these instances, termination is by agreement between the parties or by the issuance of reasonable notice, which depends on the circumstances of the case.

6.20 Registration Requirements

Short-term leases for two years or less without the option of renewal are not registrable.

Long-term leases for more than two years are required to be registered under the LRA.

Leases are required to comply with the formalities of a valid contract. The lease will also be subject to stamp duty, charged at the rate of 2% of the average annual rent. The stamped lease is lodged at the relevant land registry for registration. An entry of the registered lease will be made on the title document and on the deed file of the property maintained by the land registry. The tenant meets the registration costs and the legal fees of their advocates and the landlord's advocates.

Long-term leases of a period of 21 years and above and which confer ownership are deemed to be transfers of title. Accordingly, stamp duty is payable at 2% of the value of the leased premises if located in a rural area, or at 4% of the value of the leased premises if located in an urban area. Upon registration, a title is issued to the lessee, who bears the registration costs and the legal fees of their advocates and the landlord's advocates.

6.21 Forced Eviction

Where a lease is lawfully terminated by a landlord as discussed in **6.19 Right to Terminate a Lease**, the tenant may be evicted by the issuance of an eviction notice of at least three months. Eviction must comply with the law, particularly Section 152G of the LA.

A tenant may apply to the ELC to challenge the eviction notice.

For controlled tenancies, the tenant may challenge the eviction notice at the BPRT. In this case, eviction will be subject to the BPRT's orders.

For commercial leases, the tenant may challenge the eviction notice in courts of law. In this case, eviction will be subject to the court's orders.

For leases in respect of dwelling houses of a standard rent below KES2,500, the tenant may challenge an eviction notice at the Rent Tribu-

nal. In this case, eviction will be subject to the Tribunal's orders.

6.22 Termination by a Third Party

A lease can be terminated by the government in cases of compulsory acquisition; see **2.9 Condemnation, Expropriation or Compulsory Purchase**.

6.23 Remedies/Damages for Breach

Restrictions on Damages

There are no statutory limitations on damages that a landlord may collect in the event of a tenant breach. However, under the common law rules governing the award of damages and case law, general damages are at the discretion of the trial court. For special damages, the landlord would have to prove actual losses that have been incurred in monetary terms as a direct result of the tenant's breach.

Remedies

The remedies available to a landlord are contractually negotiated. Typically, the lease will provide for a security deposit that will be forfeited in the event of a default by the tenant. See **6.16 Forms of Security**.

The following statutes prescribe other remedies available to landlords in the event of a tenant breach:

- Section 65 (2) (b) of the LA prescribes the landlord's right to terminate a lease due to non-payment of rent or breach by the tenant of any other obligations. This is an implied covenant that the parties can exclude from their lease arrangement.
- Section 74 of the LA prescribes the landlord's right of forfeiture if a tenant breaches the terms of a lease or is adjudicated bankrupt or goes into liquidation (as applicable). The provision is not mandatory, and the parties can exclude it in their lease. However, in any event where the landlord invokes the right of forfeiture, they must comply with the notice requirements under Section 75 of the LA. Further, Section 76 of the LA permits the tenant to apply to court for reliefs against the landlord's right of forfeiture.
- Section 3 of the Distress for Rent Act (DRA) provides for the landlord's right of distress when rent is in arrears. Distress for rent involves appointing a licensed auctioneer to seize the tenant's assets for purposes of sale to recover the rent owed. The DRA prescribes the notice requirements, goods that may be seized, time for levying distress and procedures to be followed. The tenant may challenge the distress proceedings if the proper procedures are not followed.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The price of construction projects is determined by the procurement method. For government-related contracts, competitive bidding is generally required, so it is preferable for the price of the project to be fixed or capped. The price would typically include the construction costs and professional fees for the project team.

For negotiated contracts, there is more flexibility on pricing. The cost may be estimated but free of any cap. The parties may also enter a cost-reimbursable agreement, which would cushion a contractor if the construction costs exceeded the estimates.

7.2 Assigning Responsibility for the Design and Construction of a Project

The design and construction of a project may be allocated as follows.

- The project proponent may undertake the planning aspect of the project in-house in consultation with relevant professionals, including architects and engineers. In the case of government projects, public participation will be required in the design process. Once the design is approved, the project proponent invites bids for construction in accordance with the approved plan. In this case, the contractor's scope of work is limited and, therefore, the cost of construction is reduced.
- The project proponent may invite bids for both the planning (design) and construction of the project. The competitive bidder is selected to undertake both functions. Once the final plan is approved, the contractor proceeds with construction in accordance with the approved plan.

7.3 Management of Construction Risk

Construction risk is largely managed as per the terms of the construction contract, which may provide for:

- proper risk allocation to the party best suited to manage the risk – usually the contractor;
- limitation of the contractor's liability to the price of the contract;
- indemnity and warranty provisions to cushion the project proponent from constructions risks;
- the requirement for the contractor to take up insurance against construction risks;
- force majeure provisions to cushion the parties from unforeseen circumstances that may delay or render the project impossible to implement; and
- performance guarantees and bonds, particularly in government projects.

7.4 Management of Schedule-Related Risk

The parties may agree to a milestone-based construction schedule. The contract may provide for liquidated damages to be paid by the contractor in the event of inexcusable delays in attaining the milestones. In cases of inordinate inexcusable delays, the contract may also provide for termination at the discretion of the aggrieved parties.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Project owners may call for additional security to guarantee a contractor's performance, including:

- guarantees from the contractor's parent company and third-party sureties;
- performance bonds from reputable insurers;
- payment guarantees from the contractor's bankers;
- letters of credit from reputable financiers; or
- holding the contract sums in an escrow account, with payments being released to the contractor upon the attainment of relevant milestones.

7.6 Liens or Encumbrances in the Event of Non-payment

Unless restricted in the construction contract, an unpaid contractor has a builder's lien over the constructed property so long as they maintain possession of the property. Financiers may require a contractor to sign a waiver of a builder's lien.

Notably, the Government Proceedings Act prohibits the exercising of liens over government property.

7.7 Requirements Before Use or Inhabitation

For a project to be inhabited, a certificate of practical completion must be issued by a qualified architect, and a certificate of occupation must be issued by the relevant county government.

8. Tax

8.1 VAT and Sales Tax

The sale of non-residential premises is subject to VAT under the VAT Act. This position was recently confirmed in the case of National Bank of Kenya Limited v Commissioner of Domestic Taxes (Income Tax Appeal Nos. E155 & 533 of 2020) where the High Court held that Kenya Revenue Authority (KRA) was justified in charging VAT on the sale of commercial property since commercial land and buildings are not expressly listed as exempt supplies in the VAT Act. This was a departure from the earlier finding in David Mwangi Ndegwa v KRA [2018] eKLR, where the High Court held that VAT is not payable on the sale or purchase of both residential and non-residential premises. The appeal against the finding in the latter case is still pending.

8.2 Mitigation of Tax Liability

Large real estate investors mitigate tax liability by:

- applying for the development to be declared a special economic zone (SEZ) under the SEZ Act, which has many tax benefits, including reduced corporate taxes and exemption from the payment of CGT on transfers of property within the SEZ, stamp duty and excise duty. Further, royalties, interest, management fees, professional fees, training fees, consultancy fees, agency or contractual fees paid by an SEZ developer, operator or enterprise to a non-resident person are exempt from tax for the first 10 years of the establishment of the SEZ developer, operator or enterprise;
- where possible, acquiring the shares of the landowner instead of purchasing land directly to reduce the stamp duty amount payable by them. However, the seller may be required to pay CGT in such instances (see **2.10 Taxes Applicable to a Transaction**);
- investing in special programmes like the AHS, which benefits from various tax incentives; or
- taking advantage of any existing statutory tax exemptions.

8.3 Municipal Taxes

The landlord or owner is obliged to pay land rates to the relevant county government if the business premises are within an urban area. Tenants may contribute towards land rates by way of the payment of service charges.

The Valuation for Rating Act exempts some properties in urban areas from the requirement to pay land rates, including churches, burial grounds and charitable institutions.

8.4 Income Tax Withholding for Foreign Investors

Withholding Tax (WHT)

Foreigners are subject to WHT, which is levied at different rates depending on the category of income earned. The rate also depends on whether the foreigner is a resident or a non-resident. WHT is 30% on rental income earned by a non-resident, 15% on dividend and interest income earned by a non-resident, and 20% on professional fees earned by a non-resident.

WHT is deducted by the payer at source and remitted to KRA.

Interest earned from loans obtained from foreign sources for purposes of investing in the energy or water sectors, or in roads, ports, railways or aerodromes is exempt from WHT pursuant to Legal Notice No. 91 of 2015.

CGT

Gains from the disposal of real estate are subject to CGT; see **2.10 Taxes Applicable to a Transaction**.

Rental Income Tax

Rental income tax is paid by residents earning annual rental income of between KES288,000 and KES15 million. The tax is charged monthly at the rate of 7.5% of gross rent received per month. No expenses or capital deductions are allowed to be deducted while computing the tax.

This tax is not applicable to non-residents. Rental income earned by a non-resident is subject to WHT at the rate of 30% of the gross rental income received.

8.5 Tax Benefits

There are no specific tax benefits from owning land. However, the following expenditures are allowable deductions when determining a person's taxable income:

- capital expenditure incurred on legal costs and stamp duty in connection with the acquisition of a lease for a period not exceeding 99 years of premises to be used for business purposes;
- capital expenditure by the owner or occupier of farmland for the prevention of soil erosion;
- sums expended during a year of income for structural alterations to the premises where the expenditure is necessary to maintain the existing rent (this does not include the extension or replacement of the premises) and
- capital expenditure incurred by the owner or tenant of agricultural land in clearing that land or in planting permanent or semi-permanent crops thereon.

REITs also enjoy the following tax exemptions:

- REITs and its investee companies which have been registered by the Commissioner of Domestic Taxes are exempted from income tax, pursuant to Section 20 (1) (c) and (d) of the Income Tax Act. This exemption does not extend to the unit holders and shareholders of REITs and investee companies; and
- the transfer of assets into REITs and related transactions are exempted from VAT, pursuant to paragraph 33 of Part II of the First Schedule to the VAT Act.

Trends and Developments

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Dentons Hamilton Harrison & Mathews

Dentons Hamilton Harrison & Mathews is one of Kenya's most highly acclaimed law firms, with a tradition of excellence dating back to 1902. Its legacy of being the oldest and one of the most prestigious law firms in Kenya means clients benefit from a depth of understanding that underpins solution-driven advice. The firm has built up a reputation as an innovative, experienced, responsive and highly-skilled firm with the capacity and technical expertise to offer practical legal solutions to both corporate and individual clients. Dentons Hamilton Harrison & Mathews has consistently been rated as top tier in real estate, dispute resolution, corporate and commercial law in Kenya by various international legal directories. Dentons Hamilton Harrison & Mathews provides a full range of legal services to an extensive client base, which includes local and foreign companies, individuals, state corporations and NGOs.

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Development in Kenya's Real Estate Sector

Kenya has a dynamic real estate sector that is evolving constantly to adapt to the needs of the market and has registered exponential growth over the years.

This article highlights some of the recent legal and policy developments and market trends in the sector.

Real estate due diligence obligations on a purchaser: Dina Management Limited v County Government of Mombasa

In the landmark judgment in Dina Management Limited v County Government of Mombasa & five others [SC Petition No8 (e010) of 2021] (the "Case"), the Supreme Court (the "Court") considered the level of due diligence that should be undertaken to support a claim that one is a bona fide purchaser of land. This judgment sets a precedent for thorough due diligence in property transactions.

A bona fide purchaser is one who buys land for value without notice of another's claim to the land.

Under Section 26 of the Land Registration Act, 2012, a certificate of title constitutes clear evidence that the person named as an owner of land is the land's absolute and indefeasible owner except where the land was obtained by fraudulent means, illegally, or through corruption.

Facts of the case

The Mombasa County Government challenged the validity of the title of property belonging to Dina Management Ltd. because the first owner had obtained the title in 1989 unprocedurally and it was public land.

The Court's decision

The Court ruled that the property was public land that could not give rise to a private proprietary interest.

The Court concluded that Dina Management Ltd. could not benefit from the defence that it was a bona fide purchaser as it should have "been more cautious in undertaking its due diligence".

For property investors, the judgment implies that a purchaser is now required to take steps

to investigate the history of land and "go to the root of the title", as opposed to simply concluding that the title held by a seller is evidence of the seller's legal ownership.

These steps include:

- requesting allotment letters and similar documents in cases where land might be public land;
- undertaking property searches and requesting an inspection of the files at the Lands Office;
- appointing a surveyor to undertake survey due diligence and searches at the Survey of Kenya; and
- checking whether the property is listed in the Ndungu Report on Illegal/Irregular Allocation of Public Land in Kenya.

Legislative and Policy Developments

The Affordable Housing Act, 2024

With the rapid increase in Kenya's population, the government has embarked on an ambitious affordable low-cost housing programme targeting an average of 250,000 units a year. The aim is to give millions of Kenyans access to affordable housing, create job opportunities and support the local construction industry.

The Affordable Housing Act, 2024 (AHA) was enacted as law on 19 March 2024 to provide a legal framework for the implementation of the affordable housing programme.

The enactment of the AHA comes after a ruling by the High Court declaring the affordable housing levy unconstitutional, as discussed below.

The Affordable Housing Levy

The AHA introduces a mandatory levy known as the Affordable Housing Levy (the "Levy") which shall be at the rate of 1.5% of:

- the gross salary of an employee (with an equivalent amount being contributed by their employer) [which the employer shall match an equivalent]; or
- the gross income of persons earning income other than salaried income.

The Levy must be remitted to the Kenya Revenue Authority (KRA) on or before the ninth working day after the end of the month, and failure to do so will result in the accrual of a penalty of 3% on the unpaid amount.

The Cabinet Secretary of the National Treasury is allowed under the AHA to exempt certain persons or income from deduction of the Levy on the recommendation of the Cabinet Secretary of Lands, Public Works, Housing and Urban Development. The Cabinet Secretary is yet to gazette this exemption.

Categories of affordable housing units

The AHA categorises affordable housing units as follows.

- Social housing units, targeting those whose monthly income is below KES20,000 (Approx USD153.85).
- Affordable housing units, targeting those whose monthly income is KES20,000 to KES149,000 (approximately USD153 to USD376).
- Affordable middle-class housing units, aimed at those whose monthly income exceeds KES149,000 (USD376).
- Rural affordable housing units, for people living in any area which is not an urban area.

Establishment of the Affordable Housing Fund and Affordable Housing Board

The AHA will establish the Affordable Housing Fund (the "Fund"), which will receive the Levy

for the development of affordable housing units. The Fund will, among other functions, provide low-interest loans or low-monthly-payment home loans for acquisition of the affordable housing units.

The Fund will be managed by the Affordable Housing Board (the "Board"). Under the AHA, the Board will present a five-year affordable housing investment programme every five years for approval by the Cabinet Secretary of the National Treasury and Parliament.

The following eligibility conditions apply for an affordable housing unit.

- Only natural persons are eligible for allocation of one housing unit. This means that companies, savings and credit co-operative organisations, and partnerships are not eligible.
- A person owning an affordable housing unit is not allowed to sell their unit except with the written consent of the Board.

Tax relief and deductions are allowable under the AHA as follows.

- Tax resident individuals who pay the Levy are entitled to affordable housing relief of 15% of their contributions subject to a cap of KES108,000 per annum.
- Amounts contributed to the Fund are allowable deductions by employers and businesses under Section 15 of the Income Tax Act, thereby reducing overall taxable income.

Private investors in the Affordable Housing Programme are also offered the opportunity to develop and construct affordable housing units along the following lines.

- They may supply goods and materials in connection with the construction of affordable housing units by way of an agreement between the investor and the Board.
- Prior to entering into an agreement, the Board will first be required to invite tenders from the public in at least two national newspapers.
- The Cabinet Secretary will prescribe guidelines on the tendering process.

Conclusion

The AHA marks a step towards achieving affordable housing in Kenya. It also presents a viable opportunity for private investors to invest in the affordable housing programme. Its effectiveness will nonetheless require streamlined co-ordination, financial prudence, and effective stakeholder engagement if the benefits are to be realised.

Currently, the AHA is facing legal hurdles as a case has been filed in the High Court of Kenya seeking to quash it in its entirety.

The Real Estate Regulation Bill, 2023

The Real Estate Regulation Bill, 2023 (the "Bill") is a bill of Parliament that seeks to provide a mechanism for regulating the registration of real estate agents, land companies and developers. Its objective is to protect real estate purchasers and curb the rampant fraud within the sector.

The Bill is yet to be passed into law and is currently at the second reading stage in Parliament.

The key provisions of the of the Bill cover the following.

- Creation of the real estate board (the "Board"), which will be responsible for licencing and regulation of real estate agents and developers.

- Creation of the real estate portal, an online real estate portal to facilitate registration of real estate agents and projects.
- Registering and licensing of real estate agents whose applications will be submitted to the Board in the prescribed forms.
- The requirement that no real estate agent will facilitate the selling or renting of any parcel of land, apartment or building in a real estate project which is not registered under the Bill.
- Prohibition of real estate agents from involvement in any unfair trade practices, such as making any false or misleading representations.
- Real estate project registration,whereреal estate developers will be required to register their projects before advertising, marketing, booking, selling, or inviting persons to purchase any plot, apartment or building in any real estate project. Further, where the Board revokes a licence granted to any developer, the Board may direct the developer's bank to freeze its bank account.
- Introduction of real estate developers' duties, including responsibility for structural defects in a development; obtaining completion and occupation certificates and lease certificates; providing and maintaining essential services until the takeover of units by purchasers and paying service charges until physical transfer of possession to the purchasers.
- Purchaser compensation if statements turn out to be false or incorrect – ie, providing purchaser protection mechanisms including compensation if a person makes a deposit based on the information contained in a notice, advertisement or prospectus, or based on any model apartment, plot or building and sustains loss or damage because of a false statement.
- Offences and penalties – Undertaking a real estate project without registration will attract a fine of not less than KES5 million or imprisonment for a term not exceeding three years, or both. The Board also has the power to suspend, fine or revoke the licence of any real estate agent or developer convicted of an offence under the Bill.

The Land Laws (Amendments) Bills, 2023

There are two versions of the Land Laws (Amendments) Bill, 2023 (the "Bills"):

- the Land Laws (Amendment) Bill 2023 (National Assembly Bills No. 65), and
- the Land Laws (Amendment) Bill 2023 (National Assembly Bills No. 76).

The Bills seek to amend the following statutes:

- the Land Act, 2012;
- the Land Registration Act, 2012;
- the National Land Commission Act, 2012;
- the Registration of Documents Act;
- the Land Control Act, Cap 302;
- the Community Land Act, 2016, and
- the Sectional Properties Act, 2020.

The Bills are in the second reading stage of the bill process. Some of the notable proposed legislative amendments in the Bills include the following.

- The timeline for the review of grants and dispositions of public land – the Bills seek to remove the timeline requirements for the review of grants and dispositions of public land to establish their propriety or legality. The initial timeline was five years from the commencement of the Land Act.
- A land rent review every ten years – the Bills introduce a periodical review of land rent and valuation of land for rent after every ten years

for leasehold properties. This will not apply to freehold properties.
- Land valuation for land rent payable – the Bills introduce a requirement that land be valued every ten years until the expiration of the term for purposes of determining the land rent payable for the subsequent period. The land rent payable will be charged at a percentage of the unimproved value of the land assessed.
- Full payment of land rent prior to registration of a charge – the Bills introduce a provision that the Registrar will not register a charge unless land rent is not owing, or the land is freehold.
- Decentralisation of registry of documents, providing for the decentralisation of land registries for the registration of documents across the country as opposed to when such services were only available in Nairobi and Mombasa.
- Land Control Board consents to foreigners, enabling consent to foreigners to carry out controlled transactions to be granted. As an example, controlled transactions are those involving agricultural land.

Main Market Trends and Developments in the Real Estate Sector

This section will cover new emerging trends in the real estate sector, the economic outlook and its impact on the real estate industry.

Finance trends and access to credit

Access to credit – and particularly the interest rates at which it can be accessed – by real estate developers and purchasers is a key factor in the growth of the real estate sector. The Monetary Policy Committee (MPC) of the Central Bank of Kenya (CBK) is responsible for setting the country's monetary policy, including its base lending rates.

In periods of accommodative monetary policies, including lower base lending rates, we expect an increase in real estate property sales, along with a rise in investments. Similarly, in times of monetary policy contraction, the desire to purchase real estate property decreases, leading to a corresponding decline in investment activity.

The base lending rates are considered the main avenue by which monetary policy affects economic activity. In February 2024, the MPC revised the base lending rate upwards from 12.5% to 13.00% to curb inflation and support the Kenyan shilling. This was the highest rate in over ten years.

Increased base lending rates lead to banks exercising risk-based loan pricing, where it offers borrowers higher interest rates. This locks out potential investors from accessing credit for financing real estate development or purchasing property.

However, with the increasing stability and strengthening of the Kenyan shilling, as well as weaker inflation, the CBK is expected to ease monetary policy in the last quarter of 2024, and this could result in a reduction in base lending rates.

The Nairobi County's high-rise development proposal

The Nairobi City County Government (the "County") has, with Sessional Paper No 1 of 2023 on Nairobi City County Development Control Policy, proposed to amend the zoning regulations to alter the maximum allowable building heights in different sections of the city. This includes raising the height limit from four floors to fifteen floors in residential zones such as Kilimani and Kileleshwa and potentially permitting structures

as tall as 75 floors in the Central Business District and its environs.

This proposal has sparked an uproar and resulted in objections from at least 26 professional and resident associations in Nairobi. While it attempts to address the city's increasing housing demand, thereby stimulating economic growth through a surge in construction activities, it may lead to the following risks and challenges by:

- putting a strain on existing infrastructure including transportation systems, water supply, sewage, and waste management, thereby aggravating service deficiencies;
- causing concerns about energy consumption, carbon emissions, urban heat island effects due to a proliferation of high-rise buildings and skyscrapers; and
- resulting in potential breaches of building codes, safety standards, and environmental regulations, exposing the public to health and safety hazards.

The County must mitigate the above challenges through the following:

- development of new infrastructure;
- adoption of sustainable design and green building practices; and
- strict enforcement of building codes and regulations.

Effective engagement is essential to address stakeholders' apprehensions and incorporate diverse perspectives into decision-making processes. The County must also demonstrate transparency, accountability, and responsiveness in soliciting feedback and addressing concerns raised by the stakeholders.

AI's potential to transform Kenya's real estate industry

In Kenya's dynamic real estate landscape, Artificial Intelligence (AI) presents endless opportunities and opens doors to unprecedented possibilities.

Property valuation

Traditional property valuation involves tedious and time-consuming site visits, data collection and manual data analysis which are often subject to error. AI algorithms can streamline this process by automating data collection and analysing various data points, such as property location, market trends and historical transactions, to provide more accurate property valuations.

Predictive analytics

AI-powered predictive analytics can forecast market trends, property demand and pricing fluctuations. This information is valuable for developers, investors and real estate agencies in planning their strategies and investments, which ultimately leads to improved business outcomes.

Marketing

AI can be utilised for property marketing through AI-powered features such as virtual reality (VR) and augmented reality (AR). VR and AR can be utilised for virtual property tours, which can cater for potential buyers across the globe. This will allow the potential buyers to virtually walk through the properties for sale or lease.

Customer service chatbots

Real estate companies in Kenya can deploy AI-powered chatbots on their websites and social media platforms to handle customer inquiries and assist with basic transactions. For example, the National Land Information System dubbed

"Ardhisasa" has a chatbot that utilises AI technology to provide users with personalised assistance and information regarding the system and real estate matters.

Smart buildings

AI can be utilised in the real estate sector to optimise building operations and energy efficiency. Smart building systems equipped with AI algorithms can monitor and control heating, ventilation, and air-conditioning systems, lighting, security, and occupancy levels in real time, resulting in cost savings and sustainability. For example, the iconic Britam Tower in Nairobi utilises AI technology to monitor the tower's energy and utility consumption.

Conclusion

Overall, the adoption of AI in the real estate sector in Kenya is still in its infancy, but is steadily growing as the Government of Kenya, the private sector, and other stakeholders in the real estate industry recognise the potential for increased efficiency, accuracy, and innovation in real estate transactions.

ESG

Kenya's real estate sector is starting to adopt ESG principles, thus demonstrating a commitment to sustainable development and ethical business practices. This trend mirrors a global shift towards sustainability, with ESG considerations becoming essential for ensuring long-term corporate success and promoting community welfare.

The adoption of ESG principles in the real estate sector is influenced by both legal obligations and industry-driven initiatives, reflecting a comprehensive approach towards sustainability in Kenya's business landscape.

Legal framework and ESG integration

The Companies Act under Section 655 (4) (b) mandates corporate directors to evaluate ESG issues that might influence a company's future performance. This underscores the importance of integrating ESG considerations into corporate governance and decision-making processes.

Furthermore, legislative proposals such as the Preservation of Human Dignity and Enforcement of Economic and Social Rights Bill, 2021 and the Carbon Credit Trading and Benefit Sharing Bill, 2023 aim to establish frameworks for enforcing economic and social rights and regulating carbon credit trading respectively.

In addition to legal mandates, private sector initiatives are pivotal in advancing ESG principles. The Nairobi Declaration on Sustainable Insurance and the Kenya Bankers Association's Sustainable Finance Initiative exemplify the insurance and banking industries' drive towards incorporating ESG considerations into business models.

Real estate industry and ESG trends

Despite the absence of mandatory ESG compliance requirements for the real estate industry under Kenyan law, some stakeholders have proactively engaged global and local ESG standards to integrate sustainability principles into their projects. The following are key trends within the sector.

- *Sustainable construction practices*. These include utilising eco-friendly materials such as green steel, green concrete and sustainable timber for construction projects, reflecting a commitment to minimising environmental impact.
- *Air quality improvement*. Design elements that enhance air quality are incorporated in con-

struction projects to promote healthier living and working environments.

- *Incorporation of health and wellness amenities*. Projects are designedwith amenities that support the wellbeing of occupants, aligning with the social pillar of ESG.
- *Accessibility to essential services*.This ensures easy access to hospitals, schools and shopping centres, thereby contributing to social infrastructure and community welfare.
- *Retrofitting instead of demolition*.Choosing the retrofitting of existing structures over demolition aligns with sustainability goals by reducing waste and conserving resources.
- *Adoption of ESG benchmarks and certifications*. Certifications such as the Leadership in Energy and Environmental Design (LEED) and the Excellence in Design for Greater Efficiencies (EDGE) green building rating system for real estate are sought for projects. For example, Africa Logistics Properties' ALP North development in Kenya has been certified as EDGE compliant being the first green sustainable warehousing in Africa.

Conclusion

The integration of ESG principles within Kenya's real estate sector exemplifies a holistic approach to sustainable development, balancing environmental stewardship, social responsibility and ethical governance. Through a combination of legal mandates and industry initiatives, Kenya is fostering a real estate sector that not only contributes to economic growth but also promotes the wellbeing of its communities and the environment. As these trends continue to evolve, the Kenyan real estate industry is set to play a pivotal role in the global movement towards sustainable development.

LITHUANIA



Law and Practice

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WALLESS has a solid real estate practice in the Baltics. The Vilnius office has a team of 16 dedicated professionals, who have diverse experience in real estate law. WALLESS is unique in that its real estate team is made up of professionals working as three elite forces (real estate development and construction, real estate transactions, and public procurement and PPP), covering a wide range of real estate legal services. The firm is especially proud of its deep knowledge in real estate investments, zoning and planning, and dispute resolution on construction in cultural heritage territories. The WALLESS real estate practice is consulted by four out of five major municipalities in Lithuania and by four out of five major developers in the market. The firm participates in the most complicated developments and is a member of the Real Estate Developers Association.

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1. General

1.1 Main Sources of Law

Lithuania is a civil law country with a strict hierarchy of laws, starting with the Constitution and laws, followed by by-laws and ordinances.

The Civil Code of the Republic of Lithuania is the main source of real estate law. It regulates separate sale and purchase, lease and construction contracting agreements, and also contains general regulations on ownership, restrictions, obligations and contracts.

The Law on Construction, the Law on Spatial Planning and the Law on Municipal Infrastructure Development are also significant when it comes to real estate development. There are also numerous construction-related technical regulations approved by the Ministry of Environment, and other by-laws approved by the government and other ministries, which set frequently changing imperative rules. Therefore, it is essential to seek advice from a local lawyer when targeting a newly constructed property or a property with development opportunities.

1.2 Main Market Trends and Deals

In 2023, the rising inflation and increases in interest rates as well as the war in Ukraine had an obvious impact on the Lithuanian economy and the real estate market. The largest real estate development projects continued but, due to the uncertainty caused by the global pandemic, some investors were quite hesitant to initiate new major residential and commercial development projects. The development of industrial and logistics objects continues, with new building developments underway, especially in hi-tech industries.

According to experts, the most sought-after new projects in 2023 were commercial properties. Market conditions demanded sustainable, modern buildings, so developers focused the majority of their resources on income-producing, long-term projects that would generate foot traffic. Partly because of this trend, some smaller residential projects were sold off or at least postponed. However, 2024 is expected to be an exceptional year due to the planned abundance of prestigious housing options already in the pipeline. On the other hand, if interest rates reach a critical tipping point, we may also see an increase in more affordable housing projects.

The retail segment took the lead but the biggest transaction was in the office sector: the purchase of the Technopolis Lietuva campus (more than 106,000 square metres of office space) in Vilnius by Lords LB. Also noteworthy is the sale of an office building owned by Northern Horizon Capital.

Real estate investors, developers and lenders in Lithuania have not yet adapted to the recent emergence of blockchain, decentralised finance, proptech and other disruptive technologies in the real estate industry, so none of these technologies is expected to have a significant impact on the real estate market in Lithuania over the next 12 months.

Alternative crowdfunding platforms are attracting more and more capital, which makes the real estate finance market more diverse and sustainable in Lithuania. Crowdfunding platforms began to gain momentum in the second half of 2021 in particular, and offer possibilities to invest in various real estate assets. This trend continued in 2023, as crowdfunding platforms allow entities with smaller capital funds to make real estate investments in bigger projects.

1.3 Proposals for Reform

In general, the real estate investment, ownership and development processes in Lithuania are quite clear and easy to implement, and the government is trying to enact more legislation to make the process more transparent, including the following.

- The Law on Special Land Conditions was introduced in 2020.
- A new Law on Municipal Infrastructure Development was enacted in 2021.
- Amendments to the Law on Land came into force in March 2022, which have changed the rules for developing on state-owned land – developers now pay huge fees (up to 75% of the value of the land plot) for development rights, which has prompted investors to buy-out the land plots from the state.
- Amendments to the Law on Land came into force in January 2023, which allow the municipalities to gain rights over state-owned land in cities and smaller towns. These additional changes to the regulations on leasing state-owned land were long awaited. The municipalities have been given more tools to plan and prioritise brownfield development in state-owned land plots leased by private parties.
- Amendments to the Law on Construction will come into force in November 2023. These changes are designed to streamline permitting procedures, significantly reducing their duration, and to afford greater flexibility to industry professionals, empowering them to select the most efficient design solutions for building projects.
- Further amendments in construction and spatial planning regulation are expected by the end of 2023 as the Codex on Construction is in the works. This codex is set to replace and simplify current construction and spatial planning regulation.

2. Sale and Purchase

2.1 Categories of Property Rights

The most common types of property rights are:

- ownership;
- lease (short- and long-term lease of state land);
- mortgage;
- servitude; and
- usus fructus.

2.2 Laws Applicable to Transfer of Title

The transfer of title is governed by the Lithuanian Civil Code. There are no special laws that would apply to the transfer of any specific types of real estate (eg, residential, industrial, offices, retail, hotels). However, some laws (eg, the Law on Forests, the Law on Agricultural Land) provide some restrictions regarding the transfer of ownership rights to specific types of land (agricultural or forest land). These restrictions relate to subjects that have a priority right to acquire land, to the amount of land that can be acquired, etc. Discussions are currently underway as to whether the limitations on the acquisition of agricultural land should be lifted.

2.3 Effecting Lawful and Proper Transfer of Title

All real estate transactions related to disposal or restraint of disposal should be confirmed by the public notary. The ownership of real estate passes over from the moment it is handed over to the buyer. The handover of real estate is to be documented by a separate handover deed unless the parties agree that the sale and purchase agreement itself constitutes a handover deed of real estate, in which case the ownership of the real estate passes over from the moment such an agreement is entered into.

The pandemic-related limitations in governmental office functionality and in-person availability for document signing or notarisation did result in new procedures for the documentation and completion of real estate transactions. Most documents, such as sale and purchase agreements, and powers of attorney, can now be approved via virtual meetings.

All real estate in Lithuania is registered in the Real Estate Register, which provides comprehensive information on a real estate owner (including the transfers of title), leases, mortgages, seizures and other encumbrances registered in respect of real estate, and also regarding ongoing lawsuits, decisions of authorities affecting the real estate (eg, decisions regarding expropriation procedures), etc. Thus, an investor can receive up-to-date data on any real estate at any time.

By virtue of law, data recorded in the public register is deemed accurate and true (prima facie evidence) unless rebutted. As a result, given that the registration system in Lithuania is comprehensive and reliable, title insurance is not common.

2.4 Real Estate Due Diligence

Buyers usually carry out real estate due diligence before entering into a transaction. Typically, the buyer carries out legal, commercial (if the real estate is acquired through an investment vehicle rather than directly), financial, technical and environmental due diligence. Any type of due diligence normally includes three parts.

- Preparation – this includes the identification of objects, goals and timelines, as well as entering into confidential and non-disclosure agreements.
- Investigation – this includes the collection of facts and documents from both the seller and the buyer. The information is mainly gathered according to the checklist provided by the buyer team. Typically, all the information requested by the buyer and its consultants is uploaded to virtual data rooms; in today's world, it is quite rare to have a physical data room. This stage also includes the analysis and evaluation of the information and material provided, and questions or interviews with the management and relevant personnel of the seller.

- Results – this typically includes the preparation and presentation of the due diligence report, which details the main risks involved and makes suggestions for transaction documentation.

Usually, red-flag due diligence is performed, outlining only the major issues pertaining to the real estate under the agreed materiality threshold.

2.5 Typical Representations and Warranties

The seller has a statutory obligation to disclose to the buyer all third parties' rights, mortgages, seizures, ongoing litigation and other encumbrances with respect to the real estate. In the case of a breach by the seller or if the seller is not able to prove that the buyer was aware of the respective encumbrances, the buyer is entitled to claim a reduction of the purchase price or termination of the sale and purchase agreement. Fines are the most common security for the enforcement of those remedies; representation and warranty insurance is not used in Lithuania.

No specific new representations and warranties were brought about by the COVID-19 pandemic. Risks related to the pandemic were usually managed through the structuring of the transaction.

There is no typical cap on the seller's liability for a breach of its representations and warranties. In some cases, such cap is agreed but it depends on the specifics of the transaction and/or the real estate.

Usually, only the representations and warranties related to the suitability of construction works expire after the end of the warranty terms stipulated in the legal acts – five, ten or 20 years. Other representations and warranties are subject to a general limitation period for filing a claim with the court (ten years, in most cases).

The buyer cannot rely on the encumbrances over real estate and invoke remedy measures against the seller if the seller has notified the buyer of those encumbrances or if the buyer could have learned of them from the public registers.

2.6 Important Areas of Law for Investors

Depending on the type of investment, it is important for an investor to consider planning and zoning, environmental law, competition law, etc. Merger clearance (required by the Law on Competition) is necessary when:

- the total gross income of the companies participating in the merger (concentration) in Lithuania during the last financial year before the merger is more than EUR20 million; and
- the total gross income of each of at least two companies participating in the merger during the last financial year before the merger is more than EUR2 million.

2.7 Soil Pollution or Environmental Contamination

In the case of pollution or contamination, Lithuania implements the "polluter pays" rule, under which the buyer of a real estate asset will be held responsible for soil pollution or environmental contamination if they cannot identify the person responsible for such damage.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Permitted uses of a parcel of real estate are asserted according to a master plan, or the detailed plan if one has been prepared. However, for certain developments, construction opportunities may be assured only after the construction permit is issued. Until the issue of such permits,

the rights to develop the land plot are in danger due to the vague requirements of the Law on Architecture.

The Law on Architecture also introduces regional councils of architects, which may decide on the aesthetics of future developments, and any developments that do not satisfy subjective criteria may be stopped. The Law on Spatial Planning provides for the possibility of concluding an agreement on the implementation of the solutions of the detailed plan; however, in practice, such agreements are rarely concluded, and they regulate only infrastructure development issues.

2.9 Condemnation, Expropriation or Compulsory Purchase

Land expropriation procedures can only be initiated if the land is required for public needs, and upon relevant compensation being provided to the owner. Land expropriation is initiated by the Lithuanian Land Service. The owners are duly informed about any such initiated procedure and can participate in the evaluation of the compensation.

The state has a priority right to purchase private agricultural or forest land for sale within certain areas.

Agricultural or forest land may also be compulsorily purchased by the state where it appears that it was acquired by a buyer who infringed the rules and restrictions for the acquisition of such land.

2.10 Taxes Applicable to a Transaction

A real estate acquisition transaction is subject to notarisation. The notary fee for the acquisition of real estate is equal to 0.37% of the transaction value and cannot exceed the established cap of EUR5,000. If more than one real estate unit is subject to the same sale and purchase agreement, the notary fee may not exceed EUR12,000.

The registration fee for ownership of the real estate with the Real Estate Register for legal persons is based on the value of the real estate, and may not exceed EUR17.19 per unit.

The notary costs are typically shared by the buyer and the seller in equal parts.

The transfer of at least 25% of shares in the property-owning company is also subject to notarisation, except in the following cases:

- when the personal securities accounts of the shareholders of the private limited company have been transferred for management to a legal person who is entitled to open and manage personal accounts for financial instruments; and
- when the price for shares is less than EUR14,500.

The notary fee for the acquisition of shares is equal to 0.26% of the transaction value, and cannot exceed the established cap of EUR5,000.

A mortgage/pledge of real estate and/or shares in the company is always subject to notarisation. However, notary fees for the mortgage of real estate as well as shares, based on the value of the object, may not be more than EUR360.

The taxes listed above are also applied in the case of a partial ownership transfer; there are no exemptions.

2.11 Legal Restrictions on Foreign Investors

A foreign investor wishing to acquire land must comply with the criteria of European and Trans-

atlantic Integration. A legal person is required to be established in – or a natural person is required to hold the citizenship or a permanent residency of – countries that are not part of political, military, economic or other unions or alliances of states established on the basis of the former Union of Soviet Socialist Republics and that are members of at least one of the following organisations and treaties:

- the European Union (EU);
- the North Atlantic Treaty Organisation (NATO);
- the Agreement on the European Economic Area (EEA); or
- the Organisation for Economic Co-operation and Development (OECD).

A list of land for which acquisition is restricted for foreign investors is defined by law (nature reserves, state parks, special economic zones, etc).

Foreign investors may use and hold (without owning) land on some other legal basis (eg, leasing) without restrictions.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The acquisition of commercial real estate in Lithuania is financed by both equity and debt, with the ratio between them depending on the market.

Equity is often provided downstream in the form of shareholder loans, which are expected to be subordinated to the debt financing. In the case of insufficient equity, additional funds are sought by way of mezzanine or senior debt.

3.2 Typical Security Created by Commercial Investors

A security package for the financing of the acquisition and/or development of real estate in Lithuania is tailored to each transaction, considering the specific circumstances and the risk profile of the borrower. Usually, at least the following security is sought by the lenders in Lithuania:

- a pledge over shares in the borrower;
- a pledge over the borrower's receivables (rental income) and funds in bank accounts;
- a mortgage over the borrower's real estate – land (or land leasehold rights) and/or building(s) (or premises); and
- upstream or cross-stream guarantees.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions under Lithuanian law on granting security over real estate to foreign lenders, nor on repayments being made to a foreign lender under any security document or loan agreement.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The creation and perfection of Lithuanian law-governed security over real estate involves a notary and registration fee, which is calculated as follows:

- up to EUR360 (the exact amount depends on the value of the real estate that is subject to the mortgage) multiplied by the number of different real estate assets that are subject to the mortgage; plus
- registry expenses (these are usually around EUR150 for each security instrument).

Enforcement of Lithuanian law-governed security over real estate also involves:

- a notary fee of up to EUR338, with the exact amount depending on the value of the mortgaged real estate; and
- a bailiff fee consisting of:
  (a) up to EUR220 as administration expenses (the exact amount depends on the amount subject to recovery);
  (b) a success fee calculated as a percentage of the amount subject to recovery (from 4% to 19%); plus
  (c) additional expenses.

All fees are net of VAT (21%, if applicable).

3.5 Legal Requirements Before an Entity Can Give Valid Security

The creation of security by a Lithuanian entity may raise two concerns:

- potential non-compliance with Lithuanian financial assistance restrictions; and
- potential non-compliance with corporate benefit requirements.

Article 45 (2) of the Law on Companies of the Republic of Lithuania indicates that a company may not directly or indirectly advance funds, make a loan nor grant security to individuals or corporate entities if doing so facilitates the acquisition of shares by the latter persons. This means that the Lithuanian entity is not permitted to secure debt obligations if the only purpose and utilisation of such funds is to finance the acquisition of the Lithuanian entity.

Furthermore, the principles of Lithuanian civil law and corporate law require that an entity entering into any transaction should have sufficient commercial benefit from that transaction.

Both of these issues may lead to the invalidity or unenforceability of obligations of the Lithuanian guarantor and/or mortgagor (pledgor).

3.6 Formalities When a Borrower Is in Default

If a borrower fails to fulfil secured obligations, enforcement of the mortgage over the real estate would be carried out through an out-of-court enforcement procedure. A creditor would have to apply to a notary public, requesting the issuing of an enforceable instrument. After the enforceable instrument has been issued by the notary public, the creditor would have to apply to a bailiff, requesting the initiation of a recovery procedure over the real estate mortgaged in favour of the creditor.

Under Lithuanian law, the priority of a mortgage over real estate is decided by considering the timing of the mortgage registration in the Register of Agreements and Constraints of the Republic of Lithuania – ie, registration will reflect the registered mortgage priority over any other not-yet-registered mortgages and any subsequently registered mortgages, as well as all unsecured claims. The duration of the enforcement and realisation on real property security can vary greatly. If there are no unfounded complaints, the enforcement takes about six months from the application to the bailiff. If the debtor has exhibited malice in making unfounded complaints, the litigation may last for several years. No specific rules regarding restrictions on a lender's ability to foreclose or realise on collateral in real estate lending have been implemented by governmental entities in response to the pandemic.

3.7 Subordinating Existing Debt to Newly Created Debt

A debt may become subordinated upon the consent of a previous creditor and the conclusion of

an agreement with said previous creditor. In such a case, the registered security that was created first would have to be re-registered to give it priority over a later-created and registered security.

3.8 Lenders' Liability Under Environmental Laws

Only an owner or possessor of real estate who performs an activity would be liable under the relevant environmental laws. A lender holding or enforcing security over real estate will not usually be liable under environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

Generally, the commencement of insolvency proceedings does not have an adverse effect on a security interest over property. On the contrary, under Lithuanian insolvency law, secured creditors have priority to recover their debts from the value of the insolvent borrower's property given as security. It should be noted, however, that any security granted by the borrower at the time they had financial difficulties may be subject to claw-back under Lithuanian insolvency law.

3.10 Taxes on Loans

Currently there are no existing, pending, or proposed rules, regulations, or requirements that lenders or borrowers pay any recording or similar taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Strategic planning is usually organised by the government and municipalities, and is implemented via spatial planning. The Law on Spatial Planning provides for spatial plans at the national, municipal and local levels.

The government and the Ministry of Environment organise and implement the master plan of the Republic of Lithuania.

The councils of municipalities approve the master plans of municipalities, which are organised and implemented by the administrations of municipalities.

The administrations of municipalities organise and control the implementation of the detailed plans, which are at the lowest level of the spatial planning hierarchy.

There are also special spatial plans, which are used to plan territories for exceptional use (protected areas, projects of state importance, etc). These plans are organised and implemented by various authorities. All real estate owners and developers should adhere to the regulations set by special plans, despite the solutions of the detailed plans.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Design and construction processes are governed by the Law on Construction and construction technical regulations.

The appearance of future buildings is reviewed by the municipality. The public and municipalities may also request a review of the project by regional architecture councils. The so-called "advice" of these councils is mandatory when participants (usually local communities) complain during a public hearing at the pre-design stage. In some cases, the design ideas of the

larger buildings have to be selected through a design contest.

The design documentation of a project is reviewed by municipalities and other competent institutions, depending on the type of the building and its location (Department of Cultural Heritage, National Public Health Centre, Directorate of a certain protected area, etc).

The method of construction and related solutions provided in the design are reviewed by the municipalities. Usually, municipalities rely on the mandatory expertise embodied in the design, which has to be carried out by the builder when evaluating the more technical matters of the construction, such as solutions of chosen structures and chosen construction methods.

The construction process is supervised by the State Territorial Planning and Construction Inspectorate under the Ministry of Environment, which may also check the design documentation upon the reasoned claim.

4.3 Regulatory Authorities

The main regulations on development are indicated in laws, which are approved by the Parliament. By-laws regulating the development and designated use of individual parcels of real estate are adopted by the Ministry of Environment and the Ministry of Agriculture. Municipalities and the National Land Service under the Ministry of Environment are the main bodies that make decisions on the division of parcels and the indication of designated purposes under the zoning documentation.

If the development is planned in certain protected areas (eg, cultural heritage areas), specific regulations adopted by the Ministry of Culture and other directorates are applicable.

The Law on Spatial Planning, the Law on Land, the Law on Construction, the Law on Architecture and various construction regulations mainly apply during the development.

4.4 Obtaining Entitlements to Develop a New Project

Projects on a larger scale should go through the environmental impact assessment procedure. Any third party has the opportunity to express its opinion during the procedures of publishing the environmental impact assessment and to affect the planned development by attracting the attention of public authorities to a possible infringement of the law.

Even if the environmental impact assessment procedure is not applicable, any third party has the right to participate and express its objection to a certain development in the pre-design stage during a pre-design public hearing.

A public hearing is mandatory for the prepared design proposals on any planned development that is bigger than 300 square metres. During the public hearing, any third party can suggest its solutions to the project, which can be accepted or rejected by the designer. If any such proposals are rejected, the chief architect of the municipality may confirm the pre-design solutions only if the consent of the regional architecture council is received.

When the design stage is over and the municipality issues the construction permit, any third party (that has a material interest) may present a claim to the court and dispute the issued permit.

As of 1 November 2021, in a transfer of development rights with the construction permit, the information regarding the new developer has to

be provided in order to change the relevant data of the construction permit.

4.5 Right of Appeal Against an Authority's Decision

The authority's decision respecting an application for permission for development or the carrying on of a designated use can be appealed to the administrative court or the administrative dispute commissions.

4.6 Agreements With Local or Governmental Authorities

The Law on Development of Municipal Infrastructure came into force on 1 January 2021 and provides for the possibility of entering into an agreement under which municipal infrastructure would be developed as part of an implemented project (this is a mandatory requirement in some cases).

Municipal infrastructure that is developed by a private developer should be transferred to the municipality. Compensation will be received in five years, but only if the development was performed in the territory intended for prioritised development. Compensation may be received from other joining developers, but only if they join that infrastructure in ten years in territories that were not set for prioritised development under master plans.

4.7 Enforcement of Restrictions on Development and Designated Use

The restrictions on development or designated use are usually enforced during zoning and planning procedures.

Nevertheless, general architectural requirements or cultural heritage requirements, and protected areas' protection requirements, may be introduced and applied during the pre-design, design or even construction stages.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The following main types of entities are available to investors to hold real estate assets:

- a private limited company;
- a public limited company;
- a personal enterprise (sole proprietorship);
- a general partnership;
- a limited partnership;
- a small partnership;
- a European company (Societas Europaea);
- a co-operative company; and
- an agricultural company.

The most common types of investment vehicle among both foreign and local investors are the private company (sometimes referred to as a private joint stock company) and the limited partnership.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The private and public limited liability company is a limited liability company where the shareholders' liability is limited to the amount of share capital that was contributed to those companies. Such companies are governed mainly by the Company Law of the Republic of Lithuania (and other legal acts that are applicable to publicly listed limited liability companies).

A limited partnership is a legal entity that is formed by at least two members. It has limited liability partners and general partners with no limited liability. An agreement is signed between

the partners on the management of a partnership. There is no minimum share capital requirement to conclude a partnership agreement.

5.3 REITs

Real estate investment trusts are becoming more popular in Lithuania. Trusts are usually operated in private form, but some are public – ie, used more as a crowdfunding platform. Under Lithuanian law, there are no general restrictions on the participation of foreign investors in real estate investment trusts, however they are subject to the same requirements as Lithuanian investors (it depends on whether an investor is considered professional or non-professional). Activities of REITs are monitored by the Bank of Lithuania. REITs are simply another type of investment vehicle for real estate development; there are no clear advantages to using them in Lithuania.

5.4 Minimum Capital Requirement

As of 1 May 2023, the minimum share capital required to set up a private limited company is EUR1,000. A small partnership can be established with a minimum share capital of EUR1, but this type of entity is not popular with developers.

5.5 Applicable Governance Requirements

A private limited company can have a four-tier governance structure, comprising the following elements:

- a general meeting of shareholders;
- a supervisory council;
- a board (of directors); and
- a CEO.

It is not obligatory to form a supervisory council and/or board in a private limited company. Supervisory councils are rarely established in private limited companies but boards are formed quite often, particularly in larger private companies.

Unlike existing practice abroad, in Lithuania a board does not have direct executive powers. Instead, it is responsible for the strategic management of the company, the election of the CEO and some other decisions related to the company (decisions to invest in other companies, etc). Also, only natural persons can be members of a board.

5.6 Annual Entity Maintenance and Accounting Compliance

Each entity is required to have a CEO. Accounting services can be outsourced. The annual entity maintenance costs comprise the salary of the CEO and the costs for accounting services, and vary for each company.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Under Lithuanian law, a person, company or other organisation is entitled to occupy and use real estate for a limited period of time under lease or gratuitous lease agreements.

6.2 Types of Commercial Leases

There are no different types of commercial leases in Lithuania.

6.3 Regulation of Rents or Lease Terms

In general, rents and lease agreements are freely negotiable, provided they do not infringe certain imperative norms established in the Civil Code. Certain market standards of commercial leases

are not obligatory, but are voluntarily applied by the largest players in the market.

There are no material ongoing regulations regarding rents or lease terms that resulted from the COVID-19 pandemic. The pandemic did not have a substantial effect on existing leases, and deals continued to be made between landlords and tenants regarding payments for leased premises during the pandemic. Due to trends in the lease market, the leasing of residential and/or office buildings is still booming.

6.4 Typical Terms of a Lease

The typical terms of a lease of business premises are outlined below.

- The maximum term of any lease may not exceed 100 years.
- The tenant is usually responsible for daily maintenance and current repairs of the leased property, and the landlord is responsible for capital repairs of the property.
- The rent payment is typically paid every month for the upcoming month in advance.
- Pandemic issues are usually solved through standard lease provisions of force majeure, inability to use the premises, etc. Usually, the tenant and the landlord agree on some rent discount or delay of payments.

So far, there have been no marked standard lease conditions aimed at pandemic issues, and the parties are free to negotiate any such specific condition. The market does not usually use specific clauses that would deal with construction build-out/supply chain issues due to the pandemic.

6.5 Rent Variation

The rent payable is usually reviewed and indexed (increased) every year according to the index chosen by the parties. The Lithuanian consumer price index (CPI) or the Lithuanian CPI harmonised under the methodology applied across other European Union member states (Harmonized Index of Consumer Prices, HICP) are used in most commercial leases.

6.6 Determination of New Rent

As mentioned in **6.5 Rent Variation**, the rent is typically increased each year as a result of indexation. No additional consent for any such increase is usually required from the tenant.

If either party wishes to change or increase the rent, it must follow specific procedures and rules established in the lease agreement. In the event of the absence of any such procedure and consent from the other party, the rent may only be changed or increased through court proceedings.

6.7 Payment of VAT

VAT is payable on rent. It is not applicable in certain cases related to general tax regulations (eg, a foreign tenant who is not registered as a VAT payer).

6.8 Costs Payable by a Tenant at the Start of a Lease

In addition to the payment of rent, the tenant typically covers the costs for communal services rendered in the premises as well as operational fees intended to cover maintenance, repairs, management, insurance of the building, real estate, land tax and related costs. Operation fees are typically calculated in proportion to the size of the area occupied by the tenant.

6.9 Payment of Maintenance and Repair

The costs for the maintenance and repair of areas used by several tenants – eg, parking lots and gardens – are usually shared by all the ten-

ants as part of the operational fees described in **6.8 Costs Payable by a Tenant at the Start of a Lease**.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications that serve a property occupied by several tenants are usually divided in proportion to the area leased by each of the tenants.

6.11 Insurance Issues

The costs of insuring the building are usually paid proportionally by the tenants as part of the operational fees.

The tenants of a commercial property are usually required to obtain the following insurance:

- tenant's civil liability insurance against third-party claims arising from physical injury, property loss or damage; and
- property insurance covering losses of and damage to all the tenant's assets in the premises as a result of fire, water, theft, breaking of glass, natural calamities, unlawful activity of third parties and other usual risks, etc.

The tenant and the landlord usually agree on some rent discount or delay of payments as there is very little incentive for tenants to insure leases as part of business interruption insurance. Tenants with business interruption insurance policies that cover rent payments did seek compensation during the pandemic.

6.12 Restrictions on the Use of Real Estate

Real estate can only be used in accordance with the purpose registered for it in the public register and the main purpose of use included in the lease agreement. If the tenant uses real estate in a way that is not in accordance with the purpose or main purpose of use as agreed in the lease agreement, the landlord has the right to terminate the lease agreement.

6.13 Tenant's Ability to Alter and Improve Real Estate

As a rule, the tenant is permitted to alter or improve the real estate only if they have prior consent from the landlord. Usually, the lease agreement includes certain conditions under which such works must be performed (specific hours for performance of works, quality of materials used, etc).

6.14 Specific Regulations

No response has been provided in this jurisdiction.

6.15 Effect of the Tenant's Insolvency

The lease agreement usually gives the landlord the possibility of terminating the lease agreement upon the tenant's insolvency. The landlord is also included in the list of creditors for any unpaid amounts before the termination of the lease agreement and other debts of the tenant.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The landlord's interests against a failure by the tenant to meet its obligations are usually protected by a deposit, bank or parent guarantee provided by the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

According to the Civil Code, if the tenant continues to occupy the premises after the expiry of a lease, the lease agreement becomes a lease for an indefinite period, and each party may terminate that agreement by serving the other party

with a three-month written notice. Commercial lease agreements usually include the opposite rule, stating that the lease does not become a lease with an indefinite term.

Commercial lease agreements usually include a specific procedure for the vacating of the premises after the expiry or termination of a commercial lease. If the tenant fails to vacate the premises under the agreed terms, the landlord is usually entitled to terminate the supply of utility services, enter the premises and remove the tenant's belongings at the cost of the tenant.

6.18 Right to Assign a Leasehold Interest

As a rule, the tenant is permitted to assign its leasehold interest in the lease or to sublease all or a portion of the leased premises only with prior consent from the landlord.

6.19 Right to Terminate a Lease

The lease may be terminated through the following methods:

- by mutual agreement of the parties;
- by either party's demand, if the other party commits a material breach and fails to rectify that breach in due course (the parties may agree on what is to be considered a material breach under the agreement; otherwise, the material breach is to be determined based on statutory provisions); or
- on other grounds set out in the agreement (the parties are free to establish any grounds for unilateral termination of the agreement, either through the judicial procedure or without applying to court).

The landlord is entitled to terminate the lease agreement unilaterally if the following occurs:

- the tenant uses the leased objects not in accordance with the agreement/permitted use;
- the tenant worsens the condition of the leased objects wilfully or through negligence;
- the tenant fails to pay rent and/or other payments under the agreement in time;
- the tenant unreasonably refuses to sign the handover deed or does not sign it in due time;
- the tenant fails to perform repair works on the premises; or
- the tenant commits another material breach.

The tenant is entitled to terminate the lease agreement unilaterally if the following occurs:

- the premises cannot be used by the tenant due to circumstances not attributable to the tenant;
- capital repair works are not performed by the landlord when the landlord is obliged to perform them;
- the landlord unreasonably refuses to sign the handover deed;
- the premises have material defects that prevent the tenant from using them for their permitted use; or
- the landlord commits another material breach.

Under the Civil Code, the tenant may terminate the lease if the landlord transfers title to the leased object. Usually, commercial leases include a waiver of the tenant's right. In addition, in the case of an investment transaction (asset deal), the buyers request the sellers to obtain specific confirmations from the tenants (usually anchor tenants) that the tenants will not terminate the lease in the case of a change of landlord.

6.20 Registration Requirements

There is no obligation to register lease agreements in the public register. However, only registered lease agreements may be invoked against third parties (eg, the new owner of the real estate).

The costs for registering the lease agreement with the Real Estate Register are minor, amounting to EUR7.33. Higher fees may apply for expedited registration.

6.21 Forced Eviction

Generally, a landlord seeking the eviction of their tenant is required to apply to court. If the tenant fails or refuses to vacate the premises after the adoption of the final decision in favour of the landlord, the latter will need to apply to a bailiff for the enforcement of the court decision.

The length of an eviction proceeding depends on a number of circumstances, such as the availability of written evidence, the tenant's objections, etc. In the best-case scenario, the first-instance court's decision (which may be appealed) could be expected in approximately two to three months after application to the court.

Although there is no extensive case law surrounding the landlord's rights to exercise self-defence, commercial leases usually contain a right for the landlord to cut off the supply of electricity and other public utilities, lock the doors, make an inventory of, and remove, the tenant's property and invoke other similar measures against a tenant who refuses to vacate the leased premises.

6.22 Termination by a Third Party

Termination of a lease by a third party is not common, and can only occur in specific circumstances (defence of public interest, land expropriation, etc). Usually, this process is time-consuming, as it may involve legal proceedings to contest the termination in court.

6.23 Remedies/Damages for Breach

In the event of a tenant breach leading to lease termination, the damages are usually limited to direct expenses suffered by the landlord. These expenses are covered either by stipulating a fixed sum (either as an exact amount or as a percentage of the lease fee) of liquidated damages in the agreement or by requesting the tenant to cover the amount of damages through documented evidence. In some cases, the parties agree that the tenant is also responsible for any non-direct damages suffered by the landlord (such as the difference between the existing lease fee and the potential fee obtainable from third parties under market conditions). However, this practice is not widely adopted due to the prevailing conditions of the lease market, where tenants typically hold a stronger negotiating position.

Landlords typically hold security deposits posted by tenants. These security deposits are usually kept in cash.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Private developers use their own forms of contracts, and the various wording is settled differently in every project. When it comes to the public sector, Red and Yellow forms of FIDIC 1999/2017 are used most frequently. Developers with Scandinavian capital prefer to use a YSE form, which is also used in the market.

Construction projects are usually priced using a fixed-price model, especially when it comes

to general contracting. Other structures would be priced using the maximum guaranteed price and unit price. The market trend was to employ a construction management company that employs several contractors, or to employ one general contractor with a nomination of suppliers or contractors of certain works for a fixed price. The changes in construction regulation which will come into force as of November 2024 will secure the market model of working by a form of general contracting.

7.2 Assigning Responsibility for the Design and Construction of a Project

Control and full responsibility for the design process are usually assigned to the designer until the construction permit is received. The owner is only required to provide initial information and to approve the solutions.

After the construction permit is issued, the preparation of the work's design documentation is usually assigned to the contractors who perform the construction works.

During the construction, the contractors are responsible for the proper performance of the construction. However, the construction results are reviewed by the technical engineer and the designer, who ensure that the construction follows the solutions of the design documentation.

The market trend is to employ a design and construction management company that not only selects the designers and contractors, but also supervises them.

7.3 Management of Construction Risk

Market players use various methods to manage construction risks. Employers request contractors to secure all risk (CAR) insurance to cover their damages. A wide list of insurance and warranties over standard representations and warranties (REPs) is requested. Employers also request an advance payment guarantee and a contract implementation guarantee (5% to 10% of the contract price), and retain 5% to 10% of the contract price, which is released when a three-year guarantee is presented – this is usually a 5% warranty issued by the insurance company.

The parties' liability is usually limited to 10% of the contract prices. The limitation of liability cannot be applied when there is gross negligence, where the damage was caused intentionally or when there is loss of life or health, or non-material losses.

7.4 Management of Schedule-Related Risk

Schedule-related risks are among the most discussed in the market. Some employers insure this risk, but usually monetary compensation is awarded in cases when the contractor fails to achieve certain milestones on the critical path to the development of the project. However, the parties can agree on much stricter terms.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The construction market uses all basic forms of security that are known in other contractual relations. The employers usually request that the contractors provide an insurance company's performance warranty or, in some cases, even the first-demand guarantee issued by the bank. Escrow accounts are not so popular in the market. Mother-company surety is also widely used, on the contractor's side when the development budget is tight, and on the employer's side when a general contractor or supplier has doubts about the development of a special-purpose vehicle's future performance.

7.6 Liens or Encumbrances in the Event of Non-payment

Under the law, contractors and/or designers are not permitted to lien or otherwise encumber a property. Such actions can be taken only if doing so is provided for in the concluded agreement or through court proceedings during the litigation process.

7.7 Requirements Before Use or Inhabitation

A building can be used only once its construction is completed, and this is formally declared. A certificate on completion of construction must be received from a commission of construction completion for buildings indicated by the law. The construction of simple structures or simple works is officially finished by a declaration signed by the builder.

8. Tax

8.1 VAT and Sales Tax

As a principle, only new buildings (up to 24 months after completion of construction) and land for construction are subject to VAT. However, if both transaction parties are registered as VAT payers, they are free to agree to apply VAT on any real estate transaction.

If VAT applies, it is added on top of the transaction price and paid to the state by the seller. When both parties are registered VAT payers, they have the option to manage cash flow by transferring VAT arrears.

Real estate transactions are subject to a standard VAT rate of 21%; no reduced rates apply.

8.2 Mitigation of Tax Liability

In Lithuania, real estate transactions are commonly structured as either an asset deal or a share deal.

The most appropriate method is decided on a case-by-case basis, and usually depends on whether the buyer is interested in the real estate alone (asset deal), or in the business as a going concern related to the particular real estate (share deal). If a real estate transaction is structured as a share deal, it might be subject to income tax (on capital gains received), but not Lithuanian VAT.

Therefore, before entering into a large real estate portfolio transaction, parties are advised to carefully analyse the subject of the transaction and to consider all the available protections, including individual advance tax rulings on the tax treatment of the transaction.

8.3 Municipal Taxes

Business premises are subject to real estate tax in Lithuania. The annual rate of the tax is set every year by the local municipality and ranges between 0.5% and 3%.

A company must pay real estate tax on the premises if those premises are:

- owned by the company; or
- transferred by a natural person for the use of the enterprise for a period exceeding one month.

There are various tax exemptions applicable to real estate tax, including for the property of companies in free economic zones or the property of bankrupt companies. Also, the municipality has the right to reduce the tax rate for a particular taxpayer or to exempt them from taxation (after

receiving the application from the taxpayer, the municipality council adopts a decision on the reduction of the tax rate or exemption from taxation).

8.4 Income Tax Withholding for Foreign Investors

Foreign investors' income from the transfer and/or rent of a property located in Lithuania is taxable in Lithuania by applying the general taxation principles. The received taxable rent income is decreased by costs related to real estate maintenance. Taxable income (gains) from the transfer of the property is decreased by the acquisition price (minus depreciation, if applied).

In 2024, real estate-related income is subject to 15% income tax, and to 20% income tax on the taxable income exceeding EUR 228,324 (20% applies only to natural persons).

When the buyer or the lessee is a Lithuanian entity, it must withhold taxes and pay them to the state on behalf of the foreign investor. If the buyer/lessee is a natural person, the foreign investor must take care of the Lithuanian tax liabilities themselves.

8.5 Tax Benefits

Premises used in commercial activity are fixed assets of the entity.

Fixed assets (buildings) may be depreciated for up to eight years for new buildings and 15 years for other commercial buildings.

LUXEMBOURG



Law and Practice

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Stibbe

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Stibbe is an internationally oriented Benelux law firm with more than 420 lawyers. It handles complex legal challenges for clients both locally and cross-border, from its main offices in Amsterdam, Brussels and Luxembourg, together with its branch office in London. The ten-person real estate team handles a broad spectrum of issues, such as zoning and planning, building and construction, leases, corporate structuring, tax, real estate funds and financing, as well as the disputes/litigation in relation to such matters. Clients include leading property developers, financial institutions, institutional investors and private equity houses.

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1. General

1.1 Main Sources of Law

The Luxembourg Civil Code regulates the main aspects of real estate law in Luxembourg. It covers ownership, mortgages and leases.

The following legislation also applies:

- the Law of 10 August 1915 on commercial companies, as amended;
- the Law of 17 April 2018 on country planning, as amended;
- the Law of 10 June 1999 on classified establishments, operating permits, the commodo-incommodo procedures regulating the security, environmental and technical aspects of construction, as amended;
- the Regulation of 5 May 2012 on energy performance of residential and functional buildings;
- the Law of 19 July 2004 on communal planning and urban development, as amended;
- the Law of 22 October 2008 on the right of superficies and emphyteusis, as amended;
- the Law of 18 July 2018 on the protection of nature and natural resources, as amended;
- the Law of 15 December 2020 on the climate, as amended;
- the Law of 21 June 1976 on noise control, as amended;
- the Law of 7 August 2023 on individual housing subsidies;
- the Law of 7 August 2023 on affordable housing and amending the Law of 25 February 1979 on housing assistance;
- the amended Law of 19 July 2004 on municipal planning and urban development;
- the amended Law of 19 July 2004 on urban planning and urban development;
- the Law of 30 July 2021 on the Housing Pact 2.0; and
- the Law of 7 August 2023 on individual housing subsidies.

Regarding real estate investments, the main legislation comprises:

- the Law of 15 June 2004 on investment companies in risk capital (SICAR);
- the Law of 5 August 2005 on financial collateral arrangements (the Collateral Law);
- the Law of 13 February 2007 on specialised investment funds (SIF);
- the Law of 12 July 2013 on alternative investment fund managers (AIFM) implementing Directive 2011/61/EU on alternative investment fund managers (AIFMD);
- the Law of 17 December 2010 on undertakings for collective investment (UCI);
- the Law of 23 July 2016 on reserved alternative investment funds (RAIF); and
- the Law of 19 December 2020 on the temporary adaptation of certain procedural rules in civil and commercial matters.

1.2 Main Market Trends and Deals

Until 2023, Luxembourg's geographic and demographic characteristics, alongside its political stability and economic growth, fostered significant growth in the real estate market and attracted foreign workers. This situation has evolved in 2023/2024, reflecting broader economic challenges. With interest rates and inflation rising, combined with international geopolitical tensions and rising construction costs, the real estate market was facing a period of adjustment during 2023 and Q1 of 2024. Demand for residential property remained high, but purchasing capacity has been hampered, leading to a shift towards rental markets. Statistics show that most nationals own their primary residence, often outside Luxembourg City. Luxembourg's rental market is mostly focused on apartments

owned by private investors, with a greater concentration in the country's centre. Due to high rents and reduced offerings in some areas, newcomers and even nationals often decide to live abroad, in one of the neighbouring countries.

The construction sector, which has been in distress for several months, suffered a major blow in 2023. This impact is clearly reflected by several major bankruptcies of companies in the construction industry.

After an already challenging period in 2022, Q1 2023 witnessed a further decline in occupancy, which fell by 17% to almost 176,000 m², with the biggest transactions being KPMG leasing 31,000 m² in BPI's Kronos project in Kirchberg, the European Parliament taking occupancy of its new 30,000 m² Konrad Adenauer building, and Intertrust taking occupancy of 6,479 m² in the White House building at the Cloche d'Or, while also leasing 1,800 m² in the Emerald building next door.

The global economic downturn and the rising cost of building materials ultimately led to the suspension of numerous construction projects in 2023. The real estate industry is facing a complex and challenging situation; however, a recovery is still anticipated in 2024 with the expected fall in interest rates.

Notably, the law of 7 August 2023 on individual housing subsidies, which took effect on 1 September 2023, and the law of 7 August 2023 on affordable housing subsidies, which took effect on 1 October 2023, introduced public measures largely to promote access to housing and home ownership for citizens.

1.3 Proposals for Reform

A draft bill on heritage foundation was launched in 2013 to complete asset planning. This project is still pending, and has not been amended since 2014.

More recently, a bill on land management and urban development has been under discussion, aiming to implement practical and operational support.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights (for full ownership) are as follows:

- the right to use the asset (usus);
- the right to use the fruits – rents, etc (fructus); and
- the right to dispose of the asset (abusus).

Property rights may be acquired partially or totally through:

- full ownership;
- a lease (rental or commercial, livestock);
- usufruct;
- the rights of emphyteosis (*emphyteose*) or surface (*superficie*);
- co-ownership (*copropriété*); and
- joint ownership (*indivision*).

2.2 Laws Applicable to Transfer of Title

The transfer of real estate assets located in Luxembourg is governed by the laws of Luxembourg, as lex rei sitae.

The provisions of the Civil Code mainly govern the transfer of title. Other specific laws or regulations may apply, depending on the type of

assets, the type of activity or the quality of the parties.

2.3 Effecting Lawful and Proper Transfer of Title

The transfer of a real estate asset must be recorded in a notarial deed. It is then registered and recorded in the mortgage registry held by the Land Registration and VAT Authorities (*Administration de l'Enregistrement, des Domaines et de la TVA*), to ensure enforceability against third parties. The deed is also applicable to:

- all other remaining in rem rights pertaining to real estate assets;
- any mortgage inscriptions or easements (with the exception of legal easements); and
- commercial lease agreements with a duration of more than nine years.

2.4 Real Estate Due Diligence

Due diligence is usually carried out by making the relevant documentation linked to the real estate available in a virtual data room, which is accessible to the buyers. The findings resulting from the analysis of such documents are summarised in a due diligence report, which may take the form of a full detailed report or a "red flag" summary reporting only the points that might raise an issue for the buyer.

A due diligence report will usually address legal, financial, technical and sustainability/environmental topics.

All due diligence is now conducted (when possible) on a virtual basis.

2.5 Typical Representations and Warranties

Typical representations and warranties under Luxembourg law address the following points:

- disclosure;
- the capacity of the seller and the consequences of the sale;
- property ownership (encumbrances, expropriation, conditions of the property, etc);
- leases;
- insurance;
- permitting; and
- easements.

In cases of misrepresentation, the buyer may take legal action in order to have the sale declared void by a judge or, if that proves unattainable, to seek compensation for damages.

2.6 Important Areas of Law for Investors

Ownership rights are notably subject to Civil Code provisions, land use rules (town and country planning), the protection of archaeological and/or specially classified sites, mandatory expropriation for reasons of public interest (*expropriation pour cause d'utilité publique*) or pre-emption rights (droit de préemption) in favour of the state or municipalities. Ownership rights can also be restricted by easements for public use (*servitude d'utilité publique*). Certain plots of land owned by the state may only be available under temporary occupation rights, rather than full ownership title (see **3. Real Estate Finance**).

2.7 Soil Pollution or Environmental Contamination

The requirements regarding who is responsible for soil pollution or environmental contamination of a property are integrated into the authorisation to be obtained from the Ministry of Environment (operating permit).

The authorities may impose soil survey or clean-up requirements on the owner, user and/or operator of any land by virtue of other legal frameworks, such as the legislation on classified

installations, waste management or environmental liabilities.

In terms of responsibilities, the Law of 20 April 2009 on environmental responsibility with regard to the prevention and compensation of environmental damage, as amended, provides for the responsibility of the user/operator of the land. The user/operator supports the costs of prevention or curative measures ordered by the authorities. The Law also includes certain exceptions designed to prevent the user/operator from being held accountable, primarily in situations where a third party is at fault, which must be substantiated with evidence.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

At a national level, the amended Law of 19 July 2004 on municipal planning and urban development provides rules to control and regulate planning and zoning in Luxembourg, and sets out the division of the country into a general development plan (*plan d'aménagement général* – PAG), corresponding to the administrative division of the country into municipalities (communes).

The territories of the municipalities are governed by two main types of zoning plans: the general zoning plan (PAG) and special zoning plans (*plans d'aménagement particulier* – PAP).

The municipalities are in charge of issuing the PAG and the various PAPs.

The PAG divides the municipal territory into various zones, stating the following for each zone:

- how the land is to be used (eg, dwellings, economic activity, green zone); and
- the degree of land use (number of houses, green spaces, etc).

Specific zones of the PAG may be divided into PAPs that implement and specify the nature and extent of land use in each zone or part of a zone of the PAG.

Urban planning law also requires a building permit for a wide range of works, including construction or reconstruction, the modification or extension of existing buildings, and changing the use of an existing building.

Building permits are issued by the mayor of the municipality concerned. A building permit may only be issued if the intended building complies with the applicable PAG and PAPs.

An allotment permit is required in order to divide a plot of land.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation takes place by authority of justice, through a declaration in a grand ducal decree. It may relate to all or part of a building or real property rights. It must be guided by reasons of public utility and it is only possible with fair and prior compensation.

The state and the municipalities benefit from preemptive rights, subject to specific conditions.

2.10 Taxes Applicable to a Transaction

In the disposal of a real estate asset located in Luxembourg (ie, an asset deal), a transfer tax of 6% and a transcription tax of 1% are to be paid. If the asset is an office or commercial property located in Luxembourg City, a municipal surcharge of 50% on the transfer tax is levied (leading to an aggregate rate of 10%).

The transfer taxes are usually payable by the purchaser (unless otherwise agreed upon). The

taxable base corresponds to either the purchase price or the fair market value of the property, whichever is higher.

As a rule, if a Luxembourg real estate asset is contributed to a company against the issuance of shares, reduced transfer taxes apply, amounting to 3.4% (or 4.6% for an office or commercial property located in Luxembourg City).

No Luxembourg transfer taxes should apply to the disposal of shares in an opaque company holding a Luxembourg property.

2.11 Legal Restrictions on Foreign Investors

There are no specific legal restrictions on foreign investors.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate in Luxembourg are commonly financed through a combination of equity, quasi-equity and senior debt in the form of a loan, which may be completed with junior (subordinated) debt depending on the risk profile of the transaction, the size of the portfolio and the required loan-to-value ratio.

The debt portion of the financing may take the following forms:

- a mortgage debt for the financing of the acquisition of real estate assets;
- an acquisition debt for the financing of the acquisition of the shares of the entities holding real estate assets; or
- a combination of both for the financing of the acquisition of the shares of entities holding real estate assets and the refinancing of the existing indebtedness of such entities.

3.2 Typical Security Created by Commercial Investors

The financing of acquisitions and development projects is generally secured by securities created over the assets and the shares of the borrower; lenders usually accept non-recourse financing for the acquisition of commercial real estate assets, whereas investor and/or bank guarantees will usually be required in addition to the standard security package for development projects.

Typically, the lenders will require securities that allow them to recover the financed asset directly or indirectly. Such security may take the form of a contractual mortgage (*hypothèque*) over the real estate asset and/or a pledge over the shares of the entity holding such asset.

The security package will also include a security interest over cash flow related to the real estate asset or resulting from the financing transaction, usually in the form of an assignment of rights (insurances, rent), a pledge over receivables (generally related to intragroup financing) and a bank account pledge (over the relevant accounts such as rent account).

Depending on the type of transaction, the creditors may also require security over the borrower's other movable assets.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Generally, there are no restrictions on granting security to foreign lenders, nor on payments made to foreign lenders under a security document or loan agreement. To remain enforceable

against third parties, the mortgage on real estate property must be renewed every ten years.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Real estate assets are often secured by first-ranking mortgages, the registration of which triggers a 0.24% registration duty and a 0.05% inscription fee, with both rates being applied to the total secured debt (usually borne by the purchaser).

The notary fees to record the mortgage inscription in the mortgage registry are calculated on a sliding scale and are also generally borne by the purchaser.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The issuance of a guarantee or the granting of security over its assets by a Luxembourg company must comply with the following rules.

- Financial assistance in Luxembourg refers to the prohibition on public limited liability companies or partnerships limited by shares advancing funds, making loans or granting security, directly or indirectly, for the purpose of a third-party acquisition of its shares. It is arguable whether the financial assistance prohibition also applies to private limited liability companies, but the prohibition can be mitigated by the application of the so-called "white-wash procedure", which allows the management and shareholders of the applicable company to overrule the financial assistance prohibition.
- Upstream and cross-stream guarantees:
  (a) the possibility of the issuance of a guarantee to third parties or companies within the same group shall be set out in the articles of association of the Luxembourg company; and
  (b) the managers/directors of the company must ensure that the issuance of the guarantee is in the company's corporate benefit (*intérêt social*).
- The corporate benefit test is the responsibility of the managers/directors. The company giving the guarantee shall receive some consideration in return (either economical or commercial benefit), but the benefit shall be proportionate to the burden of the guarantee/security granted.
- More generally, all guarantees issued and security granted by a Luxembourg company shall be discussed and approved at a dedicated meeting of the board of managers/directors.

3.6 Formalities When a Borrower Is in Default

The events of default are generally provided under the main credit agreement and, as such, Luxembourg security agreements usually refer to them by cross-reference.

If the main credit agreement contains a specific acceleration procedure clause, it should also be applied to the enforcement of Luxembourg security agreements.

If that is not the case, the creditor informs the debtor of the occurrence of an event of default and the enforcement of its security (all or only some of them).

Usually, the enforcement is realised over the shares of the company owning the real estate. The creditor usually creates a specific purpose vehicle, which will appropriate the shares.

Unless there are creditors benefiting from privileged rights, no other creditors may take precedence over the rights of secured creditors.

3.7 Subordinating Existing Debt to Newly Created Debt

Contractual subordination is allowed under Luxembourg law. The existing creditor may agree to subordinate the existing secured debt contractually to newly created debt by entering into an inter-creditor agreement or subordination agreement. This will determine the rights of each class of creditors (senior, mezzanine, junior) with respect to, in particular, their rank and subordination, the payment arrangements and the enforcement of security interests.

In theory, contractual subordination survives an insolvency situation of a Luxembourg borrower.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over a real estate property or shares should not be liable for environmental damage, provided it did not cause the damage to the environment itself, nor otherwise controlled the activities of the operator of the real estate property at the origin of any environmental damage.

3.9 Effects of a Borrower Becoming Insolvent

A specific regime applies for insolvency proceedings. Debtors who qualify for bankruptcy must submit their filings to Luxembourg courts within one month. However, due to the pandemic, this deadline was temporarily suspended until 30 June 2022.

The assets subject to the financial collateral arrangement(s) shall not be considered part of the assets subject to insolvency proceedings (estate), enabling the beneficiary to enforce the relevant security regardless of the opening of insolvency proceedings and regardless of other estate creditors. Moreover, any actions taken during the "suspect period" cannot be contested by the court-appointed receiver.

Mortgages over real estate property remain in full force and effect even in the case of an insolvency proceeding.

3.10 Taxes on Loans

Under existing rules, the registration of a mortgage loan or mezzanine loans related to real estate triggers a registration tax of 0.29%, corresponding to a 0.24% registration duty and a 0.05% inscription fee, with both rates being applied to the total secured debt (usually borne by the purchaser).

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

See **2.8 Permitted Uses of Real Estate under Zoning or Planning Law**.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The construction of new buildings or the refurbishment of existing buildings is subject to the municipal building regulations (*Règlement sur les Bâtisses* – Rb), which provide detailed rules regarding the design, appearance and method of construction.

Each municipality in Luxembourg sets its own municipal building regulation.

4.3 Regulatory Authorities

The state and the municipalities are responsible for regulating the designated use of individual parcels of real estate.

The modified Law of 19 July 2004 applies, as does the given municipality PAG, PAP and/or Rb.

4.4 Obtaining Entitlements to Develop a New Project

Each project is subject to a building permit issued by the municipality (the mayor – *Bourgmestre*).

If the parcel(s) of land is (are) situated in a zone identified in the PAG as being subject to the adoption of a PAP, such PAP will have to be defined and adopted by the municipality council before the owner can be put in a position to apply for a building permit.

A building permit is then only granted if the project is compliant with:

- the applicable PAG;
- the PAP for a new or existing development, where applicable; and
- the building, public road and site regulations.

Third parties with a direct interest (eg, neighbours) have a right to participate and object to the issuance of the building permit. Once the building permit application is approved by the mayor, a certificate is issued, which must:

- be clearly and legibly displayed by the developer at the boundaries of the work site; and
- state that the public can view the file at the communal authority (for the period allowed for objections, which is three months from the date when the certificate is displayed on the work site).

4.5 Right of Appeal Against an Authority's Decision

Regarding the building permit issuance process, any person may appeal to the court to have the decision overturned. The appeal must be filed within three months of the certificate being displayed by the developer at the boundaries of the parcel of land.

Regarding the PAP adoption process, any person who lodged a complaint with the communal council during the publication period and is not satisfied by the response from the Minister for Home Affairs may appeal to the court to have the decision overturned.

4.6 Agreements With Local or Governmental Authorities

Developers and owners remain free to enter into a contract with the relevant authorities, primarily the municipality, to address potential issues in advance.

4.7 Enforcement of Restrictions on Development and Designated Use

The mayor of the municipality is empowered to stop the works and/or to lodge a criminal complaint and initiate criminal proceedings against the developer/owner.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Luxembourg law provides for a wide array of company forms that are capable of acquiring and holding real estate assets, with the most frequently used types being:

- the private limited liability company;
- the public limited liability company;

- the partnership limited by shares; and
- the common and special limited partnerships.

The civil company (*société civile*) is also very occasionally used to acquire and hold real estate assets, but cannot be used for repeated speculative real estate operations. Therefore, it appears to be of lesser interest to investors.

Luxembourg also offers a wide range of flexible and efficient investment fund regimes, which are of particular interest to real estate asset managers who are willing to raise capital from investors with a view to acquiring real estate assets:

- UCIs subject to part II of the Law of 17 December 2010 on undertakings for collective investment (UCIs Part II):
  - (a) are undertakings for collective investment open to retail investors subject to the ongoing supervision of the Luxembourg Supervisory Authority for the Financial Sector (*Commission de Surveillance du Secteur Financier* – CSSF);
  - (b) may invest in any type of real estate assets and pursue any real estate strategy, but are subject to strict diversification requirements; and
  - (c) may be established as standalone structures or with multiple compartments under a corporate form – an investment company with variable or fixed share capital (SICAV or SICAF) in any of the legal forms mentioned above or under a contractual form (common fund – *fonds commun de placement*).
- SIFs:
  - (a) qualify as undertakings for collective investment subject to the ongoing supervision of the CSSF, but are restricted to well-informed investors;
  - (b) may invest in any type of real estate asset and pursue any real estate strategy, and are subject to less stringent diversification requirements than apply to UCIs Part II; and
  - (c) may be established as standalone structures or with multiple compartments under a corporate or contractual form.
- SICARs:
  - (a) are investment companies restricted to well-informed investors, subject to the ongoing supervision of the CSSF;
  - (b) are not subject to any risk diversification requirements but may only invest in "risk capital" qualifying assets – ie, characterised by the concurrent gathering of two elements, namely a high risk and an intention to develop a project (value creation);
  - (c) may not hold real estate directly but may invest indirectly via entities that hold or invest in real estate assets representing risk capital characteristics (private equity real estate) and may contribute capital to real estate companies;
  - (d) would not be permitted to pursue Core/Core+ strategies, as the purpose of SICARs shall, in any case, be to bring about a development (ie, the creation of added value) at the level of the underlying real estate assets; and
  - (e) may only be established under a corporate form, with either a variable or fixed share capital.
- RAIFs:
  - (a) are not subject to the ongoing supervision of the CSSF but have to be either internally managed or managed by a duly authorised external alternative investment fund manager in accordance with the AIFMD so as to offer a certain level of protection to investors through the indirect supervision of the investment management of the RAIF;

(b) are more attractive and quicker to market than regulated funds, due to the absence of regulatory supervision and pre-approval requirements;
(c) are flexible investment vehicles that may mirror the features of either the SIF (well-informed investors only, any asset class and risk diversification requirement) or the SICAR (well-informed investors only, "risk capital" qualifying assets and no risk diversification); and
(d) may be established as standalone structures or with multiple compartments under a corporate or contractual form.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A public limited liability company, a private limited liability company and a partnership limited by shares may only be incorporated by way of a special notarial deed. Each of these company types will acquire its legal personality from the date of the relevant notarial deed. The incorporation deed of each such company form will be published in its entirety.

These entities are subject to corporate income tax and municipal business tax at a combined rate of 24.94% in Luxembourg City for 2024, and to net wealth tax on their unitary value (ie, adjusted net asset value, it being understood that the unitary value of real estate assets is determined based on the value of the property or of a similar property in 1941, which is then multiplied by a communal rate) on 1 January each year at a rate of 0.5% up to EUR500 million of unitary value, and 0.05% for any unitary value exceeding EUR500 million.

These entities are able to recognise tax-deductible depreciation based on the asset's expected useful life. Business expenses such as management fees are deductible under certain conditions. Arm's length borrowing costs can also be deducted annually, up to EUR3 million or 30% EBITDA (save for exceptions), whichever is higher. Furthermore, Luxembourg tax law allows (under certain conditions) a Luxembourg company to defer capital gains realised upon the disposal of a real estate asset if an amount corresponding to the sale proceeds realised is reinvested into another fixed asset.

A common limited partnership and a special limited partnership can be incorporated by way of either a notarial deed or a deed under a private seal. While the special limited partnership is deprived of legal personality, the common limited partnership will acquire its legal personality from the day of execution of the partnership agreement, thus allowing for maximum flexibility. The constitutive document of each such partnership will be published by way of extracts only. The relevant extract will include the following:

- the precise designation of the unlimited members;
- the name of the entity, its object and the place of its registered office;
- the designation of the managers as well as their signatory powers; and
- the date on which the company starts and the date on which it ends, thus ensuring an appreciable level of confidentiality.

The formation process is quite straightforward and can generally be completed within a few days.

As a rule, these entities should be considered tax transparent and should therefore not be subject to corporate income tax, municipal business tax or net wealth tax.

With respect to investment fund regimes, investment funds subject to the ongoing supervision of the CSSF (ie, UCIs Part II, SIFs and SICARs) have to be authorised by the CSSF before they are established, and will only be authorised if the CSSF has approved the constitutive document of the fund, the management and the choice of the depositary.

The regulatory approval process usually takes between two and six months, depending on the fund regime and the initiator and fund specifics.

These vehicles, except for the SICAR, are exempt from corporate income tax, municipal business tax and net wealth tax, but are subject to subscription tax. Typically, UCIs are subject to subscription tax at a rate of 0.05% of their net asset value and SIFs at a rate of 0.01% of their net asset value (subject to exemptions).

Additionally, these vehicles, except for the SICAR, are subject as of 1 January 2021 to a lump-sum 20% real estate levy on gross rental income and capital gains derived from real estate assets located in Luxembourg.

SICARs established as tax opaque entities are subject to corporate income tax and municipal business tax at a combined rate of 24.94% in Luxembourg City for 2024, but are exempt from income derived from transferable securities. Although not subject to net wealth tax, those vehicles remain subject to minimum net wealth tax. SICARs established as tax transparent entities are not subject to corporate income tax (except where reverse hybrid rules apply), municipal business tax, net wealth tax or subscription tax.

5.3 REITs

There is no specific REIT legislation in Luxembourg.

5.4 Minimum Capital Requirement

There is no minimum share capital requirement for the common limited partnership or the special limited partnership. Public limited liability companies must have a minimum share capital of EUR30,000, or its equivalent in any other currency; the same requirement applies to a partnership limited by shares. The share capital of a private limited liability company must be at least EUR12,000, or its equivalent in any other currency.

Luxembourg investment fund regimes impose different requirements in terms of minimum capitalisation:

- UCIs Part II – the net asset value of a UCI Part II may not be less than EUR1.25 million, and this minimum must be reached within twelve months following its authorisation; and
- SIFs/RAIFs/SICARs – the subscribed capital of a SIF/RAIF/SICAR increased by the share premium or the value of the amount constituting partnership interests, or the net asset value of a SIF/RAIF under contractual form, may not be less than a certain amount (EUR1.25 million for SIFs and RAIFs, or EUR1 million for SICARs), which must be reached within twenty-four months of the authorisation of the SIF or SICAR or establishment of the RAIF.

5.5 Applicable Governance Requirements

Public Limited Liability Company

Under Luxembourg law, public limited liability companies can have either a one-tier or a two-tier board structure.

In a one-tier board structure, the company will be managed by a board of directors comprising at least three members, unless the company has a sole shareholder, in which case the management may be entrusted to a sole director. Directors are appointed by the general meeting of the shareholders for a term that may not exceed six years. The board of directors represents the public limited liability company in dealings with third parties. However, the articles of association may authorise one or more directors to represent the company, either alone or jointly. The board of directors may create specific committees and is entitled to determine the composition, powers and duties thereof. Such committees will act under the responsibility of the board of directors. The articles may further authorise the board of directors to delegate its powers to a management committee or to a managing executive. Such delegation may neither comprise the general policy of the company nor cover all actions reserved to the board pursuant to applicable law.

In a two-tier board structure, the public limited liability company will be managed by a management board, whose powers and duties may be carried out by a sole person if the company has a sole shareholder or if the share capital is less than EUR100,000. Members of the management board will be appointed by the supervisory board, or by the general meeting for a term that may not exceed six years. Both physical and legal persons may be appointed as management board members, but a permanent representative will have to be appointed in the latter case. The company will be represented by its management board, but the articles may authorise one or more members of the management board to represent the company either alone or jointly. As in a one-tier board structure, the management board may create committees. The supervisory board will have an unlimited right to inspect all the transactions of the company.

The supervision of the company's affairs will be carried out by one or more supervisory auditor(s) (*commissaires*) appointed by the general meeting of the shareholders for a term that may not exceed six years, unless the accounts are audited by an approved statutory auditor (*réviseur d'entreprises agréé*).

The general meeting of the shareholders holds certain exclusive powers granted by law, including:

- the appointment/removal of the members of the board of directors;
- the appointment of the supervisory auditor(s);
- any amendment to the company's articles of association;
- the approval of the annual accounts and the allocation of the result; and
- the dissolution and subsequent opening of the liquidation of the relevant company.

Partnership Limited by Shares

Partnerships limited by shares are governed by the same governance rules as public limited liability companies, except for the following features.

- The management of the partnership will be carried out by one or more managers, who may be unlimited members but do not need to be. Typically, the management will be entrusted to a general partner, being the holder of all unlimited shares in the partnership. In order to mitigate any unlimited liability risks, such a general partner will usually be incorporated under the form of a private limited liability company. Even if a limited partner may be a member of the management board,

it is strictly prohibited from carrying out any management acts towards third parties.
- The supervision of the company must be entrusted to at least three supervisory auditors (*commissaires aux comptes*), who will form a supervisory board unless an approved statutory auditor (*réviseur d'entreprises agréé*) has been appointed.

Private Limited Liability Company

Private limited liability companies are more flexible and allow for tailor-made governance regimes, making this company form the most popular investment vehicle for real estate.

The management of a private limited liability company will be carried out by one or more managers, who will be appointed by the general meeting or by the sole shareholder for a limited or unlimited period of time. The managers have the widest powers to achieve corporate objectives and may take any action necessary in relation thereto, with the exception of those tasks reserved by law or the articles of association for the general meeting.

The general meeting of the shareholders will enjoy certain reserved powers similar to those of the general meeting of a public limited liability company.

The supervision of the company must only be entrusted to a supervisory board comprising one or more supervisory auditors only where the company has more than sixty shareholders and no approved statutory auditor (*réviseur d'entreprises agréé*) has been appointed.

Common and Special Limited Partnerships

The governance regime of both partnerships is characterised by an extremely high level of contractual freedom, making it a popular company form for real estate investments.

The management of each partnership will be entrusted to one or several managers, who do not need to be general partners. Limited partners may be members of the management body but cannot take any management action towards third parties without jeopardising their limited liability. In practice, as for the partnership limited by shares, the management will be entrusted to a private limited liability company that will act as general (unlimited) partner.

Matters that necessarily fall within the competence of the general meeting of the partners include:

- amendments to the corporate object of the partnership;
- a change of the nationality of the partnership;
- the conversion or liquidation of the partnership; and
- the approval of the annual accounts, as applicable.

Such a list may be freely supplemented in the partnership agreement.

Specific Governance Rules Applicable to Companies Listed on the Luxembourg Stock Exchange

Such companies must further comply with the specific governance rules enshrined in the X Principles of Corporate Governance of the Luxembourg Stock Exchange (eg, the establishment of a nomination committee and an audit committee) and the law of 24 May 2011 on the exercise of certain rights of shareholders in general meetings of listed companies and implementing Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the

exercise of certain rights of shareholders in listed companies.

Specific Requirements Applicable to Alternative Investment Funds (AIFs)

Any undertaking for collective investment that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which does not require an authorisation as an undertaking for collective investments in transferable securities (UCITS) pursuant to Directive 2009/65/EC on UCITS, will in principle qualify as an AIF within the meaning of the AIFMD and as such has to either be managed by an external AIFM designated by the AIF or be itself authorised as an internally managed AIF.

External AIFMs may either be authorised by or registered with the competent authority of an EU member state, or be a non-EU AIFM.

Specific Requirements Applicable to Regulated Investment Funds

The directors of a regulated investment fund set up in a corporate form (UCI Part II, SIF or SICAR) must be of sufficiently good repute and sufficiently experienced, having particular regard to the type of investment fund and its investment policy.

Regulated investment funds set up in the contractual form (UCI Part II or SIF only) shall only be authorised by the CSSF if the CSSF has approved the application of the management company to manage that common fund.

5.6 Annual Entity Maintenance and Accounting Compliance

Accounting compliance costs will increase significantly if the annual accounts are to be audited by an approved statutory auditor (*réviseur d'entreprises agréé*). The appointment of an approved statutory auditor is compulsory under Luxembourg law for public limited liability companies, partnerships limited by shares and private limited liability companies, and also for common partnerships under certain specific circumstances. In addition, in accordance with the AIFMD, Luxembourg AIFs managed by a duly authorised AIFM must have their accounts audited.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Real estate may be subject to long-term in rem rights under the following:

- a *droit de superficie*, which is a tenancy and building right with renewable terms of a maximum of 99 years each time; and
- a *bail emphythéotique*, which is a tenancy right with a duration between 27 and 99 years, which can be renewed.

Actual leases of real estate only confer personal rights of use of the premises to the tenant, and are split into the following three main categories:

- residential lease agreements, mainly governed by the general lease rules of the Civil Code and the Law of 21 September 2006, as amended on residential leases;
- commercial lease agreements, mainly governed by the general lease rules of the Civil Code and (to the extent the lease exceeds a term of one year) by Articles 1762-3 et seq of the Civil Code, concerning real estate used for commercial, industrial or craftsmanship activities; and

- lease agreements with respect to real estate used for other purposes (eg, office buildings used for administrative purposes or for liberal professions), which are not subject to the specific rules of residential or commercial leases; the leases benefit from the most extensive contractual freedom, and are only subject to the general rules of the Civil Code applying to leases (to the extent not otherwise contractually agreed).

The analysis of the following questions will be limited to commercial lease agreements.

6.2 Types of Commercial Leases

There is only one type of commercial lease, which applies exclusively to real estate used for commercial, industrial or craftsmanship activities.

6.3 Regulation of Rents or Lease Terms

Rents and lease terms for commercial leases are generally freely negotiable, but the tenant (or subtenant, if subleasing is allowed) may request the renewal of the lease at the end of its term, subject to specific conditions. No specific amendments to the generally applicable legislation have been implemented following the COVID-19 pandemic.

6.4 Typical Terms of a Lease

Commercial leases are usually concluded for a duration of nine years, with a possibility for the tenant to terminate the lease after three and six years of occupancy. However, commercial leases can be entered into for any other terms or for an undetermined duration. Leases with a fixed term exceeding nine years must, in principle, be entered into by notarial deed.

Major repairs are at the charge of the landlord, whereas the tenant is liable for the costs of maintenance and "minor" repairs, unless such repairs are caused by dilapidation or force majeure. The parties may derogate from these rules.

As no specific lists of repairs incumbent upon the landlord or the tenant have been established, this has to be determined on a case-by-case basis by the competent courts in cases of dispute. The frequency of rent payments is freely determined by the parties.

No specific COVID-19 practices have been implemented. It is likely that force majeure clauses for future lease agreements will foresee a carve-out in favour of the landlord to exclude any derogation from the lease terms for a specific pandemic; however, at present, no legislation or precedents have implemented this.

6.5 Rent Variation

Periodic rent adjustments during the course of the contractual relationship are usually provided for in the lease agreement.

6.6 Determination of New Rent

A commonly used mechanism is a contractual reference to an index published by the *Service Central de la statistique et des études économiques*.

It is important to determine in the lease agreement which index is to be applied, and rent will then be adjusted. Lease agreements usually stipulate that the amount of rent may not decrease should the relevant index drop.

6.7 Payment of VAT

The rental of real estate property located in Luxembourg is generally VAT exempt.

However, the right to opt for VAT may be exercised under certain conditions.

The VAT exemption waiver form is to be submitted to the Luxembourg VAT authorities for approval. The standard 17% rate then becomes applicable on the rent.

6.8 Costs Payable by a Tenant at the Start of a Lease

The tenant may be liable to settle agency fees to the real estate agents. In addition, the tenant will in principle have to make advance payments for the maintenance of common spaces of the building.

6.9 Payment of Maintenance and Repair

All occupants of a building must participate in the maintenance, repair and other costs related to common areas. The proportion of participation in such costs by a tenant depends exclusively on the size of the space rented compared to the total size of the building.

6.10 Payment of Utilities and Telecommunications

Generally, each tenant has its own subscription for utilities like water, sewer, refuse, electricity and telecommunication services. Where appropriate, each rental unit will have its own meters/counters for such purposes. Alternatively, certain services may be included in the monthly charges for common spaces.

6.11 Insurance Issues

The parties are free to decide who bears the direct cost of insurance policies. The tenant may be liable to take out appropriate insurance cover directly for the rented premises, or the building management may take out policies for the entire building (in which case, the costs are normally reflected in the monthly common charges).

The usual mandatory insurance policies (whether taken out by the building management or individual tenants) cover fire, water, storm, other natural forces and glass breakage.

In any case, tenants are usually required to take out separate cover for damage to their personal assets and general tort liability for any harm caused to visitors within their rented premises.

Issues related to COVID-19 are subject to the specific insurance policies potentially entered into.

6.12 Restrictions on the Use of Real Estate

The landlord can limit the use of the premises rented out (eg, for office/administrative use only).

Zoning and other legislation may apply and limit the use of premises for commercial, industrial, residential or other use.

For certain activities that are qualified as “hazardous”, the tenant will also be required to obtain specific authorisations from the competent authorities.

6.13 Tenant’s Ability to Alter and Improve Real Estate

Any alteration to the rented premises by the tenant is normally subject to the prior approval of the landlord. If alterations are planned from the beginning, they are usually authorised within the framework of the lease agreement.

Alterations that would interfere with the normal use of their premises by other tenants or owners are generally restricted and will require the additional approval of the building management.

For major alterations, building permits from the competent authorities may be required.

Unless otherwise agreed between the landlord and the tenant, the tenant bears the cost of any alterations and improvements. At the end of the lease term, the landlord usually has the option to either keep the modifications or require the tenant to restore the premises to their original condition.

6.14 Specific Regulations

See **6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time**.

6.15 Effect of the Tenant's Insolvency

The insolvency/bankruptcy of a tenant does not automatically result in the immediate termination of a lease agreement. However, lease agreements often contain a possibility for the landlord to terminate the lease agreement without notice if the tenant is declared bankrupt. The landlord and the bankruptcy receiver agree on the termination of the lease and its terms.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

For commercial lease agreements, the common security is a security cash deposit, a first demand bank guarantee or other equivalent guarantee covering an amount limited by statute to six months of rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

Whether or not a tenant has a right to continue occupying the relevant real estate after the expiry or termination of a commercial lease depends on whether the commercial lease has a fixed term (it ends automatically at the end of the term without requiring formal notice) or an indefinite duration (the notice period to be granted is contractually agreed and cannot be less than six months). If no termination notice has been given, a commercial lease agreement that ends for any reason is tacitly renewed for an indefinite period.

For fixed-term commercial leases, it is advisable to send a formal notice of termination at least six months before the lease's agreed term, requesting the tenant to vacate the premises at the end of the agreed term to avoid an automatic tacit renewal.

However, the landlord only has the right to terminate an indefinite duration lease or to refuse the renewal of a fixed-term lease (if timely requested by the tenant) in the following circumstances:

- if the landlord or their first-degree descendants intend to personally use the premises;
- if the premises will no longer be rented for the same activities; or
- in case of the reconstruction or transformation of the rented building.

If the tenant has occupied the rented premises for at least nine years, the landlord can refuse a renewal of the term lease or terminate an indefinite duration lease without giving reasons, but only if the landlord or a third party agrees to pay an eviction indemnity to the tenant before the end of the lease.

6.18 Right to Assign a Leasehold Interest

A contractual clause in a commercial lease prohibiting the assignment of the lease or sublease of the leased premises is null and void if the assignment of the lease or the subleasing is made together with the assignment of the commercial activity (*fonds de commerce*) and an identical commercial activity will remain established on the premises.

A prohibition of the assignment of the lease or subleasing by the landlord should remain possible to the extent it is not made in conjunction with the assignment of the underlying business.

Any assignment of the lease or any sublease must be notified to the landlord, who has 30 days to refuse consent for valid reasons. The tenant has the ability to object before the competent court, within eight days of the refusal.

The tenant remains bound, as joint and several surety, for the performance of the obligations under the assigned or subleased lease agreement.

6.19 Right to Terminate a Lease

The landlord may request the competent court to terminate a commercial lease with immediate effect and ahead of term if the tenant does not respect the obligations contained in the lease agreement. The lease agreement can also contain a clause entitling the landlord to terminate the lease with immediate effect for violation by the tenant of substantial obligations under the lease agreement. If the tenant refuses to vacate the premises, the landlord can request a confirmation of termination by the competent court to evict the tenant.

6.20 Registration Requirements

There is no requirement to register a lease agreement or perform any other particular execution formality. Registration of the lease agreement can be made on a voluntary basis with the Luxembourg VAT authorities.

6.21 Forced Eviction

See **6.19 Right to Terminate a Lease**.

The landlord can request the competent court to confirm the immediate termination of the lease and to order the eviction of the tenant. The court may grant a reasonable deadline for the tenant to vacate the premises. Court proceedings with respect to lease agreements usually take approximately six months.

6.22 Termination by a Third Party

If the Luxembourg government initiates an expropriation procedure for premises occupied by a tenant, for public reasons, the tenant will be called by the landlord to participate in the expropriation proceedings and will normally be indemnified by the government if the lease has to be terminated following the expropriation procedure.

6.23 Remedies/Damages for Breach

The provisions with respect to damages for breach of the lease agreement are typically contracted in the lease agreement, and usually include:

- payment of a certain amount of rent (calculated in months) by the tenant;
- a relocation indemnity (to cover for the period until the premises can/will be leased out again); and
- coverage of costs for damages that may have been caused to the property and which would be attributable to the tenant.

The security deposits have been summarised in **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations**.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are three main methods used to price construction projects, as follows:

- the fixed price contract is most appropriate where simplicity of management is a consideration due to the size of the project or the management team;
- the cost-plus contract allows the contractor to be paid the full price for all agreed-upon construction-related costs and overheads, and a fee representing the contractor's profit; and
- the unit price contract is often used for repetitive projects as it sets a price for each unit of work or task to be completed.

7.2 Assigning Responsibility for the Design and Construction of a Project

The architect is liable for the design in the event of a plan defect, if the plans have been rigorously followed by the constructor (contractor) and the owner (client). The architect is bound by an obligation of result.

The constructor/contractor can be held jointly and severally liable with that of the architect if a defect arises during the works.

Finally, the consulting engineer may also be held jointly and severally liable with the architect because their interventions are intermingled.

All participants can be held liable for a breach of the client's advice and due diligence.

7.3 Management of Construction Risk

Risk factors can be split into two groups:

- internal risks, which fall within the control of clients, consultants and contractors; and
- external risks, which include risk elements that are not in the control of key stakeholders.

Constructions are regulated by Luxembourg common law provided by the Civil Code.

7.4 Management of Schedule-Related Risk

All possibilities offered by the Civil Code can operate. In particular, forfeiture clauses allow monetary compensation at key stages of the construction. Parties usually use such indemnification clauses.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The main securities under a construction contract consist of the following:

- cash retention, which involves withholding a small amount from the contractor's claim (typically 10% of the claim) until a certain value of security has accumulated (typically 5% of the contract sum);
- using a separate bank account to give the contractor greater reassurance that it will eventually receive the security amount once its obligations have been discharged;
- a guarantee given by a bank to pay an amount on demand to the named beneficiary;
- insurance bonds that are similar to bank guarantees, in that they are issued by a third-party financial institution (usually an insurance company) and are payable on demand to the named beneficiary; and
- a letter of comfort, which consists of an assurance given by a third party, such as a bank, accountant or related body corporate, about the financial standing of a particular entity.

7.6 Liens or Encumbrances in the Event of Non-payment

Mortgages are often used in construction (see **2.3 Effecting Lawful and Proper Transfer of Title**).

7.7 Requirements Before Use or Inhabitation

Ownership rights relating to real property are entered into the Administration Registry and the Mortgage Registry, which prevents a third party from purchasing the same piece of property in good faith.

8. Tax

8.1 VAT and Sales Tax

In Luxembourg, purchasing an existing building is generally exempt from VAT. However, under certain conditions and similar to renting, this purchase can be subject to VAT by submitting a VAT option form (see **6.7 Payment of VAT**).

In the case of a building to be constructed, the construction work is subject to VAT at a rate of 17%.

A super-reduced VAT rate of 3% on the construction and renovation of housing may apply if the property is used as the main residence for a period of at least two years. This VAT benefit may not exceed EUR50,000 per built or renovated residence.

8.2 Mitigation of Tax Liability

The significant transfer taxes on real estate assets (7% to 10%, depending on the location and nature of the property) led to the vast majority of large real estate transactions assuming the format of share deals. Since the registered owner of the property remains unchanged, no transfer taxes are due. In addition, the underlying capital gains on the property itself will not be realised and thus will not be taxed. The latent tax burden is transferred to the new shareholder and will only be realised when the property is sold in an asset deal. Therefore, the selling price is frequently discounted by a provision for latent capital gains.

Most of the investment vehicles can be structured to ensure tax efficiency.

8.3 Municipal Taxes

Each municipality in Luxembourg is authorised to levy a property tax on any immovable property situated within the limits of the municipality, whether built on or not. The property tax ranges between 0.7% and 1% of the unitary value of real property (determined based on the value of the property or of a similar property in 1941, which is then multiplied by a communal rate).

8.4 Income Tax Withholding for Foreign Investors

Rental Income

Non-resident companies or individuals are subject to taxation on their Luxembourg-sourced rental income similarly to Luxembourg resident taxpayers, although subject to the provisions of any applicable tax treaty. Double tax treaties concluded by Luxembourg are based on Article 6 of the OECD Model Convention as far as the taxation of rental income is concerned, according to which rental income is taxable in the state where the immovable property is located.

Non-resident companies deriving real estate income (ie, rents) from properties in Luxembourg are subject to the same Luxembourg taxation as resident companies.

For non-resident individuals directly owning real estate assets located in Luxembourg, the rental income will be subject to personal income tax in Luxembourg, in accordance with progressive rates.

Non-residents may be entitled, under certain conditions, to deduct general expenses related to the obtainment of real estate income, and also to depreciate the value of the assets.

Capital Gains Upon the Sale of a Luxembourg Property

The basis for assessing real estate income tax is usually the difference between the purchase price and the sale price of the real estate property.

The capital gains realised upon the alienation of an immovable property are generally taxable in the country of location of such property (ie, Luxembourg). The state of residence of the alienator typically provides relief for the taxes paid in Luxembourg.

Accordingly, capital gains arising from the sale of a Luxembourg property by a non-resident company are subject to the standard Luxembourg corporate income tax rates.

For non-resident individuals, capital gains are not subject to a separate tax but instead to the standard rates of personal income tax (or reduced rates under certain conditions).

As of 1 January 2021, a 20% real estate levy applies to rents and capital gains derived from real estate located in Luxembourg whenever the owner is a tax opaque UCI, a SIF or a RAIF. Specific reporting is required of the relevant fund vehicles in relation to this levy.

8.5 Tax Benefits

When a Luxembourg opaque company owns real estate, the company can recognise tax-deductible depreciation based on the asset's expected useful life.

Business expenses such as management fees are deductible under certain conditions.

Arm's length borrowing costs can also be deducted annually, up to EUR3 million or 30% EBITDA (save for exceptions), whichever is higher.

Furthermore, Luxembourg tax law enables (under certain conditions) a Luxembourg company to defer capital gains realised upon the disposal of a real estate asset if an amount corresponding to the sale proceeds realised is reinvested into another fixed asset.

Similarly, individuals are allowed to defer capital gains realised upon disposal of a real estate asset held at least two years after its acquisition in the context of their private wealth management if an amount corresponding to the sale proceeds realised is reinvested in real estate rented out as social housing or in real estate meeting certain energy and environmental criteria.

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Law and Practice

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1. General

1.1 Main Sources of Law

The main sources of real estate law are the following:

- Civil Code, Chapter 16 of the Laws of Malta;
- Private Residential Leases Act, Chapter 604 of the Laws of Malta;
- Reletting of Urban Property (Regulation) Ordinance, Chapter 69 of the Laws of Malta;
- Housing (Decontrol) Ordinance, Chapter 158 of the Laws of Malta;
- Agricultural Leases (Reletting) Act, Chapter 199 of the Laws of Malta;
- Government Lands Act, Chapter 573 of the Laws of Malta;
- Real Estate Agents, Property Brokers and Property Consultants Act, Chapter 615 of the Laws of Malta;
- Development Planning Act, Chapter 552 of the Laws of Malta;
- Immovable Property (Acquisition by Non-residents) Act, Chapter 246 of the Laws of Malta;
- Duty on Documents and Transfers Act, Chapter 364 of the Laws of Malta;
- Income Tax and Duty on Documents and Transfers on Transfers of Dwelling Houses to Shareholders Exemption Order, Subsidiary legislation 123.54 of the Laws of Malta; and
- Income Tax and Duty on Documents and Transfers on Transfers of Dwelling Houses by Commercial Partnerships Exemption Order, Subsidiary legislation 123.58 of the Laws of Malta.

1.2 Main Market Trends and Deals

The cost of real estate in Malta has increased at a consistent rate as can be seen from the Property Price Index (PPI). The inclusion of first-time and second-time buyer schemes and reduced taxes for both purchasers and sellers of immovable property can be seen to sustain the demand for property, and also aims to encourage first-time buyers in acquiring property.

In fact, first-time property buyers shall continue to benefit from a EUR1,000 grant for a period of ten years. In addition, all property buyers (including non-first-time buyers) will continue to benefit from an income tax and stamp duty exemption on the first EUR750,000 of the higher of the value of or consideration paid for the acquired property if the property prior to the transfer date:

- has been constructed for a period of 20 years or more;
- has been vacant for more than seven continuous years; and
- is situated in an Urban Conservative Area (UCA).

In addition, property restoration schemes have also been introduced with the aim of preserving Malta's national heritage, whereby homeowners of qualifying properties will be able to benefit from a refund of VAT expenses incurred such as architect's fees, project management fees and planning permit fees (up to EUR54,000 on the first EUR300,000 of the property's total purchase price). Qualifying properties means those properties which satisfy the aforementioned conditions.

Also, property purchases in Gozo outside an Urban Conservative Area (UCA) have drastically increased mainly due to a government incentivised reduction of the applicable stamp duty from a rate of 5% to 2%. Although the incentive has now been removed, this nevertheless created an unprecedented tide of real estate investors attempting to acquire property in Gozo, which does not seem to be slowing down any time soon.

Furthermore, it does not seem that the pandemic had any lasting effect on the inflation prices of real estate as purchasers continue to face difficulty in obtaining bank loans to acquire immovable property in Malta.

1.3 Proposals for Reform

A number of recommendations have been made to address the shortcomings seen to be present in the regulation of the construction sector and its enforcement. In this respect, it would also be relevant to mention Legal notice 37 of 2024 on the Avoidance of Damage to Third Party Property (Amendment) Regulations, and Legal notice 38 of 2024 on Construction Sites Insurance Obligation Regulations, as these have been implemented to regulate contractors.

In fact, contractors are required to have a licence covered by a valid insurance policy that covers any loss, damage, injury or death that may be suffered as a consequence of an act or omission by the contractors, its/their employees or any person operating under its/their direction. Should such licensed personnel not be covered by a valid insurance, they shall be personally liable for any damage that may ensue. Additionally, a vetting process has been introduced to ensure scrutiny and guarantee transparency whereby any natural or legal person applying to become a construction contractor must fulfil certain requirements such as being in possession of a mason's licence or employing people who have a minimum number of years of experience.

As mentioned, a number of recommendations that target the construction sector have also been made. It has been suggested that a set of National Building Codes should be concluded and published on the basis of European Building Codes to ensure that architects are compliant with the Building Construction Act. The issue of health and safety has also been delved into and it has been suggested that site safety officers should have the authority to suspend any construction works until any wrongdoing has been remedied, especially when the health and safety of workers have been grossly prejudiced.

It has been recommended that administrative practices be further scrutinised, to ensure that work permit applications by employers for third-country nationals are better verified. Lastly, and of note, is the carrying out of workplace inspections in that no construction site should ever operate in an uninspected manner.

In addition to the above, the government is set to amend the current law on leases, by regulating the number of tenants that a residence can have. It is expected that the government shall prescribe that the number of people allowed to share a bedroom shall not exceed that of two tenants in the case of shared rentals. Also, landlords shall be able to register between eight and ten tenants in residences with four to five bedrooms, provided that there is a minimum of two bathrooms in the property. Such proposals have been made as response to the current tenant situation whereby landlords in Malta have been accepting more tenants than they should, given the size of the property being leased.

Although most of these recommendations have been implemented, it still remains to be seen whether such provisions shall be enforced and, if enforced, then the manner in which they will impact the construction industry and landlords choosing to rent out their property.

2. Sale and Purchase

2.1 Categories of Property Rights

There are various titles by which property may be conveyed, and institutes by virtue of which rights may be secured, the following being the principal rights.

- *Ownership* is the right of enjoying and disposing of immovable property in the most absolute manner and is acquired by the lawful owners following the transfer by title of full ownership to the purchaser.
- *Lease* is acquired whenever the lessor enters into a lease agreement with the lessee, granting the latter the right of possession of the property.
- *Emphyteusis* refers to when one of the contracting parties transfers to the other, by means of a contract, in perpetuity or for a specified period of time, a property subject to the payment of an annual ground rent. In perpetual emphyteusis, the emphyteuta can choose to redeem the ground rent and convert the right of emphyteusis into a title of ownership.
- *Usufruct* is a legal right to use and derive benefits from the property belonging to another person, subject to the condition that the manner and form of the property is preserved. This right can be constituted for a specified period of time or otherwise until the fulfilment of a particular condition.
- *Hypothec* is typically granted by the owner of immovable property as a way of offering security in lieu of a loan. Hence, ownership will only be lost in the event that property owner defaults on the loan.
- A property may also be the subject of an *easement* or a *servitude*. The right of easement is that created by law in favour of a property over another property for the purpose of making use of such other property, or of restraining the owner from the free use thereof. There are different types of easements such as that arising from the position of the property whereby the lower situated property is subject to receiving water which may pass from the higher property, and it shall not be lawful for the owner of the lower property to do anything that may prevent such waterflow. This is typically common in agricultural property. Similarly, the right of servitude occurs where a person holds certain rights over the property of another, such as the right of passage.

2.2 Laws Applicable to Transfer of Title

The main laws that apply to a transfer of title of real estate are as follows:

- Civil Code, Chapter 16 of the Laws of Malta regulating the transfer of property inter vivos and causa mortis (ie, through inheritance) including the sale by licitation of the property;
- Reletting of Urban Property (Regulation) Ordinance, Chapter 69 of the Laws of Malta (regulating pre-1995 commercial leases);
- Immovable Property (Acquisition by Non-residents) Act, Chapter 246 of the Laws of Malta;
- Private Residential Leases Act, Chapter 604 of the Laws of Malta;
- Housing (Decontrol) Ordinance, Chapter 158 of the Laws of Malta;
- Agricultural Leases (Reletting) Act, Chapter 199 of the Laws of Malta (regulating agricultural leases); and
- Notarial Profession and Notarial Archives Act, Chapter 55 of the Laws of Malta.

2.3 Effecting Lawful and Proper Transfer of Title

Any agreement that purports to promise the transfer or acquisition of the ownership of

immovable property or any other right over such property, under whatever title, must be done by means of a public deed or a private writing. Whereas a public deed published by a notary public is required for a contract of sale of property or a contract of emphyteusis, a lease agreement can be effected by means of a private writing.

It may be the case that the immovable property to be transferred falls within a registration area requiring compulsory registration as classified by the responsible minister. In Malta, the Lands Authority together with the Public Registry are responsible for such registrations. In fact, if such registration is not effected as necessary, the following shall not become effective in respect of third parties, whether beneficially or in an adverse manner:

- any contract conveying the transfer of ownership, or any real right over such property, including transactions that relate to immovable property held under trusts, or any contract having the effect of dissolving, rescinding or revoking any such transfer of ownership or of any real right over immovable property;
- any judgment with the effect of dissolving, rescinding or revoking the ownership or any real right of immovable property or with the effect of adjudging any transfer of ownership, any real right over property, any hypothec created by law, or of creating a hypothec; and
- any transfer of immovable property by means of a judicial sale and any redemption of ground rent.

Registration is only completed once the duty on the property has been paid in terms of the Duty on Documents and Transfers Act, Chapter 364 of the Laws of Malta.

Similarly, all private residential lease contracts entered into, from 2020 onwards, must be registered with the Housing Authority within ten days from the commencement of the lease, and registration is subject to an administrative fee as levied by the responsible minister, as stipulated by the Private Residential Leases Act, Chapter 604 of the Laws of Malta. Failure to do so shall render such contract null and void, with the lessor liable for a fine. The law does, however, contemplate the right of either party to register the contract, always at the expense of the lessor.

2.4 Real Estate Due Diligence

When entering into a promise of sale, a notary is normally engaged to carry out examination of title over the relevant immovable property. Once the relevant searches and due diligence have been carried out, generally in the interim period between the promise of sale and the eventual sale/purchase agreement, the notary shall then inform the transferee of the facts and findings resulting from the searches carried out and report all information that has come to their knowledge.

2.5 Typical Representations and Warranties

It is normal practice for parties entering into a commercial real estate transaction to guarantee that they possess the necessary capacity and consent together with the other requirements stipulated by law to enter into such a contract. In such contracts, it is essential for the owner of the property to guarantee their title of ownership by means of the warrant of peaceful possession and against any latent defects that may render the property unfit for use or diminish its value.

The title of ownership is often guaranteed by means of a general hypothec, which, as explained previously, is a legal right over all

the seller's property, both present and future; or, otherwise, by means of a special hypothec over other specific property owned by the seller, which is more effective since it follows the property and not the person.

Customarily, the remedies available to a buyer in the event of misrepresentations made by the seller are:

- the rescission of the contract of sale;
- to restore the parties to the position they were in prior to entering the contract; or
- the payment of damages being either pre-liquidated damages or in the form of quantifiable damages as agreed by the parties in terms of the contract, subject to the highest applicable interest rate under the laws of Malta at the time (currently 8% per annum in civil matters).

The law does not provide any limit as to the amount of damages that may be liquidated in terms of misrepresentation, provided that the amount is considered equitable and just, according to the circumstances, and represents actual losses incurred.

In leases, the lessee may demand the annulment of the contract of lease together with the payment of damages, if they can prove that misrepresentations or fraud were used to their prejudice in regard to any conditions imposed on a lease. The new lease shall remain operative on the same conditions as the previous lease, at a rent to be fixed following valuation by experts depending on the present circumstances when the conditions so impeached were accepted.

2.6 Important Areas of Law for Investors

Most notably, an investor should take cognisance of the applicable tax and duty payable on the type of property chosen and that regulating the transfer of immovable property. Throughout the years, the Maltese government has taken the initiative to lower the duty payable on UCAs and other similar properties, with the intention of preserving Malta's heritage. It is also recommended to refer to the applicable provisions within the Immovable Property (Acquisition by Non-residents) Act, Chapter 246 of the Laws of Malta, which stipulate the necessary conditions that are to be fulfilled by foreign investors acquiring property in Malta.

Additionally, an investor should also proceed with consulting a notary who will proceed to file the necessary form (Form E) to the land registry and carry out all the relevant searches on the property specifically to determine whether a property is in a Registration Area. Such investor will also have the right to know whether the property has never been registered before, or, if it has been registered, whether the property is subject to a hypothec, privileges and/or cautions registered at the land registry, and/or any other known fact that may negatively influence the investor's decision to acquire the real estate. This is regulated under the Land Registration Act, Chapter 296 of the Laws of Malta.

2.7 Soil Pollution or Environmental Contamination

Maltese law stipulates that every person shall be liable for the damage that occurs through that person's own fault. Thus, where a property buyer is not aware of any soil or environmental pollution and has not committed any contributory acts, then such person is exempt from any ensuing responsibility. The same cannot be said for the seller who in bad faith sells the property without disclosing the pollution present.

The Environment Protection Act, Chapter 549 of the Laws of Malta, does, however, provide that every person and entity, whether public or private, has the duty to protect the environment and to assist in the taking of preventative measures to avoid damages or remedial measures which can remediate any damage that may have been caused. However, it should be noted that such duty is not enforceable before a court of law.

In addition, the Prevention and Remedying of Environment Regulation, Subsidiary legislation 549.97 of the Laws of Malta provides that where environmental damage is caused by pollution, it will be essential to establish a causal link between the damage and the activities of individual operators. Whether the buyer had anything to do with the damage is ancillary, as they will nevertheless have an obligation to inform the relevant authority of the situation, take all practical steps to control and prevent further environmental damage and take all necessary remedial measures, at their own cost. In any case, the competent authority will have the right to initiate cost recovery proceedings against either the buyer who acquired the property, or otherwise a third party, possibly being the seller of the property who would have caused the damage, in relation to any measures taken within five years from the date on which those measures were completed or the liable person was identified.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The Development Planning Act, Chapter 552 of the Laws of Malta provides the applicable rules relating to sustainable land planning and development management in Malta. It outlines the functions of the planning authority, which is responsible for the administration and enforcement of the policies regulating land use and planning. Buyers are advised to consult and engage a warranted architect who can provide professional guidance on the permitted use of a specific land and determine whether the intended project complies with the applicable zoning and planning laws.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Government Lands Act, Chapter 573 of the Laws of Malta, regulates the mechanism for land acquisition by the government and the procedures that follow in relation to such acquisition. The government can choose to take over any private property:

- by the absolute purchase of the property;
- for the possession and use of the property for a period of not more than ten years; or
- by acquiring part of a land by absolute purchase and part of it by possession and use.

The applicable procedure is as follows.

- If the Lands Authority (the "Authority") considers it desirable that any land should be examined to determine its possible acquisition for public purpose, it may make a declaration to be signed by the Chairperson of the Board of Governors of the Lands Authority to that effect. Following this, it shall then be lawful for the Lands Authority, or any person authorised by it, to enter and survey the land and to do all other acts necessary to determine whether the land is adapted for such purpose.
- If the land is deemed to be appropriate for public purpose, the Chairperson shall draw up and sign a declaration to that effect, which shall then be published in the Government Gazette and at least once in two daily or Sunday local newspapers. Such declaration shall contain well-defined detail to allow anyone

to identify the land being acquired, the public purpose for which it is being required, the amount of compensation which the Authority is willing to pay, together with a site plan of the land and a valuation drawn up in terms of the Government Lands Act.
- If the acquisition of the land is for possession and use, then the relevant declaration shall indicate the number of years that the Authority intends to keep the land, provided that such number does not exceed ten years. Acquisition rent shall be payable to the person entitled to receive or to let and receive the rental on lease of the land affected, or the tutor, curator, administrator, procurator or other representative of the person so entitled.
- The Authority shall not later than 14 days following the publication of the declaration, provided that this is physically possible to carry out, attach a copy of the declaration of the site plan upon or near the land which is being acquired. This notice shall also be shown on the notice board of the office of the local council and of the police station in the locality where the land is situated.
- If the land being acquired is occupied by any person, the Lands Authority shall by means of a judicial act presented in the register of the Arbitration Board, forward a copy of the declaration and the plan to those persons occupying the land.
- Any person interested in the land being acquired may contest the public purpose of the said declaration and demand its cancellation before the Arbitration Board by means of an application filed in the registry of the said Board within 50 days from the publication of the said declaration. Once the application is served on the Lands Authority, the latter shall have the right to submit a reply within 20 days from the notification. The Arbitration Board shall set down the application for hearing without delay, and, after listening to the witnesses and the submissions of the parties, it shall pass judgment within the shortest time possible but not any later than two months from the closing date within which the Lands Authority had to file its reply.
- Any party aggrieved by the decision given by the Arbitration Board may appeal before the Court of Appeal in its superior jurisdiction by means of an application filed within 20 days from the date of such decision. The Court of Appeal shall set down the cause for hearing at a date not later than two months from the date of application. After listening to the parties' oral submission, the court shall pass judgment on the merits within the shortest time period, which must not be longer than six months from the day that the appeal application was filed and the parties duly notified.

2.10 Taxes Applicable to a Transaction

The respective parties must make reference to the legal provisions regulating the tax payable on the purchase and sale of property in Malta, specifically the Income Tax Act, Chapter 123 of the Laws of Malta and the Duty on Documents and Transfers Act, Chapter 364 of the Laws of Malta. The seller is required to pay capital transfer taxes on the transfer of any property, whereas the buyer must pay the stamp duty. The tax and stamp duty are, however, dependent on a number of facts such as the relationship of the parties, whether the property is subject to transfer exemptions and whether or not the transfer is subject to any incentive measures issued by the government at the time of the transfer. In Malta, the standard rate of stamp duty to be paid by the buyer is 5% whereas the capital gains tax to be paid by the seller is 8%. The parties must pay 20% (out of the aforementioned 5%) stamp duty upon the signing of the "Promise of Sale

Agreement", with the balance payable on completion of the final deed of purchase. The rate of 5% stamp duty represents the total tax due and is ultimately equivalent to 1% of the final price.

Once a promise of sale is signed, it must be presented to the Capital Transfer Duty Section at the office of the Commissioner for Revenue within 21 days. Here, a provisional duty of 1% is paid by the purchaser based on the market price or transfer as per the contract, whichever is the higher. Once payment is received, a receipt for provisional stamp duty will be issued to the taxpayer confirming the above.

Here, it is necessary to mention that non-residents wishing to acquire immovable property in Malta may only do so after having acquired an Acquisition of Immovable Property Permit (the "AIP Permit"), whereby applicants would need to submit the relevant application together with a copy of the promise of sale of the immovable property intended to be purchased. In the case of a dwelling house, such applicant must primarily fulfil a number of conditions, as follows:

- property must be solely used as residence by the applicant and their family;
- acquisition must be effected within six months from the date of issue of the AIP Permit, save the granting of any extension as may be applied for;
- a certified copy of such deed must reach the office of the Commissioner for Revenue within three months from publication of the deed; and
- the immovable property may not be sold in part, or otherwise converted into more than one dwelling house.

Similar conditions shall apply where the property being acquired is either a garage or other adjoining property, or else a plot of land.

2.11 Legal Restrictions on Foreign Investors

As stated in **2.10 Taxes Applicable to a Transaction**, foreign investors may acquire real estate in Malta only by means of an AIP Permit, which shall require applicants to fulfil a number of requirements.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisition of commercial real estate can be financed either by means of a direct payment by the purchaser from his own assets, by means of a bank loan or otherwise through a consortium. If the purchaser chooses to obtain a bank loan, the purchasers would be required to place the estate as collateral in the event of non-payment of the loan and would be subject to a hypothec or a privilege. Alternatively, if the purchaser chooses to proceed with setting up a consortium, the purchaser will need to determine, together with the other members, the applicable terms and conditions, including but not limited to, the financial contribution to be given by each member.

3.2 Typical Security Created by Commercial Investors

Generally, security in the form of hypothecs and privileges are created to ensure the repayment of borrowed funds. A general hypothec may be created in favour of the borrower over the buyer's property or that of a third-party guarantor, both present and future, provided that the property is not sold. Alternatively, a special hypothec can be created over one or more specific properties of

the purchaser or a third party, which hypothec will continue to attach to such properties irrespective of who shall have possession of the property and irrespective of whether it is sold.

The parties may even choose to create a privilege which will ensure that the lender has a right of preference over all the other creditors of the purchaser, should there be others. The difference between a general and a special privilege will determine the ranking of the lender.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Currently, there are no restrictions on the granting of security over real estate to foreign lenders. The same applies in relation to repayments being made to a foreign lender under a security document or loan agreement.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Securities in the form of privileges and hypothecs are ineffectual unless registered in the Public Registry within two months by a notary public, the cost being the registration fee paid to the public registry together with a service fee. Once such security is preserved, the enforcement of the securities can only be done through court proceedings to obtain a court judgment recognising the debt. Any costs in this regard are computed by the court registrar, who then issues a taxed bill of costs.

3.5 Legal Requirements Before an Entity Can Give Valid Security

It is essential that an entity giving security over its real estate assets be duly recognised as possessing full ownership of the property over which it is providing security. Given that it is an entity, it is also important to demonstrate that it has been incorporated as legally required under Maltese law, clearly showing its assets and liabilities.

3.6 Formalities When a Borrower Is in Default

If a borrower defaults in its repayment obligation, the procedure normally followed is that the lender will call upon the debtor by means of a judicial letter to be filed and presented in the court registry and to be notified to the borrower/debtor. Should the latter remain in default, the lender has the option to apply to court to have the pending debt recognised by means of a judgment and subsequently to execute it. Once given, the court judgment shall constitute an executive title granting the lender the right to issue the necessary executive warrants available under Maltese law.

It is important to keep in mind that the ranking of the lender shall depend on the other creditors of the borrower. If there are creditors competing on the same property, the court will have to establish a ranking. In general, financial institutions providing loans for the acquisition of real estate are seen to rank first.

The time required to successfully enforce and realise real property security is highly dependent on various factors such as the type of security being enforced and, if applicable, the applicable timeframe if property is to be sold by judicial sale by auction.

No ongoing restrictions on a lender's ability to foreclose or realise collateral in real estate lending have been implemented since the pandemic.

3.7 Subordinating Existing Debt to Newly Created Debt

With respect to privileges, the priority of the debt is made in accordance with the nature of each

privilege, whereas, for hypothecs, priority and subsequent payment of debt is made according to the order of registration.

3.8 Lenders' Liability Under Environmental Laws

Lender holding/enforcing security over real estate subject to pollution must essentially refer to the Crimes Against the Environment Act, Chapter 522 of the Laws of Malta. Environmental liability will ensue depending on the type of action that has been committed and therefore lenders should take cognisance of involuntary offences stipulated under the aforementioned law. In this regard, lenders must ensure that they do not commit an unlawful offence against the environment through imprudence or negligence upon taking possession of a property. Such lenders shall be required to act with the diligence and prudence of a bonus paterfamilias and take all necessary measures to ensure that the land is not polluted any further, or that unlawful acts or damage are not committed.

3.9 Effects of a Borrower Becoming Insolvent

Where a borrower becomes insolvent and its assets are placed under liquidation, the lender shall be included in the ranking of creditors. The type of security interest will determine the lender's ranking amongst the other creditors, especially because privileged securities take priority over unprivileged securities.

3.10 Taxes on Loans

The only transfer to be paid is that as explained within **2.10 Taxes Applicable to a Transaction**.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Development Planning Act, Chapter 552 of the Laws of Malta, establishes an Executive Council which has monitoring and enforcement powers in relation to planning and zoning areas across Malta. These powers give the Executive Council, or any person authorised by it, the right of entry to any premises to ascertain whether an illegal development has taken or is taking place, and a general right to do anything that verifies such illegal development.

The Council is also responsible with monitoring all activities falling within the remit of the Development Planning Act such as licences, permits and certificates issued by the Authority, to ensure that all development activities are carried out in terms of the necessary legal requirements, and may for such purpose request and obtain the assistance of the police force, and that of any governmental authority scrutinising such activities.

If the Executive Council becomes aware that a development is being executed without having the necessary permit/licence or that any condition subject to which the permission was granted is not being complied with, it shall have the right to issue a stop notice to any such person carrying out such development. Further action may also be taken by the Executive Council should the development not be discontinued or stopped within the stipulated time period specified within the enforcement notice. The general public can also choose to file a report to the Planning Authority, informing it of any suspected illegal developments.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Development Planning Act, Chapter 552 of the Laws of Malta has set up a Design Advisory Committee responsible for making recommendations and providing the Planning Board with professional and expert advice required in respect of development applications filed for Urban Conservation Areas (UCAs) and other major projects. All recommendations shall be made accessible to the general public.

In addition, the Planning Authority can issue plans, policies and guidelines which can regulate the design, appearance and methodology of construction that will be followed in the development projects.

4.3 Regulatory Authorities

The development and designated use of real estate in Malta is regulated by the Planning Authority. The Development Planning (Use Classes) Order, Subsidiary legislation 552.15 stipulates the various designated uses of real estate. One may also refer to the Development Planning Act together with any subsidiary legislation, including any policies and procedures issued by the Planning Authority.

4.4 Obtaining Entitlements to Develop a New Project

Any person wishing to develop a real estate project is required to apply for a permit to the Planning Board, issued under the Development Planning Act, which board shall determine whether to grant or refuse such permit.

Any interested person may make representations on the environmental and planning issues relevant to the proposed development. The Planning Board shall then be required to determine whether to grant the permit subject to specific conditions or for a specific period of time or otherwise choose to refuse it, provided that it gives specific reasons. If the applicant considers that the conditions imposed are unreasonable, they may request the Planning Board to reconsider its position, without affecting their right of appeal.

4.5 Right of Appeal Against an Authority's Decision

If the Planning Board imposes conditions which are considered unreasonable, or has refused to reconsider its position, the applicant shall have the right to lodge an appeal before the Environment and Planning Review Tribunal. An interested third party shall also have the right to lodge an appeal against such decision taken by the Planning Board or the Planning Commission. The Tribunal shall have the power to confirm, alter or revoke such decision and may give all directions as it deems necessary according to the circumstances.

4.6 Agreements With Local or Governmental Authorities

It is possible to enter into an agreement with governmental authorities to ensure the provision of the necessary utilities required in a project.

4.7 Enforcement of Restrictions on Development and Designated Use

Please refer to the restrictions imposed by the Executive Council as outlined in **4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning**.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The different types of entities that are available to investors include limited liability companies, commercial partnerships and trusts.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Companies

Limited liability companies (LLCs) are those companies whose shareholders have limited liability and therefore their own personal assets shall not be liable to financial risk should the company encounter financial difficulties. Hence, a shareholder's liability is limited to only the amount invested within the company. As a rule, LLCs must have a minimum of two shareholders and a maximum of 50 shareholders, which can be either natural or legal persons. Such companies must have at least one individual director. The directors shall be responsible for the management of the company, its administration and ensuring that all acts are done in the best interests of the company and its shareholders.

Commercial Partnerships

Partnerships *en commandite* have two types of partners: general partners who have unlimited liability, managing the partnership; and limited partners who have limited liability, having no connection with the partnership's management. Alternatively, in partnerships *en nom collectif*, all partners have unlimited liability for the partnerships' debts and liabilities, and therefore all partners take part in the partnership's management.

Trusts

Lastly, a trust is created by a settlor who transfers assets to the trustee. The settlor can be either an individual or a company and can be either a Maltese resident or non-resident. A trustee is a person or a company who holds and administers assets for the benefit of a third party. In Malta, a person or a company acting as a trustee must be licensed by the Malta Financial Services Authority (MFSA) and must fulfil a number of requirements. The beneficiary of the trust can be either an individual or a company and can be a resident or non-resident of Malta.

5.3 REITs

The real estate investment trust (REIT) is a relatively new concept that is being introduced to the Maltese market. Currently, the government is undertaking consultation on the possibility of offering fiscal incentives which can induce such investment.

Small investors will have the opportunity to invest in company shares whose portfolio consists of rented immovable property and which company will be bound to distribute at least 85% of its dividends to its shareholders on an annual basis. In terms of the tax applicable, rental incomes will not be taxed and instead the dividends to be granted to shareholders will be taxed at a 15% rate. Given that such investment vehicle is still in its initial stages, it remains to be seen how this will develop within the market and whether it will be a useful form of investment.

5.4 Minimum Capital Requirement

The only entity subject to a minimum share capital is the limited liability company, which must have a minimum authorised share capital of EUR1,164.69.

5.5 Applicable Governance Requirements

Limited Liability Companies

A limited liability company must be registered with the Registrar of Companies and must have

a Memorandum and Articles of Association, which lay down the company's purpose, its share capital and internal rules. It must have at least one director responsible for the company's management and must act in the company's best interests in accordance with the Companies Act, Chapter 386 of the Laws of Malta.

An LLC must have at least one shareholder who owns the company's share capital. It must hold an annual general meeting (AGM) once a year where the company's shareholders are able to receive and approve the company's financial statements and appoint directors to their position. Shareholders shall also have the right to vote on other important matters.

The company is required to maintain proper accounting records and prepare financial statements. These must be audited unless the company benefits from the applicable exemption. The company must register its annual return with the Registrar of Companies, providing the Registrar with updated information on its directors, shareholders and share capital.

Commercial Partnerships

It is essential for a partnership to be registered with the Registrar of Companies, which registration must include the names and addresses of the partners, their partnership agreement and the share capital of the partnership. Such partnership agreement must outline the terms and conditions, including the rights and duties of the respective partners, the purpose of the partnership and the share of profits and losses amongst the partners.

Trusts

A trust requires a trust deed that sets out the terms and conditions of the trust, including the purpose of the trust, its beneficiaries, and the duties and powers of the trustee. A person or a company must be appointed to act in the position of a trustee. A trustee is bound by a fiduciary duty to act in the best interests of the beneficiary by exercising the care, skill and diligence required in the management of the trust property and shall comply with the terms set out in the trust deed and applicable provisions, particularly those contained in the Civil Code, Chapter 16 of the Laws of Malta.

The trust must have beneficiaries who are identified and have a vested interest in the trust property being administered. It is important that the trust property is kept distinct from the personal assets of the trustee. In fulfilling his duties, the trustee must keep proper accounting records and prepare annual financial statements.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual maintenance costs and accounting compliance costs depend on various factors such as the type and value of assets that are held by the entity, and the type of activities the entity is involved in.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The Maltese Civil Code regulates different types of institutes that would allow a person to use a property, or a part thereof, without obtaining full ownership. The main ones are as follows:

- lease;
- emphyteusis;
- usufruct;
- servitudes;

- easements;
- use; and
- commodatum.

Details of these rights are outlined at **2.1 Categories of Property Rights**.

6.2 Types of Commercial Leases

Maltese law provides that any property which is not used for residential purposes can be identified as commercial property and therefore shall be subject to a commercial lease. This therefore includes properties utilised as a store, properties used for the sale of art or trade, or, simply, a property from which a business can be carried out. It should be noted that, by way of an exception, a property leased to a musical, philanthropic, sporting or political party, and which is utilised as a club, is not deemed to be a commercial property, even where such property generates business.

Apart from the above, the law only distinguishes between those commercial leases entered into pre-1995 and those entered into post-2010: this is to determine the amount of rent payable by the tenant. In terms of any other commercial leases that may be entered into following 2010, the law does not differentiate between different types of commercial leases.

6.3 Regulation of Rents or Lease Terms

Commercial lease terms are freely negotiable and are regulated by the applicable provisions regulating leases within the Civil Code. Currently, there is no ongoing regulation of lease terms that has been enacted due to the coronavirus pandemic.

6.4 Typical Terms of a Lease

The typical terms found in commercial lease agreements depend on various factors related to the property subject to the lease, particularly the type of property, the intended purpose of the property and especially the sector in which the lessee operates, amongst other factors.

6.5 Rent Variation

The variation of rent throughout the period of the commercial lease is determined between the parties during negotiations of the lease agreement. This is not regulated by law unless the commercial lease in question refers to one entered into pre-1995 and is considered as a protected lease until the year 2028.

6.6 Determination of New Rent

Any change or increase in the rent payable must be agreed between the parties and included within the lease agreement unless the parties are open to entering into an addendum to the lease agreement. In any case, such change or increase is not regulated by law.

6.7 Payment of VAT

The VAT payable on rent for commercial leases is 18%.

6.8 Costs Payable by a Tenant at the Start of a Lease

It is normal practice for the parties to a lease agreement to agree to payment of a deposit by the lessee and also the requirement of an adequate insurance policy, which will cover damage that may be caused to the property during the course of the lease.

6.9 Payment of Maintenance and Repair

Expenses relating to the maintenance and repair of areas within the property are shared amongst co-tenants. Each tenant has the right to compel others to pay for the proper upkeep of the property and the necessary preservation thereof.

6.10 Payment of Utilities and Telecommunications

Expenses relating to utilities and telecommunications serving the property are to be shared between the different tenants of the property, in the same manner as maintenance expenses.

6.11 Insurance Issues

The payment of an insurance policy depends on the agreement entered between the parties. This matter is not regulated by any legal provision but rather is determined freely and contractually as to who shall bear the burden of paying the insurance. The Private Residential Leases Act, Chapter 604, does acknowledge that the clauses within a lease contract may impose the payment of insurance on the contents of the tenement. However, it states that any other clauses included within such agreement requiring additional payment other than rent, the deposit, insurance and other ancillary contributions shall not have effect.

The possibility of tenants recovering rent payments due to business interruption during the pandemic greatly depended on their insurance policy and whether such situation of force majeure was covered by the policy.

6.12 Restrictions on the Use of Real Estate

The landlord can choose to impose restrictions on the tenant's use of property as it deems necessary, provided that it is regulated within the lease agreement. In any lease agreement, the permitted use of the property leased has to be included within a specific clause to that effect and regulated in accordance with the applicable legal provisions imposed on real estate that determine the use of property in line with its location.

The Civil Code provides that, should the lessee use the property leased for any purpose other than that agreed upon by the parties, or as presumed according to circumstances where such purpose has not been specifically stated in the contract, or in any manner that may prejudice the lessor, the lessor may demand the dissolution of the lease agreement.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant is bound to make use of the property as a bonus paterfamilias and to restore the property to the condition in which it was received. The tenant has the right to alter or improve the real estate by carrying out all necessary repairs other than those considered as structural repairs. In doing so, the tenant must ensure that all works carried out are done in accordance with good workmanship; otherwise, the landlord shall have the right to refer the matter to the Rent Regulation Board, demanding that all repairs carried out shall be made at the tenant's expense.

It should be highlighted that the lessee may not in any case carry out such alterations during the continuance of the lease without the lessor's consent and shall not be entitled to claim the value of any improvements made without having such consent.

The lessee may choose to remove such improvements, restoring the property to its original condition, provided that, in regard to any improvements existing at the time of the termination of the lease, if the lessee can show that they can obtain some profit from taking them away and provided that the landlord does not want to keep them and pay to the lessee a sum equal to the profit to be obtained by taking them away, the latter would obtain.

The lessee shall also be liable to remediate any damage or deterioration that may have occurred during the lessee's enjoyment of the property, either through their own acts or those of any others residing in the property, unless they can prove that such deterioration or damage occurred without any fault on their part.

It is worth keeping in mind that, although it is the lessor who is bound to make good any urgent repairs that may arise, it shall nevertheless be lawful for the lessee, without the necessity of resorting to any form of proceedings, to carry out such repairs at the lessor's expense and also to retain rent on account of any serious prejudice which may have been caused through the omission or delay of the lessor to carry out such repairs.

6.14 Specific Regulations

The Private Residential Leases Act, Chapter 604 of the Laws of Malta establishes specific provisions on what can and cannot be included within a lease agreement. In fact, there are a number of clauses that dictate this, and if prohibited clauses are included then the lease agreement may be declared null and without effect.

Such restrictions mainly relate to lease duration, payment of expenses, changes and increases in rent payable, and are generally intended to protect the lessee's rights. In respect of leases other than residential leases, the provisions contained within the Civil Code regulate the terms included within lease agreements.

6.15 Effect of the Tenant's Insolvency

If the tenant becomes insolvent, the landlord shall have the right to demand dissolution of the lease agreement.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Parties to a lease agreement normally agree that the lessee is to pay a deposit upon the signing of the lease agreement, to be kept by the landlord and used to cover any extraneous expenses which may arise such as property damage. This, however, provides the landlord with only a limited form of security and therefore the parties can agree to other types of security such as the payment of an insurance policy.

The parties may also agree to security by suretyship provided that the contract of lease shall not extend to obligations resulting from the renewal of the lease, if this is the case, or the continued occupation of the property unless the surety has expressly bound themself for the whole time until the lessee vacates the property subject to the lease.

The amount and form of the security agreed to must, however, fulfil certain requirements, which will depend on the financial situation of the lessee.

In the case of commercial lease agreements, it may very well be the case that the shareholders in a limited liability company offer a personal guarantee other than their assets in the company, given that they would only have limited liability.

6.17 Right to Occupy After Termination or Expiry of a Lease

Unless the parties to a contract have included a clause within the agreement granting the tenant the right to extend its lease, then it must vacate the property immediately at the end of the lease and return possession of the property to the landlord.

6.18 Right to Assign a Leasehold Interest

The tenant's right to assign its leasehold interest is to be agreed to and regulated by the parties within the lease agreement. Such assignment may include either the entire property or a part of it. The law does not restrict the tenant's right to do so unless this is something prohibited by the landlord within the lease agreement.

6.19 Right to Terminate a Lease

A number of events may lead to the dissolution of a lease:

- expiration of the term of the lease agreed to;
- the occurrence of a resolutive condition expressly included within the lease agreement;
- if either of the parties fails to perform their obligations – in any such case, the party who is aggrieved by the non-performance of such obligations shall have the right to demand the other party perform its obligations if this is possible, or to demand dissolution of the contract and payment of damages for non-performance of such obligations; or
- if, during the lease period, the property is totally destroyed due to a fortuitous event, which will lead to the lease being terminated ipso jure.

6.20 Registration Requirements

The Private Residential Leases Act, Chapter 604 of the Laws of Malta requires the lessor to a residential lease to register the lease agreement within ten days from the commencement of the lease. If such registration is made at a later date, the registration shall be subject to an additional administration fee, which, as provided by the Housing Authority, is EUR120. The law stipulates that, where the contract is not registered, the agreement shall be null and void. The lessee does, however, have the option to register the lease contract themself, and this at the lessor's expense. Other forms of lease agreements do not need to be registered in any manner.

6.21 Forced Eviction

If a tenant remains in default of paying rent, the landlord may evict them from the property. The landlord may proceed judicially against the tenant by sending them a judicial letter requesting payment and filing an application to the Rent Regulation Board, demanding that the court orders the tenant's eviction. This process can take months or even longer, especially if there is an ongoing court dispute.

6.22 Termination by a Third Party

Unless the termination rights of a third party are regulated by the lease agreement, the only situation where such a lease agreement may be terminated by a third party would be if the latter is the government of Malta. This may occur if the government determines that the property in question is necessary for a public purpose, subject to certain conditions stipulated under the Government Lands Act, Chapter 573 of the Laws of Malta. The government has the obligation to provide compensation to the property owner; however, it is not similarly obliged to do so in respect of tenants. This process may, however, take several months to finalise.

6.23 Remedies/Damages for Breach

There are currently no limitations on the damages that may be incurred by a tenant acting in breach of or terminating their lease, and this is normally determined by the parties within the lease contract. With respect to security deposits, the parties may agree that the tenant deposit a sum of money at the beginning of the lease, which can be withheld if the tenant fails to perform any of their obligations or acts in breach of

their lease conditions. Alternatively, the parties may agree that rent paid by the tenant is to be paid for a fixed term and prior to the commencement of such term, thereby protecting the landlord against default in payment of rent.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structures used to price construction projects are bills of quantities, where a fixed price will generally be issued to the client beforehand. If there are significant changes to the costs due, which not attributable in any manner to breaches caused by the contractor, the contracts entered into between the parties would normally include a clause that would regulate such price change.

7.2 Assigning Responsibility for the Design and Construction of a Project

Responsibility for the design and construction of the project is normally assigned by means of the contract of works entered by the parties, and this to the extent provided by law. All parties must ensure that the execution of works on a building are in accordance with the best industry practices and standards that also include the respect and protection of the environment and the immediate surroundings, its users and the public in general. Each party shall necessarily bear responsibility for their own work: for instance, in every construction project there shall be a "responsible architect" who will assume responsibility for the execution of the project in its entirety. This, of course, does not exclude the liability of the contractor and the builder.

Currently, new amendments have been introduced by means of Subsidiary legislation 623.06 on the Avoidance of Damage to Third Party Property Regulations requiring that a construction site be covered by a valid insurance policy against any loss, damage, injury or death that may be sustained by third parties consequent to any act or omission done by the construction works undertaken by clients, contractors and any subcontractors or employees engaged. The extent of cover of the insurance policy shall be determined by the insurance contract based on a valid assessment of the risks involved.

7.3 Management of Construction Risk

Warranties, indemnifications, limitations of liability and waivers of certain types of damages may all be used as tools to manage construction risk on a project, to the extent permitted by law. As explained in **7.2. Assigning Responsibility for the Design and Construction of a Project**, construction projects have to be covered by a valid insurance policy whereby such policy is required to cover a third-party liability limit of not less than EUR750,000 for any loss, damage, injury or death that may be suffered by a third party due to the actions or omissions of the persons involved and responsible for the construction project in question.

7.4 Management of Schedule-Related Risk

Contractual parties for the construction of works may choose to include a clause granting the owner monetary compensation should works not be completed by a stipulated date. Such compensation may take the form of daily penalties which are imposed on the contractor once works have not been completed at a predetermined date.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for owners to seek personal guarantees and performance bonds as a form of guarantee for the contractor's performance of the works on a construction project.

7.6 Liens or Encumbrances in the Event of Non-payment

The Civil Code, Chapter 16 of the Laws of Malta provides that architects, contractors, masons and other workmen are deemed to have a privileged credit for the debt that is due to them in respect of the works and expenses furnished by them. This privilege extends over the property that has been constructed or repairs and must be registered for it to have effect. The privilege can be reduced or totally cancelled by means of a public deed, provided that the creditor has given their consent, or otherwise by means of a judgment delivered by the competent court.

7.7 Requirements Before Use or Inhabitation

On completion of the construction works, the client (ie, the person for whom the works have been carried out) shall submit to the Chief Executive Officer of the Building and Construction Authority, within two weeks from the completion of the works, a certificate of completion of the construction works as approved by the responsible architect. The certificate shall then be published on the Authority's website by the Chief Executive Officer, and the responsible architect shall have two weeks to notify all the owners and occupiers of the properties, for which a condition report on the property shall have been drawn up and submitted together with the details of the certificate regarding the project completion.

8. Tax

8.1 VAT and Sales Tax

Malta is accorded a derogation in terms of Article 387 of the EU Sixth Recast VAT Directive (VAT Directive 2006/112/EC) to continue to exempt, the supply before first occupation of a building, or parts thereof, or of the land on which it stands and the supply of building land. This is transposed in item 1(2), Part 2 of the Fifth Schedule to the VAT Act (Chapter 406 of the Laws of Malta). Therefore, a transfer of immovable property in Malta is in principle either outside the scope of VAT or exempt without credit, according to the specific circumstances.

8.2 Mitigation of Tax Liability

The acquisition of immovable property situated in Malta would be subject to stamp duty in Malta in terms of the Duty on Documents and Transfers Act. In principle, a provisional duty is levied at 1% by the notary on the promise of sale contract. The final levy of stamp duty is then levied by the notary on the transfer deed, with the default rate being 5%.

The government of Malta does provide for special schemes for the mitigation of stamp duty on the acquisition of immovable property, including special rebates for purchases in urban conservation areas or vacant buildings. This is only to the extent that such an acquisition by the foreign investor would not require an AIP permit. The requirement of this special permit in Malta for non-residents needs to be evaluated in terms of the specific circumstances of each individual case.

8.3 Municipal Taxes

Malta does not have municipal taxes and only levies direct and indirect taxation at a national level.

8.4 Income Tax Withholding for Foreign Investors

A foreign tax-resident lessor accruing or deriving rental income on immovable property situated in Malta can for the most part elect to be subject to either:

- a final withholding tax of 15% on the gross rental income in terms of Article 31D of the Income Tax Act; or
- the default tax provisions (Article 4 of the Income Tax Act) on the net rental income in terms of the applicable progressive rates for individuals or the statutory corporate income tax which is currently fixed at 35%.

In terms of the final withholding tax regime, there are no exemptions. However, the law does allow abatements for long residential leases. Similarly, in terms of the default regime, there are certain allowances (eg, maintenance allowance).

A foreign tax-resident alienator accruing or deriving income from the alienation of immovable property situated in Malta, not being a project, can elect to be subject to either of the following:

- property transfer tax (namely a final withholding tax) on the gross proceeds in terms of Article 5A of the Income Tax Act; or
- in terms of the default capital gains provisions (Article 5 of the Income Tax Act) on the net proceeds.

On the one hand, property transfer tax is levied by the notary on the deed of transfer. The default tax rate for the property transfer tax is 8% but special rates, limited deductions and exemptions may apply.

On the other hand, unless exempted, in terms of the capital gains tax regime, a 7% non-refundable provisional tax is levied on the gross proceeds by the notary on the deed of transfer. Thereafter, in the year of assessment, tax on the capital gains is levied in terms of the applicable progressive rates for individuals or the statutory corporate income tax which is currently fixed at 35%. This tax on capital gains allows for a wider set of tax deductions, which are stipulated in the law.

A foreign investor must evaluate which tax regime would be the most beneficial according to the specific circumstances, keeping in mind that turnover taxes (eg, property transfer tax) might limit the right for a double tax relief in their residence jurisdiction.

8.5 Tax Benefits

The ownership of immovable property may result in a higher effective tax leakage in certain circumstances and therefore each case needs to be seen within its proper context. However, Malta does not levy capital taxes and ownership of immovable property is encouraged. Subject to certain limitations, Malta does allow for capital allowances deductions for an industrial building or structure against trading income which is being produced through that qualifying industrial building or structure. This may be subject to balancing adjustments once such an immovable property is disposed of.

MEXICO



Law and Practice

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Cannizzo was established more than 40 years ago and is one of the pioneers in large-scale real estate developments (projects that include different real estate components, such as golf courses, residential, commercial, hospitality and marinas). The firm has participated in many large-scale development projects, including marinas in Puerto Peñasco, Guaymas, Mazatlán, Puerto Vallarta, Cancun, Ixtapa and Los Cabos, which are the largest projects in those areas. It was active in the acquisition, structuring and development of projects such as Bosque Real, Puerto Cancun, Playacar and Mayakoba. Cannizzo has participated in real estate transactions involving hospitality brands in Mexico, including Barceló, JW Marriott, Sheraton, Hyatt, Auberge, Fiesta Americana, Four Seasons, Fairmont and Hilton. In the industrial sector, Cannizzo has participated in several industrial acquisitions by Pirelli and Macquarie. In the retail and entertainment sector, the firm has provided advisory services to Cinemex in relation to 40 theatres, and more than ten shopping centres nationwide, as well as luxury brands, including Ermenegildo Zegna, Salvatore Ferragamo, Cartier and Lacoste.

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1. General

1.1 Main Sources of Law

Mexico comprises 31 states and Mexico City. The Federal Constitution outlines the matters in which the Federal Congress is authorised to approve laws. Matters not expressly delegated to the Congress are considered reserved for each state. Consequently, the laws governing real estate and property ownership vary depending on the jurisdiction in which the property is located.

In corporate combinations (ie, mergers, purchase of shares) or trusts, typically the General Law of Commercial Companies, the Commercial Code and, in some cases, the Stock Market Law are applicable. Parties are free to choose the court with subject-matter jurisdiction, provided certain requirements are met. The main laws applicable to real estate transactions, depending on the value and nature of the transaction, are as follows:

- the Federal Constitution;
- Civil Code and tax laws of the state where the real estate is located;
- Agrarian Law;
- Income Tax Law;
- VAT Law;
- Foreign Investment Law;
- General Law of Commercial Companies;
- Stock Market Law;
- General Law of Ecological Balance and Environmental Protection;
- General Law of Securities and Credit Transactions;
- Federal Antitrust Law; and
- federal, state and municipal zoning and planning provisions.

1.2 Main Market Trends and Deals

Over the past 12 months, the real estate market in Mexico has been affected by the strong peso currency, rising inflation, and increased interest rates, causing a slowdown in many real estate transactions, including leasing, commercial and office space acquisition, mortgage transactions, and the construction industry.

On the other hand, residential and industrial real estate acquisitions and rentals experienced significant growth. According to reports from market participants, despite rising prices, the real estate sector is considered a safe investment opportunity to protect capital. Experts predict growth in Mexico's real estate sector this year, with industrial and tourism markets expanding the fastest.

Rising inflation worldwide and in Mexico has led central banks to increase interest rates, potentially impacting transaction volume and values for businesses.

Many companies have permanently adopted remote work or hybrid models. The recent amendment to the Federal Labour Law, which addresses remote work, highlights that the pandemic has led to lasting changes in office space usage and the residential real estate market, with an increasing number of workers now working from home.

The activities of authorities involved in real estate transactions, such as treasury offices, public registries and municipal offices, have returned to pre-pandemic levels. Some have permanently implemented digital processes for specific procedures that used to necessitate in-person filing of documents and applications.

The past year has seen significant deals involving the reconfiguration of industrial spaces due to "Nearshoring" becoming a trend, with a number of international businesses relocating operations to Mexico for improved supply chain control and proximity to the US market. Nearshoring generated approximately USD36 billion in Mexico in 2024. The Mexican Association of Private Industrial Parks (AMPIP) estimates the arrival of at least 450 foreign companies to Mexico between 2024 and 2025. AMPIP estimates that industrial space vacancies account for less than 1% of the total inventory. In 2023, Mexico Pacific Limited announced plans to invest USD14 billion in Sonora, for the development of a gas pipeline and liquefaction facility. Moreover, Tesla has announced the development of a USD5 billion "Gigafactory", a large battery-production facility, to be built near the city of Monterrey by 2026.

Impact of Disruptive Technologies

New technologies have impacted the real estate industry in Mexico. Investors in the sector have found new ways to invest, using blockchain technology, decentralised finance (DeFi) and proptech. These advancements have facilitated the expansion of acquisition portfolios, creation of marketplaces for fractional property ownership, and even fragmentation of mortgage debt. Blockchain technology has been embraced by the real estate industry because it brings transparency to transactions, reducing risk and processing time, and could ultimately eliminate unnecessary costs for buyers, such as search and no-liens expenses, notary public fees and registration costs.

Smart contracts and the strengthening of electronic commerce has also influenced the sector. Fintech start-ups involved in the real estate sector have created digital payment solutions, which, among other benefits, reduce the use of paper cheques or cash. Such platforms facilitate smooth and secure transactions, conveniently enabling tenants to make rent payments online and property owners to receive payments electronically.

Lenders have benefited from the implementation of new technologies through risk assessment, algorithmic processes and data analysis. In the construction and development sector, contech has introduced collaborative software, improved financial management and reduced construction costs, making processes more efficient.

Moreover, the Law to Regulate Financial Technology Institutions provides a legal framework for new technologies, and the Mexican National Banking and Securities Commission (CNBV) grants authorisations to operate, so an increase in technology companies entering the market, including the real estate sector, is anticipated.

However, significant changes to business practices in the sector due to these technologies are unlikely within the next 12 months. The legal requirements of the Mexican civil law system necessitate notary public involvement and filings to transfer property titles and record mortgages, resulting in a formal and strict procedure for obtaining property title deeds under Mexican regulations.

1.3 Proposals for Reform

In March 2022, NOM-247-SE-2022, an Official Mexican Standard (*Norma Oficial Mexicana* or NOM) was published with the goal of protecting potential buyers from abusive market practices. NOMs are mandatory technical regulations. This particular regulation regulates buyer rights, seller obligations, guidelines for real estate advertising, and extended warranties against structural failures, among other aspects, in order to eliminate

informality and irregularities in property transactions. The provisions within the regulation are mandatory for suppliers such as builders, developers, and intermediaries involved in advising or selling real estate. It is also applicable to any individual or legal entity engaged in marketing residential property to the general public.

Further, the regulation outlines obligations for sellers concerning warranties. Coverage must be no less than five years for structural failures, three years for water leakage issues, and at least one year for all other problems. During the warranty period, defects must be repaired at the supplier's expense, and the supplier must provide documentation detailing how the warranty will be fulfilled.

2. Sale and Purchase

2.1 Categories of Property Rights

Mexican Civil Codes provide for several categories of property rights: full ownership, usufruct (the real and temporary right to enjoy the property of others, which includes the right to receive all the fruits/benefits, whether natural, industrial or civil, produced by the property) and other minor rights, such as use or certain easements. In infrastructure projects, rights of way or other types of easements are used for the construction of roads, gas and oil pipelines.

Another type of property is "Ejido property", which accounts for over 50% of the land in Mexico. Ejido property is a landholding in Mexico that is owned collectively by a community and is typically used for agriculture or other similar purposes. It is subject to a special regime, regulated by Article 27 of the Constitution and the Agrarian Law.

2.2 Laws Applicable to Transfer of Title

The law applicable to transfer of title, if the transfer is considered a commercial act by the Commercial Code, is the Civil Code of the relevant state where the real estate is located. If at least one of the parties is a merchant (including real estate for industrial purposes, offices, retail and hotels), the applicable law would be the Commercial Code and the Civil Code of the relevant state where the real estate is located.

In combinations involving corporations (ie, mergers, the purchase of shares) or trusts, the Commercial Code, General Law of Commercial Companies, the Stock Market Law and the General Law of Securities and Credit Transactions will apply.

For the transfer of title to Ejido property, the applicable law is the Agrarian Law.

2.3 Effecting Lawful and Proper Transfer of Title

In Mexico, the legal methods for acquiring property are usucapion, accession, succession by reason of death and by transfer, whether onerous (such as a sale and purchase agreement) or gratuitous (such as a donation agreement). The most common way to acquire property is by entering one of the following agreements:

- a purchase agreement, as defined in Article 2248 of the Civil Code for Mexico City, whereby one party agrees to transfer ownership of goods or a right, and the other party agrees to pay a specific price for it;
- a trust agreement, as defined in Article 381 of the General Law of Securities and Credit Transactions, whereby a trustor, by virtue of a trust, transfers the ownership of one or more goods or rights to a trust institution (trustee) for lawful and specified purposes, with the

trust institution responsible for realising those purposes; in an administration trust, the trustee maintains ownership of the goods or right, and the beneficiary is considered the holder of the trust rights; and
- corporate combinations (mergers or purchase of shares).

All transfers of title of real estate in Mexico are formalised before a notary public or judge, registered in the Public Registry of Property (RPP) of the state where the real estate is located or in case of agrarian property in the corresponding agrarian registry.

Protection of bad title is usually included in the purchase agreement as an indemnity in case of eviction. Although title insurance is available in Mexico, it is uncommon, as is insurance to cover contractual liability resulting from breaches of the seller's representations and warranties in an acquisition agreement. Instead, indemnity is often supported by an escrow holdback, a price adjustment, or a combination of both.

While the COVID-19 pandemic has not led to new processes or procedures for completing real estate transactions due to the Mexican civil law legal system's requirements for a notary public and specific filings, it has significantly increased the digital execution of private documents.

2.4 Real Estate Due Diligence

Buyers usually carry out real estate due diligence through their legal advisers. The matters typically involved in real estate due diligence are as follows.

- Ownership – to be performed by the attorneys. Encumbrances on the real estate (including liens and some litigation aspects) may be identified through the request of a real estate background folio, from the RPP. Payment of real estate taxes and utilities for the past five years, which, generally, is the applicable statute of limitations for tax payments, are also requested. In certain cases, searches are conducted to determine the existence of agrarian issues, mainly by reviewing the title chain and determining if the process to have the property become private property were completed. In the case of agrarian properties, there are other aspects to be reviewed, such as the records of the property in the Agrarian Registry.
- Corporate – to be performed by the attorneys. Liens on the company through the request of a commercial folio from the Public Registry of Commerce of the area where the company is located.
- Agreements – to be performed by the attorneys. The scope of the review of agreements in the context of a real estate business combination (ie, merger, purchase of shares) varies depending on the structure of the transaction.
- Assuming the transaction is the direct purchase of real estate, the review should cover at least:
  (a) the last sale-purchase agreement that transferred the property of the real estate and the chain of title;
  (b) any agreement that may affect the property, such as leases, commodatum, usufruct and easements;
  (c) federal zone concessions; credit agreements, if the real estate is subject to a mortgage, trust or any encumbrance on the property;
  (d) agreements regarding services, maintenance, repair or supply of assets or utilities;
  (e) franchise agreements;
  (f) insurance policies; and

(g) management, licensing and operation agreements.

- Environmental – to be performed by the attorneys and environmental specialists for phases I and II, and authorisations reviews.
- Tax matters – to be performed by the tax advisers.
- Disputes – to be performed by the attorneys.
- Surveys, usually under American Land Title Association standards – to be performed by professional surveyors, ALTA surveys, zoning confirmations, analysis to determine if the real estate is in an archaeological zone or historical monument, etc.

2.5 Typical Representations and Warranties

The most common representations and warranties agreed in sale and purchase agreements typically involve the seller's faculties, legitimate ownership of the real estate, absence of liens or limitations affecting the real estate (including archaeological limitations or easements), no outstanding payments (including taxes), no land use issues, existence of permits, and no agrarian issues. In relation to the environmental representations, these often pertain to the existence of certain permits or licences as well as the absence of any contamination, which is frequently qualified by the seller's knowledge. This is one of the reasons why a phase I is required, and, depending on the asset or the results of the other studies, a phase II study may also be required.

COVID-19 pandemic representations and warranties, even if not required in all cases, relate to running businesses such as hotel/office buildings and include the non-existence of health situations, claims, procedures by the authorities, and the existence of sufficient insurance coverage, mainly business interruption.

In transactions involving corporate combinations, such as mergers or share purchases, typical M&A representations and warranties are included. It is important to mention that, in some cases, where transactions are structured as an asset acquisition (real and movable property, assignment of permits and licences), there is a risk that some authorities may treat the transaction as a business acquisition. In such cases, the seller's obligations, such as tax or labour-related liabilities, may carry forward to the acquiring entity if the seller has breached their obligations with relevant authorities, like tax authorities.

In real estate transactions, there are certain statute indemnification provisions that arise from the law, where the seller shall guarantee the qualities of the thing sold and respond in case of eviction, meaning the seller is liable to the buyer if the purchased property is taken away from the buyer by a third party claiming to have a prior and preferential right of ownership over the purchased property.

To protect against seller misrepresentation, purchase agreements often include indemnities and/or provisions for payment of damages. Similar to common law jurisdictions, a variety of negotiated provisions address remedies and misrepresentations (such as maximum cap, survival period, basket, joint liability, anti-sandbagging clauses, etc). Typically, indemnities are supported by an escrow account or other types of holdback arrangements, or by joint liability of parent companies. While representations and warranties insurance is available in Mexico, it is not commonly used in transactions.

2.6 Important Areas of Law for Investors

The main areas of law to which an investor must pay attention when acquiring real estate are tax aspects (mainly determined by the Federal Tax

Code, the Income Tax Law and local real estate acquisition provisions), environmental aspects, urban development and construction limitations, and limitations imposed on the use of the real estate: eg, in terms of leasing, especially for residential purposes, limitations that may result depending on where the real estate is located (eg, federal zone residential restrictions). It is important for the investor to understand that there are specific laws which apply to the "Ejido Properties".

2.7 Soil Pollution or Environmental Contamination

Although it is common practice to include provisions in agreements that hold the seller responsible for environmental liability, the buyer may also bear responsibility before the environmental authority for the environmental condition of the land and its remediation.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In terms of the provisions of the Constitution, the municipalities in Mexico are the entities authorised to regulate zoning and planning matters following guidelines set forth by the Federal Congress and the states. Thus, to determine the land use of specific real estate, it is necessary to analyse the applicable laws (zoning and planning). At the state level, the applicable provisions might be found in the State Partial Development Plans; and, at the municipal level, in the Municipal Development Plans, the Urban Development Plans that determine the main land use of the urban centres, and, sometimes, the Detailed Plans. To confirm the land use of a given real property, the purchaser must review the land use zoning certificate and licence issued by the competent authority.

In environmental matters, at the federal level there are General Ecological Plans that regulate the use of land to protect the environment and promote sustainable development, while State Ecological Partial Plans and sector- specific programmes address agricultural, territorial and urban development issues, as well as matters related to protected natural areas. Additionally, ecological reserves are established to protect specific flora and fauna, imposing limitations on human activities within these areas.

Although it is not common to enter into specific development agreements with the relevant public authorities to facilitate a project, it can occur if the authority is interested in a specific project due to its size or impact on urban development. In practice, this has been seen in the case of large-scale developments that may include marinas, golf courses, residential, hospitality, commercial, hospitals, etc.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation Law

Possible reasons

The Mexican government is authorised at the federal and local levels to expropriate the property of individuals for public utility purposes. Causes of public utility include:

- establishment, operation or conservation of a public service;
- opening, expansion, construction or alignment of streets, roads, bridges, paths and tunnels to facilitate urban and suburban traffic;
- beautification, expansion and sanitation of towns and ports;
- construction of hospitals, schools, parks, gardens, sports fields or airfields; and

- construction of public infrastructure and services.

The Procedure

The expropriation procedure begins with a declaration of public utility by the authority published in the Federal Official Gazette and, where appropriate, in a local newspaper, and the owners of the property and rights to be affected will be personally notified to respect their right to due process. If applicable, after the process of filing evidence and allegations, the judge will issue the corresponding resolution and, subsequently, the Federal Executive will decree the relevant expropriation that will be published again in the Federal Official Gazette. The relevant decree, together with the appraisal in which the amount of the compensation will be fixed, will be notified to the interested parties, who may then go to court. The price fixed as compensation must be equal to the commercial value of the property, and in no circumstances may it be less than the fiscal value shown in the cadastral offices. Once decreed, the authority is authorised to occupy the property.

The applicable law (ie, the Expropriation Law) provides for the existence of temporary occupation, total or partial, and the simple limitation of ownership rights, which may be decreed for reasons of public utility.

National Law on Ownership Extinction

The National Law on Ownership Extinction governs the process of extinguishing property ownership in favour of the state, either through the federal government or the states, as applicable. According to the law, property can be subject to ownership extinction if it is the product, instrument or material object of certain specified crimes. These crimes include:

- offences under the Federal Law against Organised Crime;
- kidnapping;
- crimes involving hydrocarbons, oil and petrochemicals;
- crimes against health;
- human trafficking;
- corruption;
- concealment;
- crimes committed by public servants;
- vehicle theft;
- extortion; and
- offences outlined in the Federal Criminal Code relating to transactions involving resources of illicit origin.

2.10 Taxes Applicable to a Transaction

If real estate is acquired through a direct purchase of assets, different taxes and rights must be paid, namely:

- Property Acquisition Tax, which is paid by the purchaser and varies depending on the state where the property is located – it is usually between 2% and 6%;
- VAT on the value of the construction (unless it is a residence or lot), paid by the purchaser at a 16% rate; and
- income tax, paid by the seller and calculated on the net gains from the sale of the property.

Certain deductions are available (ie, acquisition cost, construction, improvements and extensions, notary expenses and commissions).

Finally, there are registration fees that the purchaser pays to the RPP and for obtaining certificates (no liens certificates, no tax debts certificate, etc).

When the seller is an individual or foreign tax resident, taxes are withheld by the notary public who formalises the transaction.

If a purchase is performed through share acquisition, only income tax will be generated.

2.11 Legal Restrictions on Foreign Investors

In principle, foreigners can acquire real estate in Mexico, with the exception of properties located within the restricted zone (100 km-wide strip along the border or 50 km-wide strip inland from the beaches). However, foreigners may participate with 100% of the equity of corporations, including in the restricted zone, provided the property will not be used for residential purposes.

A foreigner can own property located in the restricted zone through a trust, by holding beneficiary rights, which will grant to the beneficiary practically all the benefits of an owner.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are generally financed by a loan facility whose terms and conditions will depend on the creditworthiness of the borrower and the collateral available.

There are different financing options for the acquisition of large real estate portfolios or companies holding real estate. In addition to a loan facility with collateral (mortgage, pledge, etc), other options include acquiring the seller's debts or swapping shares, depending on the transaction and the parties involved.

3.2 Typical Security Created by Commercial Investors

A commercial real estate investor who is borrowing funds typically creates the securities requested by lenders. Lenders usually request mortgages, trusts, shares pledges, furniture, fixtures and equipment pledges (FF&E pledges), cash deposits, etc.

Lock boxes, trusts or other forms of cash control may also be requested by the lender. Depending on the nature and function of the real estate, the borrower may create reserves for maintenance, insurance and improvements.

The most common equity financing provisions include the following:

- equity financing – the amount of investment versus the participation percentage of the company's equity;
- access to the books and records;
- reporting and covenants;
- expected return for equity;
- the right to appoint directors; and
- investment restrictions, limiting the use of invested funds to certain projects or purposes.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting securities over real estate to foreign lenders or on repayments to foreign lenders under loan or security agreements. However, taxes may be withheld from the interest paid, which in some cases depends on the tax residence of the lender and whether there is a double taxation treaty with the lender's country of residence.

The acquisition of real estate by foreign lenders as result of a mortgage foreclosure could be

subject to restrictions based on its location and use.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The granting of security over real estate does not trigger taxes. However, notary public fees and registration fees to the RPP should be paid, and in certain locations, such as Cancun, the payment of a transfer tax (ISABI) is mandatory. Notary public fees and registration fees usually vary from state to state, depending on the amount secured. Enforcing a real estate security results in the same taxes as acquiring the property (see **2.10 Taxes Applicable to a Transaction**).

It is important to consider that in some cases, depending on the lender, where there is a foreclosure procedure, particularly when collateral is owned by a private individual, the lender may end up having to pay the borrower's taxes (income tax and/or VAT on constructions) arising from the transfer of the property as part of the foreclosure procedure. The notary public is responsible for withholding these taxes.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no special legal rules or requirements the entity must comply with to grant a valid security, other than complying with the regulations included in its by-laws, to avoid ultra vires acts.

3.6 Formalities When a Borrower Is in Default

In typical real estate transactions, collateral is structured through mortgages or security trusts. If a borrower defaults, the lender must initiate a foreclosure legal procedure in the case of a mortgage. For securities granted through trusts, the process follows the rules set forth in the relevant trust agreement, with the trustee usually acting as the executor.

When other creditors of the borrower have security interests in the same asset, priority is generally established in the document through which the security was granted. In such cases, the judge will order the notification of other creditors about the existence of the lawsuit or procedure, allowing them to participate in the process.

Under Mexican law, in situations where the borrower has other creditors, the mortgagee or trustee has priority over other creditors when it comes to collecting from the secured asset.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt by agreement of the parties involved. There are certain legal obligations which have preference in relation to pending debt or securities, such as tax and labour credits, under certain circumstances and with limitations.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing a real estate security is not liable under environmental laws for any pollution of the real estate if it did not cause it. In terms of the Federal Environmental Liability Law, the individual or legal entity which, through its action or omission, directly or indirectly damages the environment, is liable and must repair the damage, or, where repair is not possible, shall be liable for environmental compensation.

3.9 Effects of a Borrower Becoming Insolvent

Under Mexican law, a borrower's security interests in favour of a lender cannot be deemed

invalid solely due to the borrower's insolvency. However, if a borrower's grant of security affects their creditors and leads to the borrower's insolvency, the creditors may request that the security be declared void, as long as their claim precedes the grant.

3.10 Taxes on Loans

In Mexico, when participating in real estate transactions, lenders and borrowers must take into account the payment of recording fees or similar charges in connection with mortgage loans. These charges typically involve fees associated with registering mortgage deeds or other relevant documents with the RPP. The recording taxes or fees in the RPP are generally imposed at the state level and can vary from one state to another. Additionally, there may be fees charged by notaries, and these are typically calculated based on the value of the mortgage or the amount being financed through the loan. In practice, it is borrowers who usually absorb the aforementioned fees in relation to mortgage or mezzanine loans, though this may vary depending on the transaction and the agreement between the parties.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

In Mexico, municipalities are the entities authorised to regulate planning and zoning matters, following certain guidelines established by the Federal Congress and the states. At state level, the applicable provisions are in the State Partial Development Plans, and, at the municipal level, in the Municipal Development Plans and the Urban Development Plans. In addition, see the environmental provisions in **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

For legislative and government controls typically applicable to the design, appearance and method of construction of new buildings or refurbishment of existing buildings, see **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law** and construction regulations. In addition, various aspects, modalities and limitations regarding the construction and refurbishing of existing properties are usually included in the provisions that regulate condominiums, which are regulated by local laws.

4.3 Regulatory Authorities

In relation to the regulation of the development and designated use of individual parcels of real estate, see **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**.

The most common requirements set forth by plans involve the protection of natural resources, proper implementation of services, and integration with the surrounding environment. Additionally, these plans often impose legal restrictions, such as the prohibition of urbanisation in certain areas, the requirement to leave specific areas free of construction, and restricted areas due to the presence of railway facilities, drinking water systems, drainage, electricity, telecommunications and roads.

The authority responsible for oversight typically depends on the jurisdiction; municipal or state authorities are usually involved. However, for certain projects, particularly those in coastal areas or involving archaeological sites or historical monuments, federal authorities may also be

required to participate. Examples of such federal authorities include the Ministry of the Environment and Natural Resources (SEMARNAT) and the National Institute of Anthropology and History (INAH).

4.4 Obtaining Entitlements to Develop a New Project

Local Licences and Permits

In order to be legally entitled to develop a new project and carry out a major refurbishment, it is necessary to obtain, at a local level, a construction licence to be able to build, extend, modify, repair, install, demolish and dismantle a work or installation. Also, in certain cases, building permits for historical monuments and archaeological zones are required. In the case of Mexico City, due to water supply shortages, water feasibility documents issued by the government are sometimes required.

Third-Party Objections and Approval

Considering that the regulation of construction matters is the responsibility of each state, it is necessary to analyse local construction regulations to determine the rights of third parties to object to construction projects. In certain projects, an Environmental Impact Authorisation is required, involving third parties and, in some cases, neighbours, or a public consultation procedure is initiated. Finally, third parties can file appeals against the issuance of construction licences.

In the case of environmentally sensitive infrastructure projects, which may include pipelines, the community may be part of the process through a public consultation.

4.5 Right of Appeal Against an Authority's Decision

An appeal for review is available against a refusal to grant a construction licence for any type of work, or other decisions arising from construction regulations. Likewise, nullity and amparo proceedings may be initiated. Depending on the authority, it is also common for other procedures to be initiated, in the event that a new project is not approved.

4.6 Agreements With Local or Governmental Authorities

Agreements with the authorities or with utility suppliers are usually required in the following areas:

- the provision of public services such as electricity, drinking water and sewerage;
- the development of destination areas for infrastructure, urban equipment, green areas and roads for real estate developments; and
- concessions (such as ZOFEMAT (Federal Maritime Terrestrial Zone) and port authorisations).

In some cases, where the projects have certain density or requirements, the developer might enter into agreements with the authorities to build certain infrastructure, which may include treatment plants, roads, energy infrastructure, etc, and then have the said infrastructure assigned to the municipality or to the energy company (CFE).

4.7 Enforcement of Restrictions on Development and Designated Use

Failure to comply with the restrictions on development and designated use are sanctioned by each state or municipality depending on the location of the real estate and on the relevant violation. Sanctions usually include the tempo-

rary suspension of the project, cancellation of the authorisations granted, closure of the project, fines and arrest for up to 36 hours.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The most common vehicles for acquiring real estate in Mexico are commercial companies and the most frequently used are the stock company (*sociedad anónima*) and the limited liability company or LLC (*sociedad de responsabilidad limitada*), both of variable capital, and trusts. These are the most widely used forms because they have perfect patrimonial autonomy.

The Stock Company

The stock company is composed of shareholders whose liabilities are limited to the amount of their contributions. Its capital is represented by negotiable certificates, and it is the only form of corporation whose shares may be traded on the stock exchange.

The LLC

The LLC is composed of partners whose liabilities are limited to the amount of their contributions. For the transfer of equity and the admission of new partners, the consent of the partners representing the majority of the capital stock is necessary. LLCs are often used by US residents because they can be treated as transparent entities for US tax purposes.

The Trust

In the case of a trust, the property is owned by the trustee who is a regulated financial institution. Trusts are commonly used, since in many cases it is easier to determine the various obligations of the trustors and beneficiaries, vis-à-vis shareholders'/partner's agreements, such as contributions by each trustor, reversion of the property if certain conditions are not met, etc.

The FIBRA

Another vehicle widely used to acquire real estate is FIBRA (*Fideicomisos de Infraestructura y Bienes Raíces*), or REIT. See also **5.3 REITs**.

Other Structures

Other structures currently used for these types of transactions include real estate investment companies (SIBRAs), development capital certificates (CKDs) and investment project fiduciary securitisation certificates (CERPIs).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Mexican companies must be incorporated before a notary public or a commercially authorised person (*corredor público*). All of the constituent shareholders or partners (a minimum of two), or attorneys-in-fact, must be present upon the incorporation of the company. For incorporation, it is necessary to do the following:

- obtain a permit, to use the company's name; indicate domicile, purpose, amount of authorised capital and its division into shares (or equity membership); and
- indicate the internal rules of the company governing:
  - (a) shares (or equity membership), the transfer and issuing of shares;
  - (b) calling, holding, proceedings, quorum and powers of general meeting;
  - (c) appointment, removal, conduct and powers of attorney of the directors or the sole administrator and auditors;
  - (d) payment of dividends; and
  - (e) dissolution and liquidation of the company.

The by-laws containing all the above information may be drafted either by a lawyer or by the same notary public or commercially authorised person (*corredor público*) who will incorporate the company.

FIBRAs

To incorporate a FIBRA, the parties must have at least 70% of their assets invested in real estate, be engaged in the purchase or construction of real estate to be leased, and distribute among the holders at least 95% of the tax result of the previous year.

SIBRAs

SIBRAs operate in a similar manner to FIBRAs; however, they are commercial companies incorporated under Mexican law instead of trusts. As with FIBRAs, real estate developers receive some tax benefits for using a SIBRA as a financing and structuring mechanism for their project.

CKDs

CKDs are securities that are issued through an irrevocable trust. Initial patrimony is formed with the proceeds of the placement and is used to invest in or to finance Mexican companies, either directly or indirectly, through various investment vehicles. CKDs are designed to allow the flow of resources to finance projects that consume resources in the short term and later generate long-term flows.

CERPIs

CERPIs are similar to CKDs; however, only qualified investors can own CERPIs.

5.3 REITs

FIBRAs (REITs) are investment vehicles listed on the Mexican Stock Exchange (BMV) for the acquisition and construction of real estate for leasing. At present, Mexican law solely permits publicly traded FIBRAs. FIBRA assets may comprise a wide range of properties, spanning from industrial facilities such as warehouses and manufacturing sites, to corporate spaces such as offices and work areas, as well as commercial premises including malls, plazas and department stores. Legally, a minimum of 70% of a FIBRA's portfolio must be allocated towards the following:

- real estate assets designated for rental or accommodation purposes;
- procurement of rights which result in rental income; or
- providing financing for the acquisition or development of real estate assets intended for leasing.

The majority of FIBRA certificates are available for issuance, purchase and acquisition by both domestic and foreign investors who hold investment agreements with authorised institutions in Mexico. Trust certificates are offered to the general public through a public offering in the stock market. Holders of trust certificates issued by a FIBRA will be entitled to receive dividends at least once a year for at least 95% of the result of the immediately preceding fiscal year. Such distributions shall be made no later than March 15th of each year. FIBRA is typically used because it is considered a tax pass-through entity and allows for more flexible structuring of real estate combinations than may be achieved through a corporation.

5.4 Minimum Capital Requirement

For a stock company, there is no mandatory minimum capital stock required by law. The initial minimum capital stock is determined by the shareholders upon incorporation.

For an LLC, there is also no mandatory minimum capital required by law. The LLC's capital will be divided into equity memberships, with each membership representing at least MXN1 or a multiple of that amount. However, there is a restriction on the number of partners allowed in an LLC, with a maximum of 50 partners.

5.5 Applicable Governance Requirements

Stock Companies and LLCs

The obligations of a stock company and LLC are imposed on the directors by law and by the company's by-laws. The directors are jointly liable with the company for compliance with legal and statutory requirements as follows:

- in relation to the dividends;
- for the existence and maintenance of the accounting, control, recording, filing or reporting required by law;
- for the fulfilment of the shareholders'/partners' resolutions; and
- for the creation of the reserve fund required by law.

Some other special liabilities are provided by law.

Generally, a company's officers include at least one director (who, in such a case, will act as sole administrator). Furthermore, stock companies must designate one or more statutory auditors; this requirement does not apply to LLCs. Directors or employees of a company cannot be internal auditors for that company.

FIBRAs

FIBRAs must comply with certain corporate governance standards and best practices among shareholders, investors, management and the technical committee, like all companies listed on the Mexican Stock Exchange (BMV).

5.6 Annual Entity Maintenance and Accounting Compliance

In Mexico, there is no annual fee/tax for the simple existence of a company. Since companies are subject to periodic compliance with administrative and tax requirements, the maintenance cost will depend on the nature, complexity, volume and frequency of the transactions and operations carried out.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Mexican civil law recognises four arrangements that allow a person to occupy and use a real property for a limited period, without buying it outright:

- the lease (*arrendamiento*), ie, the agreement through which one of the parties grants to the other party the right to temporarily use or enjoy a property, and the other party agrees to pay a certain price for such use or enjoyment;
- the commodatum or free lease (*comodato*), ie, the agreement through which one of the parties grants to the other party the free use of a property;
- the real right of occupation (*habitación*), which grants to the right-holder the right to freely occupy part of another person's house, for themselves and/or family members; and
- the real right of usufruct (*usufructo*), ie, the real and temporary right to enjoy another person's property and to receive all the fruits,

whether natural, industrial or civil, produced thereby.

6.2 Types of Commercial Leases

Mexican civil law recognises only one type of lease agreement, although specific rules are provided in the federal and state civil codes, depending on the purpose or location of the leased premises.

6.3 Regulation of Rents or Lease Terms

Rentals and lease terms are usually freely negotiable, however, there are certain legal provisions within the regulation provided by the federal and state civil codes that are binding and non-negotiable/waivable since they are considered as public interest provisions. These are usually provisions applicable to residential leases, although certain state civil codes may also provide restrictions to other types of leases, such as maximum duration of the lease (ie, 20 years for commercial leases). It is always recommended to review the set of rules provided by the applicable state civil code.

The government has not yet enacted any legislation directly affecting leases because of the COVID-19 pandemic. However, it should be noted that civil codes already contain legal provisions applicable to the impediment of the use of leased premises, mainly in commercial leases where the leased premises cannot be operated due to a force majeure. For example, Article 2431 of the Federal Civil Code, also applicable to commercial leases, provides that, if, by reason of an Act of God or force majeure, the tenant is completely prevented from using the leased premises, no rent shall be due while the impediment lasts, and if such impediment lasts more than two months, the tenant may request the termination of the agreement. Similar provisions are included in the civil codes of the various states of Mexico.

Furthermore, in some state civil codes, the "unforeseeability theory" is acknowledged, the spirit of which is to seek a balance between the mutual obligations undertaken by the parties in the event that there are extraordinary and unforeseeable national events that make the obligations of one of the parties more onerous. In such a case, the affected party may take action to have the balance between the obligations restored, under certain conditions and circumstances.

6.4 Typical Terms of a Lease

Length

Normally, the length of a lease term is freely negotiable; however, it must be taken into account that civil codes may contain provisions for minimum and maximum terms. For example, the minimum term of a residential lease agreement, pursuant to the Civil Code for Mexico City, is one year for both parties, and may be extended at the tenant's will for up to one more year, under certain circumstances. Lease of real properties destined for commerce and industry, under the same Code, cannot exceed 20 years. Landlords and tenants may freely determine whether a term is binding and may even agree on penalties to be paid if the binding term is breached by any party.

General Rules

General rules contained in the federal and state civil codes establish that the landlord is liable for defects in the leased property that may prevent the use thereof, even if the landlord was not aware of the defects or they occurred during the lease term, provided they are not a consequence of the tenant's negligence. On the other hand, the tenant is responsible for minor repairs

required from the use of the leased property. Standard provisions stipulate that the landlord must maintain the structure of the property and perform extraordinary maintenance, while the ordinary maintenance is usually the responsibility of the tenant, who must reinstate the property to its original pre-let state, accounting for ordinary wear and tear from usage. However, the parties may negotiate and agree on the allocation of maintenance responsibilities.

Rental payment frequency is flexible and determined by both parties, with monthly payments being the most common arrangement.

Regarding COVID-19 issues, refer to **6.3 Regulation of Rents or Lease Terms**.

Lastly, regarding construction build-out or supply chain issues, there are no specific provisions under the law, so these matters should be negotiated and agreed upon by the parties.

6.5 Rent Variation

Mexican civil law allows for flexible negotiation of rental updates between parties, without imposing binding or automatic updates. The standard practice is to update rent annually by applying the same percentage increase as the National Consumer Price Index, published in the Federal Official Gazette by the National Institute of Statistics and Geography. In some cases, additional points may be added to this percentage. For lease agreements involving premises in shopping centres, it is possible for the tenant to pay a variable rent, either in addition to or as a replacement for the fixed monthly rent. This variable rent is typically calculated as a percentage of the tenant's net sales.

6.6 Determination of New Rent

Rental increases or changes are negotiable between parties. The standard practice involves applying an agreed-upon percentage increase to the existing monthly rent at the end of a specified period, typically on an annual basis. Semi-annual increases are less common but still possible. In the case of new developments, such as shopping centres, rent increases might also be tied to the number of stores open or the centre's capacity.

6.7 Payment of VAT

VAT is 16% and payable on the rent of real estate used for commercial purposes. Rents payable under lease agreements for residential purposes are not subject to VAT, unless the leased premises include furniture.

6.8 Costs Payable by a Tenant at the Start of a Lease

It is customary for tenants to pay the first month's rent in advance, plus a security deposit, typically equivalent to one or two months' rent. The deposit is held by the landlord as a guarantee to ensure the tenant fulfils their obligations under the agreement. In commercial leases (shopping centres), the landlord (or previous tenant) may also request a one-time payment referred to as goodwill or key money, the amount of which usually depends on the standards and success of the shopping centre.

6.9 Payment of Maintenance and Repair

Costs and expenses associated with maintenance and repair of common areas used by several tenants are usually charged to and paid by those same tenants to the landlord, building manager or shopping centre manager, as "condominium quotas" or common area maintenance fees. Condominium or shopping centre regulations usually establish how such quotas

are allocated among the co-owners/users of the common areas. Leases of premises located in shopping centres may also require payment of a certain amount or percentage of the rent as advertising/marketing fees. Such fees and quotas are usually payable on a monthly basis.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications that serve a property occupied by several tenants are usually paid on a pro rata basis and reflected in the maintenance.

6.11 Insurance Issues

Neither federal nor state civil codes specifically address insurance requirements for leased properties. However, tenants are generally expected to obtain an insurance policy covering civil liability and fire, as fire-related damages are the tenant's responsibility under federal and state civil codes.

Landlords typically take out insurance cover for the property of leased premises. In commercial and industrial leases, tenants may sometimes be responsible for taking out and paying for insurance cover for the property, including for risks such as earthquakes and floods. Insurance for common areas is usually included in the maintenance fees charged to tenants.

Tenants primarily obtain insurance related to the property itself. Unless financing is involved, it is not customary to have business interruption insurance in Mexico, which primarily covers property closures due to Acts of God or force majeure. It is not standard practice to include insurance cover for pandemics or similar situations.

6.12 Restrictions on the Use of Real Estate

Pursuant to the federal and state civil codes, the tenant must use the leased property solely for its agreed-upon purpose or pursuant to its intended nature and destination. If a tenant violates this provision, the landlord has the right to terminate the lease agreement.

6.13 Tenant's Ability to Alter and Improve Real Estate

The federal and state civil codes stipulate that a tenant cannot alter the form of the leased property without the landlord's express consent. If such provision is breached, the tenant is responsible for restoring the leased property to its original state and paying the damages caused to the landlord. Usually, improvements are paid by the tenant; in exceptional cases, the landlord must pay them if they are useful, urgent or authorised improvements.

6.14 Specific Regulations

Premises used for commercial, industrial, office or retail purposes are usually subject to the same set of rules. The federal and state civil codes contain a specific set of rules for residential and rural properties.

- Properties intended for residential purposes – specific rules are provided in the civil codes to address, among other things:
  - (a) hygiene and health conditions, and minimum term of lease;
  - (b) the preferential right of the tenant to acquire the leased property or enter into a new lease; and
  - (c) currency for payment of the rent.

Rules applicable to residential leases are usually considered to be of public order and social interest, and, therefore, they are not waivable.

- Rural property – specific rules are provided in the civil codes to address, among other things:
  (a) the terms for payment of rent;
  (b) the rights of the tenant in the event of lack of productivity of the leased property; and
  (c) the minimum term of the lease.

No specific COVID-19 legislation has been enacted. In addition to what was discussed in **6.3 Regulation of Rents or Lease Terms** regarding the "unforeseeability theory", it should be noted that judicial criteria have established that such a theory does not apply to commercial acts; therefore, its application to commercial leases could be challenged.

6.15 Effect of the Tenant's Insolvency

The Law on Commercial Insolvency (*Ley de Concursos Mercantiles*) provides that a tenant's commercial insolvency does not terminate a lease agreement. However, the conciliator appointed for the insolvency procedure may terminate the agreement, in which case the compensation agreed in the lease must be paid to the landlord, or, failing that, an indemnity equal to three months' rent, for early termination.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The most common security requested by landlords to ensure tenants' compliance under lease agreements are:

- security deposit (*depósito*), usually one or two months' rent;
- bond policy (*fianza*), issued by a bond institution, which guarantees the fulfilment of a tenant's obligations;
- letter of credit; and/or
- a joint and several obligation by a third party (*obligado solidario*).

6.17 Right to Occupy After Termination or Expiry of a Lease

Generally, a tenant is not entitled to continue occupying the leased property after the termination of the lease agreement, and the landlord is entitled to enforce eviction. However, if the tenant continues to occupy the property without any objection from the landlord, the lease agreement will continue for an undetermined period. In such a case, either party may terminate the agreement by giving 30 days' written notice to the other party in the case of residential property and one year in case of rural, commercial or industrial properties.

6.18 Right to Assign a Leasehold Interest

The tenant may not sublet the leased property or a portion thereof, or assign the tenant's rights, without the consent of the landlord. If breached, both the tenant and subtenant will be liable for damages.

6.19 Right to Terminate a Lease

Pursuant to the federal and state civil codes, a landlord is entitled to terminate a lease in the following cases:

- failure to pay the rent;
- failure to use the property for the agreed-upon use;
- subletting of the property, without the landlord's consent;
- material damages to the leased property attributable to the tenant; and
- where the tenant modifies the form of the leased property, without the express consent of the landlord.

On the other hand, a tenant is entitled to terminate a lease in the following cases:

- the leased property is not in a good condition;
- total or partial loss of the leased property; and
- hidden defects or flaws in the property prior to the lease and unknown to the tenant.

The parties may also agree on events of default different from or in addition to those provided by the law.

6.20 Registration Requirements

The civil codes require lease agreements to be in writing.

The state civil codes may provide certain registration requirements. The Civil Code for Mexico City, for example, establishes that lease agreements with a six-year term (or more) must be recorded in the RPP, or when advance payments of more than three years rent are made.

6.21 Forced Eviction

The landlord is entitled to terminate the lease agreement and start a procedure to enforce eviction when a termination cause provided by law or the lease agreement, occurs. The duration of the eviction process may vary, but on average it may last up to two years.

No eviction moratoriums or related restrictions were implemented by the government during the COVID-19 pandemic.

6.22 Termination by a Third Party

Expropriation of the leased property for public utility and judicial sale are grounds for termination. The landlord and tenant are entitled to receive an indemnification from the competent authority. The landlord will be indemnified in accordance with the expropriation decree. The tenant will receive an indemnification equal to six months' rent, provided it has occupied the property for more than one year. Additionally, the tenant may receive compensation for the value of any necessary improvements made during the last six months.

6.23 Remedies/Damages for Breach

Upon the event of a tenant breach and/or lease termination due to tenant's breach, in accordance with general provisions of Mexican law, landlords are entitled to recover the direct and consequential damages directly resulting from the breach, including but not limited to unpaid rents and damages suffered by the property exceeding normal wear and tear. Parties are also entitled to negotiate and insert in the lease conventional penalties and moratorium interests for tenant's breach. If penalties are inserted, the landlord will not be entitled to demand damages as well. Penalties, however, cannot lawfully exceed the amount of the main obligation. Penalties typically included are one to two months' rent for each month during which the tenant unduly keeps occupying the leased premises when the lease term has elapsed.

Regarding security deposits, it is common for landlords in Mexico to hold security deposits posted by tenants as a form of guarantee against damages and/or unpaid rent fees. These security deposits are most commonly held in cash, usually in an amount which is equivalent to one to two months' rent. The specific requirements and regulations regarding security deposits may vary depending on the terms negotiated between the landlord and tenant in the lease agreement. Security deposits must usually be returned to the tenant, either fully or in part, within a reasonable timeframe, once the lease agreement term is completed and the landlord verifies the state of the property and any deductions that should

be made to the security deposit. Though somewhat uncommon, landlords accept other forms of security, such as letters of credit. Additionally, bond policies (*fianzas*) issued by specialised bonding institutions are commonly accepted as a way to guarantee due performance by a tenant of its obligations under the lease.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structures used in Mexico to price construction projects are:

- unit-price construction agreements;
- lump-sum construction agreements; and
- refundable costs construction agreements.

Unit-Price Construction Agreements

Under the unit-price construction agreement, the parties agree on a price per construction unit and the total value of the contract will be the sum of the units multiplied by the value of each unit. Each unit must include a value that represents the value of the contractor's remuneration.

Lump-Sum Construction Agreements

Under the lump-sum construction agreement, the contractor provides the fixed price of the work, regardless of the effective costs of the work it incurs during execution of the project. Usually, the cost is higher than in other construction contracts, since the contractor tends to have a margin in case of cost variations for material, equipment and subcontractors.

Refundable Costs Construction Agreements

Under the refundable costs construction agreement, the price that the contractor receives will be that resulting from the expenses assumed in the execution of the project plus a profit.

Mexican construction contracts commonly include a "change clause" that allows the owner to modify the work to be performed and, as a consequence, the price also changes.

7.2 Assigning Responsibility for the Design and Construction of a Project

In Mexico, different methods are used to assign responsibility for the design and construction of a project. If the contractor developed the design and engineering of the project, they are responsible for the correct construction of the project and for any defect, error, failure or malfunction. Therefore, the contractor is required to guarantee all the construction work and activities performed thereunder against defects (including hidden defects), malfunctions, deficiencies and damage of any kind, including (but not limited to) structural damage, design and engineering errors, labour problems, availability of materials, malfunctions of equipment and installations, during the term of the construction agreement and commonly 12 months after the termination date of the construction (the guarantee period). If any defect is detected during the guarantee period, the contractor, usually at their own cost, shall immediately remedy any such defect, and the guarantee for the defective work shall be extended, as agreed by the parties. See also **1.3 Proposals for Reform**.

If the contractor does not develop the design and engineering of the project, unless provided otherwise, it is responsible for defects, errors, failures or malfunctions, but shall not guarantee the design and engineering defects, which are the client's responsibility.

The above-mentioned responsibilities are typically allocated in specific responsibility and indemnification clauses within the construction contract, whereby the contractor agrees to indemnify and hold the client and its indemnified parties free from any damage, claim, liability, obligation, loss, action, administrative proceeding, complaint, expenses, interest, fines and costs (including reasonable attorneys' costs and expenses) arising out of or in connection with the construction agreement.

7.3 Management of Construction Risk

In Mexico, several means are used to manage construction risk on a construction project. The most common ones are:

- bonds;
- insurance; and
- guarantee funds.

Bonds

A contractor typically grants the following bonds in construction agreements.

- Down-payment bond – to guarantee the correct use of the down payment in an amount equal to the full amount of the down payment; the down payment bond is effective until the full down payment is amortised.
- Performance bond – usually equal to 10% of the construction price, it guarantees the complete performance of the works and timely completion of the construction.
- Guarantee and quality assurance bond – usually delivered simultaneously with the completion of the construction works in an amount equal to 10% of the construction works price and effective for a one-year term from the delivery of the fully completed construction works; this bond usually guarantees the payment of any hidden defects in the construction that may arise after the completion and delivery of the construction works and any third-party claims.

Insurance

Typically, the contractor is responsible for obtaining the all-risk and civil liability insurance. Generally, it includes any risk inherent to the construction works, including constructions adjacent or within the construction site, personal damage and death, basic cover for activities and real estate, subsoil installations, demolition, machines used for work, foundations, propping and other works, and sudden and unforeseeable pollution. The insurance policy usually covers gross liability, design errors, employers' liability and damage to property.

Guarantee Funds

From the amounts paid by the client to the contractor, the client usually withholds 5% of the total amount of each invoice, until they have accrued a guarantee fund equivalent to 5% of the construction price to guarantee compliance with the obligations of the contractor under the construction agreement.

The guarantee fund is typically used by clients to address any defect, liabilities or claims against the contractor that may arise from the construction agreement, including (but not limited to) the payment of liquidated damages or where the contractor fails to comply with any obligation established in the agreement.

There is also the possibility of limiting contractor's liability or capping it at a certain amount, depending on the project and the specific negotiations. Other than with respect to the maximum liability under the law or limitation or prohibition of certain damages (consequential, risk of loss, etc) under the law, all the provisions relating to

indemnification, risk of loss, waivers and limitations of liabilities are freely negotiated by the parties.

7.4 Management of Schedule-Related Risk

Parties may agree that the owner is entitled to monetary compensation/liquidated damages if certain milestones or completion dates are not achieved. Unless there is a force majeure event or delays caused by the owner or third-party factors such as licences or permits, liquidated damages for any incomplete work are usually paid. The payments by contractor of penalties or other amounts (damages) are usually guaranteed through the issuance, for the benefit of the owner and/or owner lenders, of:

- performance and advance payment bonds;
- letters of credit; and
- parent or third-party guarantees, in addition to payment holdbacks as agreed by the parties.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common way for owners to seek to guarantee a contractor's performance of a project is to obtain performance bonds, including advance payment and performance bonds. However, letters of credit, parent guarantees, holdbacks and escrow accounts are also common.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and/or designers cannot lien or otherwise encumber a property in the event of non-payment. In Mexico, there are no mechanical liens as in other jurisdictions.

However, it is important to note that in the case of certain equipment (ie, elevators and air conditioning equipment), the seller or manufacturer may include a domain reserve in their sales agreement, which allows them to retain ownership of the equipment until payment is made. This domain reserve must be registered in the Mexican Federal Register of Property and Commerce (RUG).

7.7 Requirements Before Use or Inhabitation

Local laws determine the requirements to be met before inhabiting a project after its construction. For example, in Mexico City, it is necessary to obtain authorisation for the use and occupation of the construction, and for this it is necessary to present the construction licence and the construction logbook in which the progress of the executed works is registered and endorsed by an expert, among other things. Furthermore, it should be noted that the properties must comply with safety regulations, evacuation routes and civil protection, etc. Lastly, there are operation licences that must be obtained for the property to be used for its intended use, which depend on the business (hospitality, restaurant, parking lot, etc).

8. Tax

8.1 VAT and Sales Tax

If real estate is acquired through the direct purchase of real estate, various taxes and rights must be paid, including VAT on the value of the construction (unless it is a residence), paid by the purchaser at a rate of 16%. As previously mentioned, certain locations, such as Cancun, mandate for the payment of a transfer tax (ISABI), and such tax shall be calculated by applying a rate of 2% to the value of the property.

8.2 Mitigation of Tax Liability

The most common method used to defer transfer liability is through the use of a real estate trust. This arrangement is not considered a sale for tax purposes, in accordance with Article 14 of the Federal Tax Code, as long as the trustor retains the right to reverse the ownership of the real estate. If the reversion right is lost, either through a subsequent sale, termination of the right or failure to meet the necessary tax requirements, the transferor will be responsible for paying the taxes owed.

8.3 Municipal Taxes

There are no federal or local occupation taxes, only fees, licences and permits as required.

8.4 Income Tax Withholding for Foreign Investors

The taxes to be paid are withheld by the notary public who formalises the transaction if the seller is not a tax resident in Mexico. The amount of taxes owed is determined based on the Mexican income tax law and can be up to 35% of the net gains.

Rental income from real estate is taxed in Mexico per the income tax and VAT law. The rules regarding the taxation of rental income vary depending on the type of entity or individual receiving the income, as well as their residency status (Mexican or foreign). For example, flat fees of 20% or certain deductions may apply.

8.5 Tax Benefits

Owners of real estate in Mexico are eligible for tax depreciation of fixed assets, mainly constructions, and can deduct certain things from their income tax liabilities. These include the proven cost of acquisition, the cost of certain construction and improvements, notary fees and commissions. While there is no tax depreciation allowed for land, a portion of the sale price will be allocated to the land when the real estate is sold. These tax benefits serve to reduce the amount of income tax owed on the sale of the real estate.

Trends and Developments

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Ritch Mueller is a top-tier multidisciplinary transactional firm committed to offering high value-added legal advice to national and international clients in the structuring, development and financing of their private businesses and public sector projects in Mexico. The firm's work encompasses transactions within the financial, industrial, infrastructure, energy, retail and services sectors, among others. Its staff of more than 100 professionals seek to add value to clients by means of an efficient and in-depth service combined with high levels of expertise and experience.

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Javier Domínguez joined Ritch Mueller in 1995 and was named partner in 2007. He has more than 28 years of experience, focusing on real estate transactions and financing, capital and debt offerings in Mexico and abroad, secured and unsecured financing, financing to states and municipalities, and M&A. Javier has advised the world's largest industrial facility developer, providing advisory on acquisitions, dispositions, developments, leasing and financings. He has also advised real estate investment funds and other investors in respect to their investments and developments in Mexico, including property acquisition, disposal, financing, development and management of assets.



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Diego Rodríguez joined Ritch Mueller in 2021. He has experience advising buyers, private equity funds and sellers in the acquisition process of companies, in both domestic and international transactions. In addition, Diego has advised clients in real estate projects, as well as in the acquisition and sale of real estate portfolios. In the financial sector, he has represented borrowers and lenders in structuring and implementing financings, with particular consideration of the environmental, social and governance components of investment.

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Mexico: Are We Moving Towards the Nearshoring Paradise?

Background

Due to its privileged economic and geographic position, Mexico is playing a leading role in nearshoring, which has become a popular topic in the international business scene. Is nearshoring already a reality? Will the country succeed in capitalising on the promises of nearshoring? What are the main challenges to achieve this? What do investors seek?

Nearshoring is a strategy used by companies to relocate production chains, processes and services, among others, to areas geographically adjacent to the main consumer markets in order to reduce costs. For example, a nearshoring strategy for a European company with its main customers in the United States would consist of establishing its production processes in a place such as northern Mexico, in order to reduce the cost of transporting its products to its main customers.

In recent years, offshoring, which is the strategy that contrasts with nearshoring, has shown some limitations that have led companies to seek alternatives to reduce costs. For example, US or European companies choosing to establish their production chains in Asian countries face cultural and linguistic differences that can increase production costs, as well as logistical and geopolitical challenges. These constraints and challenges have been manifest in recent years with events such as the COVID-19 pandemic, the Russia–Ukraine war and the US–China trade war.

For example, the global COVID-19 pandemic caused massive disruptions in global supply chains due to closing of borders and trade blockades. These supply chain constraints were greatest in South-East Asia and East Asia, the regions with the highest concentration of offshoring.

The Russian invasion of Ukraine, which began in February 2022 with the military aggression ordered by President Vladimir Putin in regions along their countries' shared border, resulted in an increase of gas and oil prices, which in turn increased the cost of transporting goods. These changes in supply chains have led to global imbalances causing certain companies to consider nearshoring strategies in order to reduce geopolitical risks.

In addition to the COVID-19 pandemic and the Russia–Ukraine war, the US and China industrial trade war, which began in 2018 during Donald Trump's presidency, and continues today, has caused a significant increase in import tariffs on certain products in both China and the US.

Altogether, while offshoring initially offered cost savings advantages in terms of labour and supply chain expenses, the drawbacks outlined above have prompted companies to reassess their over-reliance on specific global regions. In this context, nearshoring has become an attractive alternative for companies, due to this strategy's relatively low production costs, compared to those of the companies' country of origin, and geographic proximity reduces relocation and logistics costs.

Nearshoring opportunities in Mexico

Mexico has positioned itself as one of the main destinations among the countries offering nearshoring opportunities. This is due to, among other factors:

- the border with the United States, one of the largest consumer markets, along with the

similarity between the time zones of both countries;
- the trade agreements that Mexico and the United States have entered into, such as the USMCA, which provide certainty to producers and reduce export costs;
- the relatively low human capital costs and the high level of specialisation as a result of already established manufacturing industries, such as the automobile industry and the software industries;
- the similarity between Mexican and US cultures, especially along the border; and
- competitive production process supply costs.

An analysis by the Inter-American Development Bank (IDB) recognises Mexico's advantageous position. The IDB estimates that nearshoring will increase global exports from Latin America by USD78 billion in the short and medium term, of which 45% would be from Mexico.

These and other factors have led to greater foreign investment in Mexico, led by companies seeking to benefit from nearshoring by establishing their production processes in Mexican industrial parks. For instance, at the beginning of 2023, the Ministry of the Economy reported that in 2022 the foreign direct investment in Mexico increased by 12% compared to 2021 and 48% of all foreign direct investment received was from new investors. This percentage of new investors is the highest the country has seen in the last ten years. The data shows that foreign companies that had not previously invested in Mexico want to set up operations in the country. This follows the reasoning behind nearshoring, which is to establish production chains near the target markets: in the case of Mexico, the United States market.

In the private sector, BBVA Research, along with the Asociación Mexicana de Parques Industriales Privados, A.C. (AMPIP), conducted a survey to quantify and anticipate the effects of nearshoring in Mexico. From that research, BBVA Research and AMPIP concluded, among others, that since the beginning of the US–China trade war in 2018, private industrial parks in Mexico have received approximately 830 new foreign tenants, 20% of which come from Asian countries. On par with new tenants, AMPIP concluded that already established tenants also want to take advantage of the nearshoring boom, as they noted that from 2018 to 2022, 21% of the already established companies expanded their leased spaces in industrial parks.

Regarding the increase in demand from Asian countries for profitable spaces to establish production chains in Mexico, in late 2023 AMPIP officials reported that just over 40% of the mentioned increase in demand during 2022 and 2023 came from Chinese companies. Overall, AMPIP reported that the total number of private industrial park tenants increased by 52% from 2019 to 2022. As AMPIP points out, many of the companies opting for nearshoring strategies are looking to establish in new industrial parks. To meet the demand for new parks, several market players have mentioned that new industrial projects are already under development. AMPIP, for example, reports that there are already 50 new industrial projects to be built between 2023 and 2024. Fibra Mty, one of the main investors in industrial portfolios in northern Mexico, estimates that it will, in the short term, expand the total area of its portfolio by nearly 52,000 square metres to have sufficient space for tenants that seek to implement nearshoring strategies.

Attracting foreign investment

In this scenario, local governments and the federal government have sought to design strategies to attract as much foreign investment as possible, although in most cases there has been no effective co-ordination, resulting in delays and increased time and costs for investors and developers.

The federal government's main strategy has been to grant tax incentives, in order to encourage foreign capital investment. Specifically, on 11 October 2023 the President issued a decree granting tax incentives to certain sectors. These incentives consist of (i) an immediate deduction for investments in new fixed assets used for export activities, and (ii) a deduction for additional personnel training expenses. The first tax incentive benefits ten industries, including food, medical-pharmaceutical, electronic components (computers, software) and automotive, and is granted to companies involved in the production, processing or industrial manufacture of goods that are intended for export. The second tax incentive is subject to certain limitations.

This strategy has been criticised by organisations with expertise in public policy. For instance, according to the Public Policy Research Center of the Mexican Institute for Competitiveness (*Centro de Investigación en Política Pública del Instituto Mexicano para la Competitividad*, IMCO), the tax burden is not one of the main concerns of companies seeking to relocate their production chains to Mexico. Although tax costs are an important issue to consider when deciding to invest in Mexico, IMCO states that the main concern of investors is the availability of modern industrial space with a sufficient supply of all necessary production supplies.

Analysts from financial institutions such as Intercam Banco and Banco BASE concur with IMCO's analysis. In several interviews, experts from these institutions stated that for Mexico to benefit from nearshoring, the government must increase public investment to develop infrastructure for public services such as water, electricity, and education, to create adequate conditions to attract foreign investors. In order to secure investment, the country must increase the supply of available space and services at the same rate as the increasing demand.

Infrastructure and other challenges

As discussed above, in order to capitalise on the unique opportunity offered by nearshoring, both the Mexican government and the private sector must focus their efforts on addressing the deficiencies that potential investors identify as obstacles to locating their production chains in Mexico. As part of the survey mentioned above, BBVA Research and AMPIP asked industrial parks what they considered to be the main obstacles that could limit foreign investment. Of the parks surveyed, 91% reported problems with the supply of electricity, and 63% reported problems with water availability.

Fitch Ratings' analysis is in line with AMPIP's finding that the main hurdle Mexico is facing concerning the nearshoring boom is the lack of access to electricity. Changes in legislation and public policy related to the electricity market over the current presidential term have limited the growth of the industry by restricting the entry of private capital.

With regard to water, officials from the National Water Commission (*Comisión Nacional del Agua*) have stated that the imbalance in the distribution of rainfall, combined with the lack of hydraulic plans at the state level that are prop-

erly integrated at the federal level, have led to water shortages in different regions of the country. Shortages have occurred especially in the northern region, which is the area of greatest interest to new investors due to its proximity to the United States.

In addition, developers and investors face other issues that may affect the growth of nearshoring, which have been raised in conferences organised by the GRI Club. First, there is a difficulty in accessing "green" or sustainable nearshoring in which the new industrial parks comply with the ESG requirements of foreign investors and of the different financing sources. Specifically, in addition to various certifications in the construction and development of industrial parks, such as LEED and EDGE, that investors and financing sources require, they are requiring that the energy sources of these nearshoring projects are renewable. Given the federal government's energy policies, this objective has become extremely difficult to meet.

The other issue that developers and investors in the GRI Club conferences have identified as a barrier to nearshoring is the lack of clarity about local, state and federal processes and costs associated with obtaining permits and licences required to develop infrastructure and the industrial parks. Regulatory and bureaucratic barriers related to certain permits and licences in some municipalities and states (and especially at the federal level) create great uncertainty about the time required to obtain such permits and licences. Regarding the costs associated with the necessary infrastructure, the lack of support and compliance from the authorities at the three levels of government, as well as (ever-increasing) requirements, increase the cost of projects in ways that are often unexpected and cannot be budgeted for in advance.

UBS bank officials have pointed out that the development of industrial infrastructure is one of the main indicators that determine the effect of nearshoring during this first phase. Considering what has been discussed in the previous paragraphs, it seems that the lack of infrastructure is one of the main obstacles identified by key market players. In this regard, UBS officials agreed that Mexico has not seen a significant increase in the development of industrial infrastructure.

The Tesla example

The Tesla case is an example of the challenges that Mexico has in welcoming investors who want to set up their production processes in the country. In February 2023, the federal government announced the investment of the automotive company Tesla in the state of Nuevo León to set up a "gigafactory" of electric vehicles. The announcement was accompanied by questions and criticism about the viability of the project. Regarding water availability, several Nuevo León government officials have stated that nearby wells in the area where the factory will be built lack sufficient reserves to supply the residents of adjacent neighbourhoods.

Regarding electricity supply, the government of Nuevo León revealed last October that the local government has made a commitment to build infrastructure to facilitate access to electricity for the factory, as part of the preliminary agreements for Tesla to complete its project in the state. The problems of water and electricity shortages stem from a lack of infrastructure, since in order to supply the gigafactory, the US company requires pipelines to channel water, power plants to produce electricity and transmission lines to transport it.

The example of Tesla illustrates some of the country's limitations, and shows that govern-

ments must commit to developing infrastructure and making services available in order to achieve a large-scale project such as the gigafactory. At the same time, this example offers some hope, as it shows that it is possible to earn the benefits of nearshoring when the will of investors is aligned with that of governments.

Conclusion

In the current context of the nearshoring boom, Mexico holds an advantageous position that sets it apart from other countries competing to attract foreign production chains, particularly those companies whose main customers are located in the United States. Based on the aforementioned data, nearshoring has increased investment in Mexico, particularly with a growing number of new investors. This reality means that there is an increased demand for modern industrial spaces and services, such as water and electricity, which the country may not be prepared to meet.

Both the private and public sectors have developed strategies to fully utilise the benefits of nearshoring. Nonetheless, Mexican investors can still seize certain opportunities to accelerate the development of the country's industrial zones and benefit from the historic opportunity that nearshoring represents.

MOROCCO



Law and Practice

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Gide Loyrette Nouel was one of the first business law firms to set up in Morocco, in 2003, and its Casablanca office brings together about 20 Moroccan and French law practitioners. Gide is one of the only firms in the country to offer legal assistance covering the various fields of Moroccan and international finance and business law, including tax-related aspects. Besides its Casablanca office, Gide's Africa team works from offices in Algiers and Tunis, as well as from Europe (mostly London, Brussels and Paris), and in close collaboration with the firm's offices in China and Turkey, in order to develop co-operation between investors in the African continent. Clients include institutional investors, investment and commercial banks, leading Moroccan groups, public institutions and foreign investors operating in various sectors of activity (banking, insurance, telecommunications, agribusiness, services, real estate, tourism, industry, utilities, infrastructure, etc).

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1. General

1.1 Main Sources of Law

Several laws and decrees, which are regularly amended and supplemented, regulate the Moroccan real estate sector.

The main sources of real estate legislation are as follows (non-exhaustive list):

- the Code of Obligations and Contracts regulating the general rules of contract law dated 12 August 1913 (as amended from time to time);
- Law No 39-08 dated 22 November 2011 forming the Real Property Code (*Code des Droits Réels*);
- Law No 14-07 dated 22 November 2011 amending and supplementing the Dahir of 12 August 1913 on land titling;
- Law No 107-12 dated 3 February 2016 amending Law No 44-00 on off-plan sales;
- Law No 18-00 dated 3 October 2002 regulating the co-ownership rules applicable to erected buildings, as amended by Law No 106-12;
- Law No 12-90 dated 17 June 1992 on urban planning, as amended by Law No 66-12 dated 25 August 2016 on control and infringements in the field of town planning and construction;
- Law No 25-90 dated 17 June 1992 on allotments, housing groups and subdivisions;
- Law No 67-12 dated 19 November 2013 governing contractual relations between landlords and tenants of premises for residential or professional use;
- Law No 49-16 dated 18 July 2016 relating to the leases of buildings or premises rented for commercial, industrial or artisanal use;
- Law No 12-03 dated 12 May 2003 on environmental impact assessments;
- Law No 47-18 dated 21 February 2019 on Regional Investment Centres;
- Law No 70-14 dated 24 August 2016 introducing the *Organismes de Placement Collectif Immobilier* (OPCI) investment vehicle dedicated to real estate (similar to a real estate investment trust or REIT);
- Law No 62-19 enacting special provisions relating to the acquisition by joint stock companies (*sociétés anonymes*) or limited liability partnership (*sociétés en commandite par actions*) of agricultural property or property intended for agricultural use outside urban areas;
- Law No 95-17 dated 24 May 2022 on arbitration and conventional mediation;
- Law No 102-21 dated 10 February 2023 on industrial areas;
- Law No 69-21 dated 25 May 2023 on payment terms (*délais de paiement*);
- Law No 80-14 dated 4 August 2015 on tourist establishments and other forms of tourist accommodation and its implementing Decree No 2-23-441 dated 13 July 2023 setting out certain provisions of Law No 80-14;
- Decree No 2-22-431 dated 8 March 2023 on public procurement;
- Decree No 2-16-375 dated 18 July 2016 defining the land registry rights;
- the General Tax Code; and
- Foreign Exchange Instruction dated 2 January 2024.

1.2 Main Market Trends and Deals

The real estate sector progressed strongly 2023. In particular, a comparison of the reports for the quarters of 2023 relating to the real estate asset price index (IPAI) published by Bank Al-Maghrib (Morocco's central bank) and by the National Land Registry Agency shows that:

- the index of real estate asset prices increased by 0.6% compared to 2022 – this increase is due to a 1.5% rise in land prices and a 1.8% rise in commercial property prices;
- residential property prices, on the other hand, are virtually stagnant; and
- in 2023, the volume of sales increased by 5.1%, driven by increases of 6.3% in residential property sales, 5.8% in commercial property sales and 0.3% in land sales.

In addition, 2023 was another banner year for tourism in Morocco, with 14.5 million arrivals, according to the Ministry of Tourism and Handicrafts. This represents an increase of 34% compared to 2022.

Morocco has also witnessed a large number of transactions in 2023, notably in infrastructure (41 billion dirhams invested in 2023) and offices (construction of a 2,000 sq m office complex in the Casablanca Finance City business district).

However, the construction sector is suffering from the rising price of building materials and inflation, which are hampering households' access to housing.

Finally, it is worth noting that the Ministry of Economy reported in March 2024 that a number of programmes and projects have been approved and/or launched to further support the recovery of the construction sector, including:

- major infrastructure projects related to Morocco's hosting of the African Cup of Nations in 2025 and joint hosing of the World Cup in 2030;
- the programme for the reconstruction and development of areas damaged by the Al Haouz earthquake; and
- the direct assistance programme for the purchase of a primary residence, which was launched in January 2024.

1.3 Proposals for Reform

Please see the website of the Ministry of National Territorial Planning, Housing and Urban Policy for details of upcoming legislative reform. Some key proposals include:

- a law regulating the profession of the real estate broker expected to be adopted in 2024;
- a draft law on new towns that aims to promote the production and supply of housing and to regulate the procedures for approving and creating new towns;
- draft Law No 023-12 on housing co-operatives that aims to promote solidarity and participatory housing, in particular by encouraging the creation of housing co-operatives (ie, companies that manage housing for homeowners); and
- a draft law on the organisation of construction operations that aims to organise construction work by regulating the quality of building materials and techniques, identifying all parties involved, defining their tasks detailing the conditions under which construction sites are managed.

2. Sale and Purchase

2.1 Categories of Property Rights

Land Tenure

The Moroccan legal framework applicable to property rights remains complex, mainly due to the variety of legal regimes governing lands and the co-existence of unregistered and registered property.

Categories of Moroccan land tenure can be summarised as follows:

- State ownership:
  - (a) public domain of the Moroccan State; and
  - (b) private domain of the Moroccan State.
- Collective ownership:
  - (a) collective lands (*terres collectives*) – lands owned by local communities/tribes;
  - (b) habous lands – lands belonging to religious institutions (such as mosques, schools, etc); and
  - (c) guich lands (*terres guichs*) – lands owned by military communities.
- Individual ownership:
  - (a) registered private land – characterised by the registration/publication process and the probative effect of being recorded in the Land Registry held by the National Agency for Real Estate Conservation, Property Registries and Cartography ("ANCFCC"); and
  - (b) non-registered private lands – this includes all the lands which have not been registered (such lands do not benefit from the legal effect of the registration).

Among the non-registered lands, the melk assets which are owned under *moulkia* rights, should be noted. The *moulkia* right is based on peaceful possession and uninterrupted common knowledge for a period of ten years (towards third parties) or 40 years (towards family members). Such ownership is proved through the issue of a document called a *moulkiya* from traditional notaries (*adouls*).

Rights in Rem (Droit Réels)

Law No 39-08 forming the Moroccan Real Property Code (*Code des Droits Réels*) lists Moroccan rights in rem as follows.

Main rights in rem (that can be defined as autonomous rights not depending on any other rights):

- freehold;
  - (a) easements and encumbrances;
  - (b) usufruct right;
  - (c) right of use;
  - (d) surface right;
  - (e) emphyteusis right;
  - (f) right of habous;
  - (g) right of zina;
  - (h) right of houa; and
  - (i) customary rights properly constituted before the coming into force of the Real Property Code.
- Ancillary rights in rem (which can be defined as rights depending on a personal right):
  - (a) privileged liens;
  - (b) mortgages; and
  - (c) antichresis.

2.2 Laws Applicable to Transfer of Title

Besides the general rules of contract law related to sale and purchase agreements, the transfer of private registered property is governed by specific legislation, such as:

- Law No 39-08 forming the Real Property Code (*Code des Droits Réels*);
- Law No 14-07 amending and supplementing the Dahir of 12 August 1913 on land titling; and
- Law No 107-12 amending Law No 44-00 on off-plan sales.

Furthermore, specific laws apply to the transfer of certain types of real estate (land belonging to the private state domain, collective lands, individual property of unregistered land (*moulkiya*), etc).

No specific provisions apply to the industrial, office, or retail sectors.

2.3 Effecting Lawful and Proper Transfer of Title

Under Moroccan law, ownership of registered land is not transferred to the buyer until the deed of sale – which must be signed before a notary public or equivalent – is registered with the Land Registry (*Conservation foncière*). This registration and publicity mechanism makes the rights of the registered owner enforceable against third parties and cancels any and all prior titles/rights which are not mentioned on the title deed. The information recorded with the Land Registry is available to the public and can be obtained for a nominal cost. Hence, title insurance is not commonly used in Morocco.

Since September 2021, deeds of sale and ancillary documents should be submitted electronically to the Land Registry by the notary public. Furthermore, the professional order of Moroccan notaries public has created its own electronic signature tool.

2.4 Real Estate Due Diligence

Buyers generally conduct the necessary due diligence reviews, which cover technical, commercial and legal matters.

With respect to legal matters, the review typically includes the following:

- the title and encumbrances, to confirm in particular the valid and full ownership of the seller, and that the title is free and clear from any liens or encumbrances such as mortgages, preventative seizure, etc;
- construction matters (building permits, certificate of conformity, guarantees and related insurance coverage);
- third-party rights;
- the rental situation;
- contracts relating to the property;
- corporate matters (comprehensive corporate due diligence must be conducted if the asset is acquired through a share deal); and
- documentation regarding litigation and other contracts relating to the property and the target company.

Specific attention must be paid to the drafting of force majeure clauses.

2.5 Typical Representations and Warranties

The following guarantees are imposed by statutory law on the seller, and may be extended or limited by the parties:

- a guarantee of eviction, which protects the buyer against any restriction on the use of the property by the seller or by any third parties claiming rights over the property; and
- a guarantee against hidden defects (*vices cachés*), which must be brought within 365 days of the handover of the property (unless otherwise agreed).

The warranties provided by the seller in a share deal include the usual representations and warranties relating to the company being sold (the existence of the company, share capital and ownership of the shares, corporate matters, the accuracy of the accounts, the company's activity, financial standing, significant contracts entered into by the company, employment matters, litigation, tax matters, etc).

There is not typically a cap on the seller's liability for a breach of its representations and warranties.

Representation and warranty insurance is not a common practice in Morocco.

2.6 Important Areas of Law for Investors

When considering the purchase of real estate in Morocco, investors should consider the following:

- the general principles of contract law, including provisions governing the sale and purchase of real estate;
- tax regulation and structuring aspects;
- foreign exchange control regulations, especially the rules applicable to the transfer abroad of revenue generated from investments made in foreign currencies in Morocco;
- registration and publicity formalities;
- construction, urban planning and zoning regulations;
- environmental law;
- regulations applicable to the contemplated business activity to be conducted from/within the building; and
- regional and local practice or customs.

2.7 Soil Pollution or Environmental Contamination

Moroccan environmental law is based on the "polluter pays" principle, which means that the person responsible for the pollution is liable for damages and must take appropriate measures to remedy the pollution. If pollution is discovered, the owner of the property has the burden of proving that the previous owner or a tenant caused the pollution in order to avoid liability.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Zoning and planning regulations must be checked before planning a construction project and applying for a building permit.

The plans and regulations for each local area are generally available to the public for a nominal fee from the local urban agency (*agence urbaine*), using a dedicated application form (*note de renseignement*) indicating applicable uses and restrictions regarding footfall, the maximum building height, etc.

No agreement with public authorities is required to facilitate a private development project. Nevertheless, in certain cases involving a specific real estate project (mainly relating to tourism, industrial and/or artisanal projects, as well as social housing), it is possible to request and obtain authorisation from the competent authorities to derogate from the applicable urban regulations.

2.9 Condemnation, Expropriation or Compulsory Purchase

Under Law No 7-81, the Moroccan state is entitled to expropriate land for reasons of public necessity or for temporary use (following a dedicated administrative and judicial procedure). In this case, compensation must be paid to the owner for the expropriated property. The compensation is based on the current and effective damage directly caused by the expropriation, according to the value of the property on the date of the expropriation decision.

2.10 Taxes Applicable to a Transaction

Asset Deals

With respect to an asset deal, the following taxes and fees are due.

- Notary public fees, generally in the range of 0.5%–1% of the purchase price, and usually paid by the purchaser.
- Registration duties with the tax administration, which are calculated at a rate of:

(a) 5% of the purchase price (if the asset purchased is a bare land or a building which will be demolished); or
(b) 4% of the purchase price if the asset purchased is a constructed building (regardless of its purpose).

- Computed on the purchase price and borne by the purchaser within 30 days of the execution date of the purchase agreement.
- Registration fees with the Land Registry, amounting to 1.5% of the purchase price (required to register the deed of sale with the tax administration and update the Land Register), also borne by the purchaser within three months from the deed of sale execution date.

Share Deals

If the target company in a share deal qualifies as a "real estate company" it will need to pay registration duties to the tax administration. Real estate companies are defined as companies whose gross assets are composed of at least 50% real estate assets (including other real estate companies), determined at the beginning of the financial year in which the taxable sale occurs. Properties used by these companies for their own commercial, industrial and other activity are not taken into account in the 50% threshold but ongoing constructions are. When shares representing a real estate company are sold, the buyer is responsible for paying registration duties at a rate of 6% of the purchase price. If the target does not qualify as a real estate company, a share purchase agreement must be registered with the tax authorities, but this is not exempted from registration duties.

If the company does not qualify as a "real estate company" (eg, if the property owned by the company is dedicated to the industrial or commercial activity of the same company), the registration of the share purchase agreement has to be registered with the tax authorities but benefits from a registration duties exemption

The purchase of shares in a real estate company does not trigger the payment of notary public fees (because the deed does not have to be authenticated by a public notary), nor does it require the payment of registration fees with the Land Registry (because the title deed does not need to be updated, as the owner of the property remains the same person).

2.11 Legal Restrictions on Foreign Investors

Apart from some industries – including agriculture, fishing, audiovisual media, banking and insurance – there are generally no limitations on foreign investors buying real estate (either directly or indirectly through the purchase of a company holding real estate assets).

It is worth noting that with respect to agricultural land, a distinction is made between purchase for agricultural and non-agricultural uses.

Agricultural Use

Prior to the reform introduced by Law No 62-19 of 14 July 2021 (see next paragraph), Law No 1-73-645 of 23 April 1975 on the acquisition of agricultural land or land for agricultural use outside urban areas providing that foreign natural and legal persons and/or limited companies, whose shareholders were not exclusively Moroccan natural or legal persons, were not allowed to purchase agricultural land for agricultural use.

Law No 62-19 of 14 July 2021 now provides for the right for joint stock companies (*sociétés anonymes*) or limited liability partnerships (*sociétés en commandite par actions*), whether owned by foreigners or not, to purchase agri-

cultural land for agricultural use. This is subject, however, to prior approval of the purchase by the unified regional investment commission (*commission régionale unifiée d'investissement*), and the signature of a specific sale and purchase agreement, the template of which has not yet been published.

Non-agricultural Use

In accordance with the provisions of Decree No 2-04-683 of 6 January 2005 on the regional commission responsible for certain land transactions, foreign natural and legal persons may purchase rural agricultural land with a view to carrying out an investment or other economic project of a non-agricultural nature. This is subject, however, to request and being granted with a certificate of non-agricultural use (*attestation de vocation non agricole*).

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Real estate investors typically use a combination of equity (including internal shareholder financing) and/or bank loans to finance the acquisition of commercial real estate in Morocco.

3.2 Typical Security Created by Commercial Investors

Lenders often request the following securities:

- a mortgage (*hypothèque*) over the real estate asset;
- a pledge over the general business concern (*nantissement de fonds de commerce*);
- a pledge over receivables (*nantissement de créances*);
- a bank account pledge (*nantissement de compte bancaire*);
- an assignment of insurance proceeds (*délégation des indemnités d'assurance*); and
- a pledge of shares (*nantissement d'actions*).

It is also common to obtain personal security, such as a guarantee from a company (usually a parent company) covering cost overruns, completion, interest and principal.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

The enforcement of a security in Morocco for the benefit of a foreign lender would result in the transfer of the enforcement proceeds outside Morocco. Such a transfer would generally require a spot authorisation from the Foreign Exchange Office, as the General Instruction on Foreign Exchange does not expressly authorise this type of operation.

With regard to repayment under a loan agreement, the General Instruction authorises foreign financing under certain circumstances to enable a Moroccan borrower to repay a loan to a foreign lender.

The creation of the beneficiary's administrative file at the Land Registry, known as the *dossier special*, which requires the collection of corporate and administrative documents in original, certified or apostilled form, and sometimes involves an exequatur procedure, may also present challenges and delays.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The following registration obligations and Land Registry fees are applicable upon the registration of a mortgage.

- Registration duties: computed on the total amount secured, but the taxable basis also

includes – in addition to the amount secured in the principal – the expected expenses (or 6% of the principal if no estimation is made) and the interest (capped at the value of the interest paid over two years). The amount of the taxable basis thus determined is subject to registration duties at a rate of 1.5% and is payable within 30 days following execution.
- Land Registry fees, which depend on the value of the mortgage, as follows:
  (a) lower than MAD250,000 – 0.5%;
  (b) between MAD250,000 and MAD5 million – 1.5%; and
  (c) above MAD5 million – 0.5%.

A fixed duty (per property) of MAD100 also applies.

No stamp duties apply to credit or security agreements (subject to exceptions).

The enforcement of a security requires no specific fee.

3.5 Legal Requirements Before an Entity Can Give Valid Security

In addition to corporate authorisations, a Moroccan entity must ensure that the following rules are complied with when granting any security.

- Financial assistance (*assistance financière*) rule: pursuant to Article 280 of Law No 17-95 relating to joint stock companies, providing financial assistance to the target company in the form of advances of funds, loans or security with a view to the subscription or purchase of its own shares by a third party is prohibited. Article 280 refers to financial assistance "in view of" the acquisition/subscription (ie, at the time of the transaction or in contemplation of a transaction). In theory, the provisions prohibiting financial assistance under Law No 17-95 do not apply to limited liability companies, and Law No 5-96 on limited liability companies does not set out similar provisions.
- Corporate benefit (*intérêt social*) rule: any decision for a company must be taken in its best interest. The existence of a corporate benefit is ultimately a business decision and, as such, is a decision for the company's directors to make. Any assessment of whether there is a benefit to the company must be made on a case-by-case basis.
- Corporate purpose (*objet social*) rule: any security granted by a Moroccan entity for the benefit of third parties must comply with the corporate purpose of the entity. Moroccan law does not provide any definition of corporate purpose, but both Law No 17-95 and Law No 5-96 provide that the corporate purpose must be specified in the articles of association.

In addition, the creation of movable and immovable securities will require (as the case may be) the completion of registration formalities with the National Register of Securities over movable assets (*registre national électronique des sûretés mobilières*) or with the competent Land Registry.

3.6 Formalities When a Borrower Is in Default

The secured lenders should have no difficulties collecting on a mortgage as long as the following criteria are met:

- the mortgage is duly registered in the local Land Registry;
- it is a first-ranking mortgage; and
- the borrower is not undergoing insolvency proceedings.

It usually takes between six and 12 months to successfully enforce a mortgage.

3.7 Subordinating Existing Debt to Newly Created Debt

According to Law No 39-08's Section 169, the priority of debt ranks from the date of registration, with same-day registration receiving equal consideration, and retains its rank and validity without further formality, until the valid registration of its withdrawal (*mainlevée*).

In order to subordinate a mortgage already registered in favour of a new mortgage, a specific subordination or intercreditor agreement between the creditors concerned exchanging ranks is required. The rules of subordination among creditors and governing the enforcement rights will be set out in that agreement.

3.8 Lenders' Liability Under Environmental Laws

In principle, and provided that they did not cause the damage themselves, the holder of security over real estate cannot be held liable for environmental damage.

3.9 Effects of a Borrower Becoming Insolvent

A security interest granted by a borrower remains valid under Moroccan law even if the borrower becomes insolvent.

However, a creditor is not entitled to proceed with the enforcement of a security interest for the duration of the borrower's insolvency proceedings. Indeed, any creditor whose claims are not privileged by law is prohibited from commencing or continuing an individual action against the debtor.

In addition, pursuant to Article 714 of the Commercial Code, if it is determined that the granting of a security is detrimental to the debtor's bankruptcy estate, the bankruptcy court may invalidate securities granted during the six-month period preceding the debtor's declaration of bankruptcy.

3.10 Taxes on Loans

Loans granted by Moroccan licensed banks, or by through shareholder loans, are exempted from registration duties but other loans (eg, those granted by foreign banks not licensed in Morocco) are subject to 1.5% registration duties.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Law No 12-90 on urban planning sets out the general rules applicable to strategic planning and zoning.

Urban Development Master Plans (*Schémas Directeurs d'Aménagement Urbain*) and zoning plans are used to establish strategic plans and zoning schemes (*plans de zonage*). Each municipality prepares development plans (*plans d'aménagement*), which categorise the land into distinct use zones and assign a different building density ratio to each zone.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

In practice, public law regulates a landowner's ability to build a new building or refurbish an existing one through an administrative authorisation that must be obtained prior to beginning any construction work.

4.3 Regulatory Authorities

Overall responsibility for regulating the development and designated use of individual parcels of real estate lies largely with local authorities, including the urban agencies and the Regional Investment Centres (*Centres Régionaux d'Investissement*) responsible for issuing building permits.

4.4 Obtaining Entitlements to Develop a New Project

A variety of authorisations and permits are necessary for the construction of a real estate project. Some of these requirements, which will depend on the nature of the project in question, are outlined below.

- Law No 12-03 relating to environmental impact assessment sets out a list of projects which must be subject to an environmental impact assessment (*étude d'impact sur l'environnement* and an environmental acceptability decision (*decision d'acceptabilité environmentale*) from the Ministry of Energy, Mines and Environment in order to be authorised.
- Law No 49-17 relating to environmental assessment has recently been published in the Official Gazette and should enter into force upon the publication of its implementation regulations. It mandates that all projects that may have negative impacts on the environment will have to be subject to an environmental impact assessment. With regard to projects existing prior to the entry into force of Law No 49-17 and for which no environmental impact assessment has been made, an environmental assessment will be carried out.
- Hazardous facilities (*installations classées*) – authorisation must be obtained from the relevant authorities (or a declaration has to be filed, depending on the nature/class of the facilities) prior to beginning construction work.
- A building permit must be obtained in order to carry out construction work. Generally speaking, the permit is issued once all the authorisations and visas required by specific laws and regulations have been obtained.
- Upon completion of the permitted construction works, which must be declared by the architect, the owner must obtain another permit: the "permit to inhabit" (*permis d'habiter*) or, if the building is not dedicated to private housing, the "certificate of compliance" (*certificat de conformité*), confirming that the buildings erected are in accordance with the provisions of the initial building permit. This permit is a prerequisite to the use of the erected building.
- By Order No 338-20 of 21 January 2020, a dematerialised procedure was set up for the submission and processing of applications for town planning authorisation, via an online platform known as Rokhas.

4.5 Right of Appeal Against an Authority's Decision

As an administrative act, any decision taken by the authorities must be justified and may be appealed before the relevant authority (*recours gracieux*) and/or the administrative courts (*recours contentieux*). A lawsuit may also be filed by third parties with a specific interest that deserves protection before the administrative authority or before the court, by asking for the decision to be annulled.

4.6 Agreements With Local or Governmental Authorities

There is generally no need to enter into agreements with local or government authorities or

agencies, or utility suppliers, in order to facilitate a development project.

4.7 Enforcement of Restrictions on Development and Designated Use

Failure to comply with the applicable building and planning regulations may result in:

- closure of the site in the absence of a valid building permit;
- the obligation to modify the building to bring it into compliance with the regulations in force; or
- the obligation to demolish the construction work.

In all cases, the offender is liable to a fine of between MAD1,000 and MAD100,000.

In addition, anyone who continues to operate a project despite being notified of the closure of the site may be punished by imprisonment of between 15 days and three months.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Real estate assets may be purchased by either natural individuals or legal entities. Companies usually possess substantial or valuable assets, with the most popular corporate forms including:

- the joint stock company (*société anonyme* – SA) governed by Law No 17-95 (as amended);
- the simplified joint stock company (*société par actions simplifiée* – SAS) governed by Law No 5-96 (as amended);
- the limited liability company (*société à responsabilité limitée* – SARL) governed by Law No 5-96; and
- the real estate civil company (*société civile immobilière* – SCI) governed by the Moroccan Obligations and Contracts Code.

Law No 70-14 dated 24 August 2016 introduced REITs, known as *Organisme de Placement Collectif Immobilier* (OPCI) into the investment legal framework. Please see **5.3. REITs** below.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

All types of companies are subject to corporate income tax (CIT) in Morocco. The finance bill for 2023 modified the CIT rates, reducing them with the aim of reaching a flat rate of 20% for financial years beginning January 2026 onwards. Companies whose profits exceed MAD100 million, for whom the CIT rate will be 35%, and licensed banks and insurance companies, which will pay CIT at a rate of 40%, are the sole exceptions.

The following rates apply/will apply to the net income (including rental income):

- under MAD300,000 – 15% in 2024, 17.5% in 2025 and 20% in 2026 (and beyond);
- between MAD300,000 and MAD1 million – 20% in 2024 (and beyond);
- between MAD1 million and MAD100 million – 22.5% in 2024, 22.75% in 2025 and 20% in 2026 (and beyond); and
- over MAD1000 million – 33% in 2024, 34% in 2025 and 35% in 2026 (and beyond).

Joint Stock Company (SA)

A joint stock company (SA) is a form of limited liability company where each shareholder's liability is, in theory, restricted to the amount of its contributions to the company. A minimum of

five shareholders is required for an SA. Unless otherwise provided in the company's articles of association (which may provide for restrictions on the transfer of shares, such as a temporary lock-up or prior approval clause (*agrément*)), the shares in an SA are freely transferable.

Simplified Joint Stock Company (SAS)

A simplified joint stock company (SAS) is a flexible corporate form that is suitable for companies with high growth potential. An SAS's shares are not permitted to be listed. One or more shareholders, who may be either individuals or legal entities, can form an SAS. The maximum amount of liability of each shareholder is their individual share contributions. The shares are freely transferable, unless otherwise set forth in the articles of association of the company. If the articles of association of the company include a lock-up clause, Moroccan law provides that this lock-up period cannot exceed ten years.

Limited Liability Company (SARL) and Sole Shareholder Limited Liability Company (SARLAU)

The Moroccan equivalent of a limited liability company is a SARL. It can be incorporated as a sole shareholder company and may have up to 50 shareholders. In that case, the firm is a sole shareholder limited liability company (SARLAU). The maximum amount of liability for each shareholder is their individual share contributions. The SARL is frequently utilised for smaller enterprises, particularly because of its simplified and less complex management structure.

Unlike a joint stock company, a SARL cannot be listed on a stock exchange and cannot issue preference shares and debt or equity securities that are convertible into shares.

Real Estate Civil Company (SCI)

A real estate civil company (SCI) is a civil company whose purpose is to hold real estate assets. Because it is a civil company, an SCI cannot have in principle a commercial or trading nature. The shareholders are indefinitely liable for the company debts, in proportion to the shares they hold in the share capital.

Some companies are subject to personal income tax (ie, tax on income is only payable at the shareholder level) and mainly include *société en nom collectif*, companies with a real estate purpose (transparent for tax purposes).

5.3 REITs

REITS are commonly available in Morocco. Please refer to **5.1 Types of Entities Available to Investors to Hold Real Estate Assets** for more detail.

There are two different forms of OPCI (*Organisme de Placement Collectif Immobilier*):

- a real estate investment trust (*fonds de placement immobilier* – FPI) organised in the form of a co-ownership without legal personality; or
- a real estate investment company (*société de placement immobilier* – SPI) organised as a joint stock company.

In both cases, their purpose is the construction or acquisition of buildings exclusively for rental purposes, which they hold directly or indirectly, as well as all operations necessary for their use or resale.

Securities issued by the OPCI may be listed on the stock exchange. OPCIs are open to foreign investors and the assets of an OPCI may be located in a free zone or in a foreign country,

denominated in foreign currency or governed by foreign legislation, in compliance with foreign exchange legislation and regulations. However, the OPCI management company must have its registered office in Morocco.

Investors can benefit from a number of advantages by investing in OPCIs:

- easy access to the real estate market;
- liquid investment in real estate via OPCIs;
- optimising net income through the OPCI's rental assets;
- professional property management; and
- an attractive tax regime.

The creation of an OPCI is subject to a number of conditions, including but not limited to:

- management by a management company (*société de gestion*), which itself is subject to certain conditions;
- obtaining (i) the authorisation of the Moroccan market regulator (*Autorité Marocaine du Marché des Capitaux* – AMMC), and (ii) the AMMC's approval of the OPCI's information document;
- having a minimum share capital (SPI)/minimum initial contribution (FPI) of MAD50 million; and
- compliance with applicable rules governing the asset mix of the OPCI.

5.4 Minimum Capital Requirement

SA

A joint stock company requires a minimum share capital of MAD300,000 or MAD3 million if its shares are traded on the stock exchange. Contributions can be made in cash (*numéraire*) or in kind (*en nature*). Contributions in kind are subject to a specific appraisal procedure by an independent appraiser.

SAS

The minimum share capital requirement for an SAS is not specified by Moroccan legislation.

SARL

A limited liability company is not required to have a minimum share capital. Contributions must be provided in kind or in cash, it being specified that contributions in kind must undergo a certain appraisal process by an independent appraiser.

SCI

A minimum share capital of MAD1 is required for a real estate civil company. Contributions can be made in cash or in kind, or may consist of technical skills (*apport en industrie*).

5.5 Applicable Governance Requirements

SA

An SA may have either (i) a board of directors (*conseil d'administration*), or (ii) a management board (directoire) and a supervisory board (*conseil de surveillance*). The CEO (*directeur général*) is responsible for the day-to-day management of the SA and has the broadest powers and authority to represent the company before third parties.

SAS

An SAS is mainly governed by the terms and conditions of its articles of association.

SARL

A SARL is managed by at least one manager, who must be an individual and who has the broadest power and authority to represent the company before third parties, except for matters legally restricted to shareholders.

SCI

An SCI is managed by at least one manager, who must be a shareholder of the company (if

the articles of association of the company do not mention this point, all the shareholders have the powers and authority to manage the company).

5.6 Annual Entity Maintenance and Accounting Compliance

SA

An SA must appoint at least one statutory auditor (two if the company is listed), and is required to file its accounts annually. These accounts must be certified by the statutory auditors who file them with the tax authorities, to which are added the statutory auditors' fees for the certification of the annual accounts. Then, these certified financial statements are closed by the board of directors and approved by the shareholders' meeting before being filed with the trade registry (costs of MAD50).

SAS

In an SAS, there is no legal obligation to appoint statutory auditors unless the company's annual turnover (excluding VAT) exceeds an amount set by decree (it being specified that this decree has not yet been promulgated). An SAS is also required to file its annual accounts, duly approved by its president, with the local tax authorities and the trade registry.

SARL

A SARL must appoint statutory auditors only if its annual turnover exceeds MAD50 million. A SARL's annual accounts must also be filed, after being duly approved by its shareholder(s), with the local tax authorities and the trade registry.

SCI

There is no requirement to appoint a statutory auditor in an SCI, nor to file annual accounts.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

In Morocco, several arrangements provide for a person, company or organisation to stay in a property for a limited period of time without having to buy it. The main types of arrangement are the lease agreement, the usufruct, the *commodat* (a free lease agreement for the use of the property) and, in relation to private state land, the authorisation to temporarily occupy publicly owned land.

6.2 Types of Commercial Leases

Aside from the general rules governing leases, as laid down by the Code of Obligations and Contracts regulating the general rules of contract law (as amended from time to time), Moroccan legislation has enacted two specific laws governing commercial leases and professional and residential leases.

The Dahir No 1-13-111 dated 19 November 2013 promulgating Law No 67-12 governs contractual relations between tenants and landlords for residential or professional premises. The professional lease mostly applies to liberal professionals not practising any commercial, industrial or handicraft activities.

The commercial lease is regulated by the Dahir No 1-16-99 dated 18 July 2016, promulgating Law No 49-16, which sets out a complete list of situations in which it applies. A commercial lease must be granted by the landlord in accordance with Law No 49-16 for:

- premises or buildings in which a business (*fonds de commerce*) is operated;

- premises or buildings regarded as an accessory to the main premises in which the business is operated;
- premises consisting of undeveloped lands that will be developed and used to operate a business;
- premises or buildings used for commercial, industrial and handicraft purposes and as part of the private state domain; and
- premises and buildings used as private schools, clinics or pharmaceutical laboratories.

Pursuant to Law No 49-16, some premises may not be subject to a commercial lease arrangement, including:

- premises or buildings that are part of the public state domain;
- premises or buildings that form part of the private state domain but are used for public interest;
- premises or buildings incorporated in a habous;
- premises or buildings rented following a court order;
- premises or buildings located in a shopping mall; and
- premises or buildings located in a dedicated zone gathering companies operating information technology, industrial or offshore activities.

The right of the tenant to renew the lease is one of the main features of a commercial lease. Hence, if the landlord decides to terminate the lease ahead of the agreed contractual term, the tenant is entitled to seek compensation (*indemnité d'éviction*), determined by taking into account the value of the considered business.

6.3 Regulation of Rents or Lease Terms

Although permitted by law, variable rents are not common in leases for office premises, but are a common feature in retail leases for premium international brands (expressed as a percentage of the annual gross revenues of the tenant's business, subject to a specified minimum fixed rent).

6.4 Typical Terms of a Lease

Duration

As the duration of commercial leases is not regulated by Moroccan Law, the parties are free to enter into a lease agreement for any amount of time. In practice, commercial leases are often entered into for an initial period of three to nine years.

One of the main features of a commercial lease is the tenant's right to freely transfer and renew the lease, which means that in the event of non-renewal, the tenant is entitled to eviction compensation based, among other things, on the value of the business. To benefit from this right of renewal, the tenant must occupy the premises for two consecutive years or have paid "key money" (*pas-de-porte*) in order to be entitled to such a right of renewal.

Please note that in the event the duration of a lease is equal to or over ten years, it is likely that the tax administration (when registering the lease) will consider that the applicable rate and taxable basis of the registration duties is the one that applies to long-term leases (*bail emphytéotique*) – ie, a 6% rate on a taxable basis of 20 times the annual rent in accordance with Article 131 19° of the Moroccan Tax Code (MTC) (against a fixed fee of MAD200 for the registration of a "standard" lease agreement).

Work and Repairs

The parties are free to allocate the various types of work and repairs. However, in general, ordinary repairs and maintenance are borne by the tenant, and the landlord bears the cost of structural and major repairs, as well as repairs resulting from wear and tear, force majeure and construction defects.

Frequency of Rent Payments

The parties are free to negotiate the frequency of rent payments. Rent for commercial premises is usually payable monthly or quarterly in advance.

6.5 Rent Variation

Under the applicable regulations, the amount of the rent, the conditions of its revision and the rate of its increase or decrease can be freely determined by the tenant and the owner.

However, Law No 07-03 on rent reviews for commercial, industrial or craft premises prohibits rent increases during the first three years from the date of conclusion of the lease agreement or the date of the last judicial or contractual review, and/or prohibits the parties from agreeing to an increase greater than the rates set by law (ie, 8% for residential leases and 10% for other leases, including commercial and professional leases).

If no agreement has been reached between the tenant and the landlord regarding the rent revision terms and the rate of increase, the parties may apply for judicial review based on the above-mentioned rates.

In practice, the parties generally agree to a rent review clause that is based on the conditions imposed by Law No 07-03 (ie, a rent increase of 8% or 10% every three years).

6.6 Determination of New Rent

Law No 07-03 provides that a rent increase may only apply every three years following the signing of the lease agreement or the date of the previous judicial or contractual rent review, provided that any such increase is limited as follows:

- for residential leases – an 8% increase in the current rent; or
- for other leases – a 10% increase in the current rent.

6.7 Payment of VAT

VAT is payable at 20% on rent in the following cases (otherwise it is out of scope of Moroccan VAT).

- Taxable rental transactions:
  - (a) rental of furnished premises;
  - (b) rental of equipped premises for business purposes;
  - (c) rental of non-equipped premises for business purposes when they were acquired within the scope of VAT;
  - (d) rental of non-equipped premises for business purposes in which an intangible asset of the business is included; and
  - (e) rental of premises in commercial complexes (“shopping malls”).
- Rental transactions not subject to Moroccan VAT:
  - (a) non equipped premises which were purchased out of scope of VAT.

If the VAT is not applicable, the landlord can opt to pay VAT (at 20%). This option is made by a formal request and can be applied globally or partially to the taxpayer’s activities (ie, the option can be applied to a given real estate project, or to a single building/premises/apartment).

6.8 Costs Payable by a Tenant at the Start of a Lease

Pursuant to Moroccan law, there are no additional costs to be paid by the tenant at the beginning of the lease term, apart from a registration duty payable to the tax administration (set at MAD200).

Although the MTC does not specifically state who is responsible for paying the registration fees, it is market practice for the tenant to bear this cost.

6.9 Payment of Maintenance and Repair

The tenant generally bears the maintenance and repair costs for common areas (ie, gardens, parking areas, stairways and elevators) by way of service charges, in proportion to the area of the premises occupied by each tenant compared to the total area of the property. In practice, the service charges are usually agreed as a lump sum.

6.10 Payment of Utilities and Telecommunications

Parties are free to determine which of them will pay the operating fees (eg, electricity, water, telecommunications and other utilities), but the utility costs are generally borne by the tenant according to its specific needs and usage.

6.11 Insurance Issues

In Morocco, landlords and tenants typically subscribe to various insurance policies to safeguard their interests under a lease agreement.

For landlords, typical policies include the following:

- *Assurance propriétaire non occupant:* This type of property insurance covers the landlord's property against risks such as fire, theft, and natural disasters. It is designed for landlords who do not reside in the property themselves.
- *Responsabilité civile propriétaire*: Liability insurance for landlords protects them in case a tenant or visitor is injured on the property and files a claim for damages. It covers legal expenses and compensation for bodily injury or property damage.
- *Assurance loyers impayés*: This insurance protects landlords against the risk of rental income loss due to tenant non-payment of rent. It typically covers unpaid rent and legal expenses associated with eviction proceedings.

For tenants, typical policies include the following:

- *Assurance multirisque*: Renter's insurance provides coverage for the tenant's personal belongings inside the rental property and includes liability coverage for damages caused to third parties.
- *Assurance dommages aux biens:* Insurance that tenants can purchase to cover damage to the landlord's property caused by the tenant. It may include coverage for accidental damage, such as broken windows or damaged appliances.

6.12 Restrictions on the Use of Real Estate

The parties generally provide that the leased premises are rented for a specific purpose, with any change being subject to the landlord's prior consent. In addition, the use of the leased premises may be restricted by legal or regulatory provisions, such as town planning and zoning regulations.

With respect to commercial leases, a judge may grant permission to the tenant (even after a

refusal by the landlord) to carry out one or more activities that are ancillary or related to the initial business activity, as long as they are not in conflict with the purpose, characteristics and location of the building, and they are not likely to affect its security.

6.13 Tenant's Ability to Alter and Improve Real Estate

Law No 49-16 governing commercial leases provides no specific provisions regarding works initiated by the tenant.

In any case, the parties are free to agree on the preferred work regime for the tenant, and it is generally provided that the tenant may not alter or improve the premises without the landlord's prior consent, especially if the work is substantial and affects the structure of the building.

6.14 Specific Regulations

Specific regulations apply to financial leases (*credit bail*), lease agreements for the use of agricultural land (*bail à ferme*), authorisations to temporarily occupy publicly owned land (*autorisation d'occupation temporaire du domaine public*), etc.

Habous properties, governed by a very specific legal regime, were subject to particular measures following the COVID-19 pandemic crisis, with habous tenants being exempted from paying their rent.

6.15 Effect of the Tenant's Insolvency

The Moroccan Commercial Code sets out the rules applicable to insolvency proceedings, but does not provide any specific rules for leases where the lessee is considered insolvent. In the event of insolvency proceedings not leading to liquidation, it is customary for the court to appoint an administrator, who may decide to uphold the lease in force if it is deemed necessary for the tenant's business operations.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The main forms of security available to landlords in the event of non-payment of rent by the tenant are:

- cash deposit of an agreed amount (limited to two months' rent for commercial tenancies);
- rent paid in advance; and
- guarantees from a bank or parent company.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant has no right to remain in occupation of a property after the expiry or termination of a lease. Therefore, if the premises are not vacated on the due date, the landlord can obtain a court order to regain possession of the premises. The lease may also contain other penalty clauses if the property remains in use after the expiry of the lease without due cause.

6.18 Right to Assign a Leasehold Interest

Pursuant to Law No 49-16 governing commercial leases, a tenant under a commercial lease cannot, in any circumstances, be deprived of the right to assign its leasehold interest – with or without its business (ie, separately). The tenant and the assignee must, however, give notice to the landlord referring to the assignment. Until such time as notice is given, the assignment shall not be binding on the landlord. The tenant remains liable to the landlord with respect to all prior commitments.

Under Law No 49-16, a tenant may sublease any part of the leased premises, unless the lease

agreement sets out otherwise. The tenant must notify the landlord about the sublease, and it only becomes effective against the landlord as of the date the notification is made.

6.19 Right to Terminate a Lease

Law No 49-16 governing commercial leases provides that the landlord may request a judicial termination of the lease if the lease contains a termination clause (*clause résolutoire*) and at least three months' rent is still unpaid by the tenant, despite a 15-day formal prior notice being served.

There are also a number of instances in which the landlord has the ability to deny the right of the tenant to renew the lease without paying an eviction fee (*indemnité d'éviction*). These cases include notably unauthorised alterations to the premises, default of payment, sublease of the premises contrary to the terms of the lease, use of the premises in breach of the originally agreed use, etc.

6.20 Registration Requirements

It is market practice for the tenant to pay and bear the registration fee, even though the MTC states that the party to whom the lease is beneficial must pay the registration fee. However, the lease may provide otherwise. Such registration duty also applies to the signing of amendments and schedules.

6.21 Forced Eviction

As mentioned in **6.19 Right to Terminate a Lease**, Law No 49-16 allows the landlord to apply to the court for early termination of the lease and eviction of the tenant in certain cases. In practice, however, this is a rather time-consuming and difficult process.

6.22 Termination by a Third Party

Third parties are not entitled to seek the termination of a valid lease agreement. This being said, Law No 49-16 states that any public authority may terminate the lease if this is in the public interest, in which case the landlord is not required to pay eviction compensation (*indemnité d'éviction*) to the tenant.

6.23 Remedies/Damages for Breach

Contractual damages (ie, damages giving rights to indemnification as a result of a contractual default) are defined in Article 264 of the Code of Obligations and Contracts, which provides that: "damages are the effective loss that the creditor has suffered and the loss of profit which are the direct consequence of the non-performance of an obligation. (…)". Hence, the Code of Obligations and Contracts limits the indemnification obligation of the defaulting party to direct damages suffered by the non-defaulting party and therefore excludes indirect and consequential damages.

This being said, it is quite customary to including contractual provisions to clarify the exact scope and intended limitations of a party's indemnification obligation as a result of a default under a specific agreement, including lease agreements.

Unless otherwise specified in the lease contract, landlords generally hold the security deposits paid by tenants or call on the guarantee (banking or corporate) granted by the tenant to the landlord.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Parties may choose between two types of pricing mechanism (sometimes be combined) for construction projects:

- quantity construction contracts (*marché au métré*), by which the contractor performs construction work for a price based on the quantities actually used for the work; or
- lump sum price construction contracts (*marché à prix forfaitaire*), in which the contractor carries out the work for a fixed and non-revisable price agreed upon at the time of signing (under this type of contract, the contractor does not have the right to request additional payment or compensation, except in limited cases such as for modifications or when the client requests additional work).

7.2 Assigning Responsibility for the Design and Construction of a Project

Different types of contractual arrangement can be adopted by the owner:

- separate contracts with the design team (architects, engineers, etc) and the construction contractor, in which case responsibility for the design will be assumed by the design team, while the contractor will be in charge of the work; or
- a single design and construction contract (*contrat de contractrant général*) with a contractor, under which the contractor responsible for the work will also be responsible for the design.

In any case, the assistance of a Moroccan architect is mandatory when applying for a building permit. This architect is responsible for drawing up the design plans and the application file for the building permit, supervising the proper execution of the work and assisting the owner in handing over the work, as well as issuing the final statement in order to obtain the certificate of conformity (*certificat de conformité*) or the occupancy permit (*permis d'habiter*).

7.3 Management of Construction Risk

In a private construction contract, the following mechanisms are typically used to manage construction risks (and are freely negotiated by the parties):

- Representations and warranties of the contractor regarding the feasibility of the project, the contractor's knowledge of the technical, environmental and legal framework applicable to the project and its ability to carry out the work under the conditions provided for in the contract.
- Holdbacks, whereby the owner retains payment of a certain amount (usually up to 10% of the contract price) to guarantee the remediation of any defects arising on the date when the work is provisionally accepted (generally, the contractor will request that a bank suretyship (*cautionnement bancaire*) be used in place of this retainer).
- A performance bond, usually from 3% to 10% of the contract price, to secure the payment of any penalties that may be imposed on the contractor for a delay or breach of contract, which is normally returned to the contractor or waived following the final acceptance of the work (occurring 12 months after provisional acceptance of the work).
- A penalty for breach/liquidated damages.
- Insurance policies covering professional construction activities (civil liability insurance of contractors, or professional insurance of architects, experts, engineers, etc) and the

coverage of certain assets (such as all-risk insurance for a construction site and a ten-year warranty owed by the contractors).

7.4 Management of Schedule-Related Risk

Delay provisions in the event that the agreed-upon milestones or completion dates are not met (unless the delay is due to force majeure or other unforeseen event, or is attributable to the owner) are generally used to avoid any schedule-related risk on construction projects. Delay penalties are often capped at a specific percentage of the contractor's contract price.

It is worth noting that Article 264 of the Code of Obligations and Contracts provides that a judge may always assess and then reduce the amount of contractual penalties.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Owners typically ask contractors for security to ensure timely completion and accurate performance of the work. A completion guarantee/performance bond as well as holdbacks (often replaced by a bank guarantee) are frequently provided by the contractor to the client (see **7.3 Management of Construction Risk**). Also, it is standard practice for clients to require an advance payment bond, payable on first demand, to ensure that any advance payments made by the client prior to the commencement of work are repaid.

7.6 Liens or Encumbrances in the Event of Non-payment

There are no specific provisions in Moroccan law regarding the ability of contractors and/or designers to pledge or otherwise encumber property in the event of non-payment by the client. Only the client is entitled to use the property as security, as the property is generally owned by the client.

7.7 Requirements Before Use or Inhabitation

In most cases, the construction contract specifies the conditions precedent that must be satisfied before the handover can take place. In practice, upon completion of the work, the parties will hold a provisional handover/acceptance (*réception provisoire*), even if there are some slight defects or snags still outstanding, which the contractor undertakes to repair during the warranty period (which is usually one year). Once the warranty period has expired, final handover/acceptance takes place (*réception definitive*).

In any case, upon completion of construction, the owner must obtain an occupancy permit (*permis d'habiter*) or, if the building is not intended for private accommodation, a certificate of conformity (*certificat de conformité*) certifying that the building as erected complies with the provisions of the building permit. This certificate is a prerequisite to the use of the erected building; using a building without such permit may give rise to fines and criminal liability.

8. Tax

8.1 VAT and Sales Tax

Real estate sales and purchases generally do not require payment of VAT (ie, when a property is second hand rather than a new building).

Pursuant to Article 89-I-4° of the MTC, VAT is payable on real estate work, subdivision/allotment operations and real estate development transactions (the sale of plots in a real estate development project is subject to VAT at a rate of 20%).

8.2 Mitigation of Tax Liability

The acquisition of large real estate portfolios has the same tax consequences as the purchase of a single real estate asset: if the transaction involves the direct purchase of real estate, it is subject to registration fees and property registration (see **2.10 Taxes Applicable to a Transaction**).

However, in order to minimise the tax cost, it might be possible to acquire shares in a company that does not qualify as a real estate company (ie, that does not have gross assets composed of at least 50% real estate properties/other real estate companies). In that case, the transaction would be free of registration duties and no property registration fee would be payable (see **2.10 Taxes Applicable to a Transaction**).

8.3 Municipal Taxes

When renting out commercial or industrial premises, tenants are liable for two main local taxes: business tax and tax on municipal services.

Business Tax

Pursuant to Article 6-II-1° of Law No 47-06 on local taxation, all newly created professional activities benefit from a total exemption of business tax for the first five years after starting their activity. Business premises benefit from this exemption.

The taxable basis for business tax is the gross yearly rental value of all the assets available to the company (including assets purchased and rented). Newly incorporated companies benefit from a five-year business tax exemption, regardless of their legal purpose.

For hotel/housing activities, the taxable basis is determined by multiplying the construction/building cost with the following proportional rates:

- 2% if the construction cost is lower than MAD3 million;
- 1.5% if the construction cost is equal to or higher than MAD3 million and less than MAD6 million;
- 1.25% the construction cost is equal to or higher than MAD6 million and less than MAD12 million; and
- 1% if the construction cost is equal to or exceeds MAD12 million.

Companies that do not own the premises they occupy must also include the amount of rent paid to the owner for all types of leases (real estate, leasing, etc) in the taxable basis.

The applicable rate is based on the nature of the activity and ranges from 10% to 30%, applicable on the annual rental value of assets used for the activity.

Tax on Municipal Services

The taxable basis for the tax on municipal services is determined with reference to the rules applicable to business tax. In principle, the municipal tax services taxable basis is identical to the business tax taxable basis (the taxable basis is reported in the same return for both taxes).

There is no exemption for the start of the activity regarding this tax (ie, it is payable as from the first year of activity).

The tax rate for the municipal services tax differs according to the geographical location of the activity, as follows:

- 10.5% for properties located within the scope of urban municipalities, delineated centres and summer, winter and spa resorts; and
- 6.5% for properties located in outlying areas of urban municipalities.

Companies that do not use the properties they own are not liable for the business and municipal taxes on such properties; instead, the tenant is subject to the taxes relating to these properties.

8.4 Income Tax Withholding for Foreign Investors

The applicable regime is based on the distinction between companies and individuals.

Companies

According to the MTC, foreign investors owning property in Morocco are subject to corporate income tax on revenues deriving from that property (depending on the provisions of any double taxation treaty that may govern taxation, but generally capital gains on real estate are taxed in the country where the property is located).

The corporate income tax rates detailed in **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity** apply for 2024, 2025 and 2026 before reaching a flat rate of 20%, depending on the taxable income (ie, mainly the capital gain generated by the sale of a real estate property located in Morocco and made by a foreign investor).

Individuals

The real estate rental income of individuals is subject to the following proportional rates:

- lower than MAD120,000 – 10%; and
- more than MAD120,000 – 15%.

If a professional (either a company or an individual) pays a rental/real estate income (public or private legal entities or individuals), this professional is required to withhold the personal income tax on behalf of the real estate owner. The tax withheld is equal to 10% of the monthly gross rent payable if the yearly rent is lower than MAD120,000, otherwise the rate is 15%.

Capital gains on real estate properties are subject to personal income tax at the rate of 20%. In the case of a capital loss (ie, sale price of a property lower than its purchase price), the minimum tax payable amounts to 3% of the sale price.

Exemption

The following is exempt from personal income tax: capital gains made by anyone who, during the calendar year, transfers buildings with a total sale price up to MAD140,000.

Double Tax Treaties

Double tax treaties entered into by Morocco generally provide that income/capital gains from immovable property may be taxed only in the contracting state in which the property is located.

Thus, the domestic treatment provided by the MTC is generally confirmed and the rental income received or capital gain carried out by a foreign investor (on a property located in Morocco) will be subject to (corporate) income tax in Morocco.

In the absence of a tax treaty, taxation will generally be applicable in Morocco and may generate a situation of double taxation.

Hence, in both cases (existence of a tax treaty or not), rental income and capital gain deriving from

a property located in Morocco will generally be taxable in Morocco under standard conditions.

8.5 Tax Benefits

When legal entities subject to corporate income tax, such as companies, own real estate, they may benefit from amortisation (computed on the building book value – no amortisation is authorised on the land's value), which is deducted within the cap of the authorised rates, pursuant to the practices of each profession, industry or branch of activity and guidelines published by the tax administration.

The recommended rates for the tax deduction of the taxable basis by the tax authorities are 4% for residential or commercial buildings, and 5% for permanently constructed industrial buildings.

Furthermore, the main new innovation in real estate ownership is the setting-up of Moroccan REITs (OPCIs), which enjoy the following tax incentives.

- Regarding the OPCIs' upfront capital investment:
  - (a) a deferral (*sursis*) from the tax on capital gains (either individual or corporate income tax) on in-kind contributions (*apport en nature*) of real estate properties for all OPCIs created (permanent regime);
  - (b) taxes on capital gains are paid on the sale of all or part of the OPCI shares;
  - (c) an exemption from registration duties to the tax administration; and
  - (d) 1.5% for registration fees with the Land Registry remain payable.
- Regarding the taxation of the OPCI:
  - (a) an exemption from corporate income tax; and
  - (b) an exemption from taxes on dividend and interests.
- Regarding the taxation of shareholders:
  - (a) corporate income tax at the standard rate;
  - (b) taxes on dividends received by individuals at a rate of 13.75% (for 2023, the rates will change each year until 2026 when the rate will be 10%);
  - (c) taxes on dividends received by non-residents at a rate of 13.75% (for 2023, the rates will change each year until 2026 when the rate will be 10%);
  - (d) capital gains tax for individuals at a rate of 20%;
  - (e) capital gains tax for companies at the standard rate; and
  - (f) an exemption from registration duties to the tax administration.

The OPCI may obtain a total exemption from corporate income tax (rental income, capital gain, dividend) if it meets the following conditions:

- assessment is made by an auditor;
- it holds the assets for a minimum of ten years from the date of contribution; and
- it distributes:
  - (a) at least 85% of the result of the fiscal year relating to the leasing of buildings built for residential or professional use;
  - (b) 100% of the dividends and shares received;
  - (c) 100% of the fixed investment revenues received; and
  - (d) a minimum of 60% of the capital gains on the sale of securities.

NETHERLANDS



Law and Practice

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Greenberg Traurig, LLP is an international law firm with approximately 2,650 attorneys serving clients from 44 offices in the United States, Latin America, Europe, Asia and the Middle East. Greenberg Traurig's real estate practice is a cornerstone of the firm and a recognised leader in the industry. Property developers, lenders, investment managers, private equity funds, operators, joint ventures, sovereign wealth funds, international developers and private owners look to Greenberg Traurig for diversified and broad legal services. Greenberg Traurig applies its expertise to the full cycle of a deal, providing a holistic approach for clients. It handles property acquisition and investment, development, management and leasing, financing, restructuring, and disposition of all asset classes of real estate. It advises on a broad spectrum of commercial, recreational and residential real estate. The company has a skilled hospitality legal team, including attorneys who have pioneered major developments within the industry.

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1. General

1.1 Main Sources of Law

The primary source of real estate law in the Netherlands is the Dutch Civil Code (DCC). Other sources include the Dutch Land Registration Act and the Dutch Agricultural Tenancies Act.

The Dutch Code of Civil Procedure contains special rules on attachments in execution against real estate and on the foreclosure of mortgages. The rules on transfer tax are set out in the Dutch Legal Transactions Act and those on VAT in the Dutch Turnover Tax Act. In addition, many specific provisions of public law apply.

1.2 Main Market Trends and Deals

The widespread economic uncertainty in the past 12 months did not prevent investors from investing in real estate and implementing their strategies, with logistic real estate proving particularly sought-after asset classes, and new parties are entering the Dutch real estate market.

Another important market trend is that investors, lenders and end users are increasing their focus on ESG, not only because it may be part of their core values or to meet governmental obligations, but also because sustainability performance can have a financial impact, either downwards or upwards. It is expected that this will be a major focus point for the coming years.

1.3 Proposals for Reform

An important change that would impact the real estate market is that, as of 2025, it is no longer possible for fiscal investment institutions (*fiscale beleggingsinstellingen*) to directly invest in real estate located in the Netherlands.

Furthermore, the impact of the Corporate Sustainability Reporting Directive (CSRD) will be become significant for the real estate sector. Further to the CSRD, (certain) EU businesses are required to report on the environmental and social impact of their corporate activities and the effect of their ESG actions. The compliance is phased in from 2024–2029, and the first reports will be publicly available in 2025.

A last proposal that must be highlighted is that the Environment and Planning Act (*Omgevingswet*) entered into effect from 1 January 2024. This Act is a comprehensive framework that combines various (old) planning and environmental laws and regulations and includes significant changes with regard to inter alia (re)development and operation of real estate assets from a planning perspective.

2. Sale and Purchase

2.1 Categories of Property Rights

Under the DCC, rights in real estate can either be in rem or personal.

Rights in rem, such as ownership and leasehold, are called absolute rights because they can be invoked against all other parties. Such rights grant the holder certain legally protected powers over the real estate.

Personal rights are mainly contractual in nature and have what is called relative effect – they can only be invoked against one or more specific parties. Examples of personal rights in real estate are rights under a sale, lease or construction contract. There is a distinction between a leasehold, which is a right in rem, and the rights under a lease contract, which are personal. The DCC contains rules on, among other things, the creation, transfer and encumbrance of rights in rem, as well as on many aspects of contracts.

The most comprehensive right in rem in real estate is ownership. This right encompasses the power to possess, use, encumber and transfer the real estate, with due observance of the law. Other rights in rem are derived from and "encumber" the right of ownership and are known as "limited rights". Such limited rights include leaseholds, servitudes/easements, rights of superficies, usufructs and mortgages.

2.2 Laws Applicable to Transfer of Title

See **1.1 Main Sources of Law**.

2.3 Effecting Lawful and Proper Transfer of Title

Under Dutch law, the involvement of a civil law notary is mandatory for a variety of legal transactions, including the creation and transfer of rights in rem in real estate. A notary is both a legal practitioner and a public official with several prescribed duties and is required to be impartial, which means that they must act in the interest of all parties to a transaction and also consider possible third-party interests.

The ownership of real estate is transferred by the execution of a deed before a civil law notary, followed by the filing of a certified copy of the deed in the public register maintained by the Land Registry Office. Rights in rem derived from ownership are created and transferred in the same way.

Before the deed is executed, the notary is required to investigate whether the owner (or the transferor or party creating the relevant right) has the power of disposal over the real estate and whether any mortgages (or other limited rights) are vested therein. This is done by, among other things, reviewing the owner's/transferor's "chain of title" and by checking the land register. If the land register shows any inconsistencies, these must be further investigated by other means.

The registration process set out above offers the buyer an appropriate level of security. In the Netherlands, the Land Registry records all important information concerning real estate. It is impossible to transfer property without registration, so title insurance is not common in the Netherlands.

2.4 Real Estate Due Diligence

It is common practice for real estate due diligence to cover the legal, tax, environmental, technical and commercial aspects of the subject of sale.

The scope of the due diligence usually depends on the investment type and value, the current state of the subject of the sale and the requirements of the purchaser in that respect.

A "standard" legal due diligence comprises a review of the following, among other things:

- title documentation;
- leases;
- environment plans;
- environmental permits;
- soil/environmental surveys;
- legionella surveys/management plans;
- construction agreements;
- warranty certificates;
- insurance documentation; and
- maintenance contracts.

The results of the various legal, tax, environmental, ESG, technical and commercial reviews are recorded in due diligence reports drawn up by the purchaser's respective advisers.

2.5 Typical Representations and Warranties

Besides case-specific warranties, it is common for the Sale and Purchase Agreement (SPA) for commercial real estate transactions to contain a set of more or less "standard" other warranties.

The number and scope of these other warranties obviously depend on the type of transaction agreed. In an "as is, where is" transaction, the SPA usually contains title warranties and only a few others, whereas the warranties in a more balanced SPA are usually quite extensive. In the latter case, the subjects commonly covered include:

- legal title;
- leases;
- other agreements that will or will not be transferred to the purchaser;
- environment plans (previously zoning plans);
- environmental permits;
- legal proceedings, if any;
- any claims of contractors and other third parties; and
- the due diligence documentation provided by the vendor.

The SPA often contains provisions limiting the vendor's liability relating to (i) the liability period, (ii) the maximum amount of any such claims, and (iii) thresholds for filing a claim.

Warranty and indemnity (W&I) insurance policies can also be part of a commercial real estate transaction.

2.6 Important Areas of Law for Investors

See **1.1 Main Sources of Law**.

2.7 Soil Pollution or Environmental Contamination

A buyer of a real estate asset can be responsible for soil pollution or environmental contamination of a property even if the buyer did not cause the pollution or contamination. The extent of the responsibility depends, inter alia, on the type of real estate, when the soil pollution was caused and whether any decisions have already been taken by the competent authority with respect to the soil pollution.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In order to ascertain the permitted uses of a parcel of real estate under applicable zoning or planning law, a buyer can consult a publicly available website on which the relevant environment plans that detail the permitted use are shown. It is possible to enter into development agreements with the competent authority to facilitate a project, with the caveat that such agreement generally does not guarantee that the project will be permitted because the competent authority always reserves its rights and obligations under public law in these agreements.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental taking of land, condemnation, expropriation, or compulsory purchase is possible in the Netherlands. The general process of expropriation is that the competent authority takes an expropriation decision, which must be confirmed by the district court. Further appeal is possible against the judgment of the court with the Administrative Law Division of the Council of State. Once the expropriation decision is irrevocable, a notary will transfer title to the land to the government. The compensation that the authorities have to pay in relation to the expropriation is determined in a separate civil court procedure.

2.10 Taxes Applicable to a Transaction

No stamp duties or similar documentary taxes are levied in the Netherlands.

The acquisition of real estate is generally subject to 10.4% real estate transfer tax (RETT), levied from the acquirer, on the property's fair market value (or, if higher, the purchase price). The acquisition of (partial) beneficial ownership of real estate located in the Netherlands is also subject to RETT.

Furthermore, the acquisition of shares in a qualifying real estate company is a deemed acquisition of real estate, which is subject to 10.4% RETT if the acquirer obtains a "substantial interest" (of at least one third) in such company.

RETT exemptions may apply where the acquisition concerns newly constructed real estate or building land (see **8.2 Mitigation of Tax Liability**). RETT reductions may apply if the acquisition takes place within six months of a previous acquisition of the same real estate.

2.11 Legal Restrictions on Foreign Investors

Subject to sanction regulations, there are no legal restrictions on foreign investors acquiring real estate in the Netherlands.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate typically entail a special purpose vehicle (SPV) attracting senior (or mezzanine, via a holding company of the SPV) financing from banks, alternative or institutional lenders, while receiving equity from a holding company. Equity will be provided by the investor(s), in the form of share capital, a share premium or (although legally not considered as equity) subordinated (shareholder) loans.

Terms of the financing depend on the size and complexity of the financing and the relevant property, and whether the relevant lender(s) has a syndication strategy, in which case documentation will be based on Loan Market Association (LMA) standard forms. For smaller and more straightforward financings by a single Dutch lender, financing will typically be provided on the basis of standard bank documentation.

3.2 Typical Security Created by Commercial Investors

The main types of security for a lender are in rem security rights (mortgage and pledge) and security rights in personam (guarantees), albeit that real estate finance is generally non-recourse, which means that lenders will not have recourse (via guarantees or similar security) against the investors of the borrower.

A Dutch law in rem security right can only secure monetary payment obligations. Typically in Dutch real estate financings, lenders will require the following:

- a right of mortgage on the land and building – this is the most relevant asset;
- a right of pledge on movable assets;
- a right of pledge on receivables (including bank accounts, lease receivables, intercompany receivables, insurance receivables, etc); and
- a right of pledge on the shares in the borrower.

If Dutch law in rem security is created in favour of an agent or trustee for the benefit of other parties, a parallel debt is required, as it is gener-

ally assumed that a Dutch law right of mortgage or pledge cannot be validly created in favour of a person who is not the creditor of the secured liabilities. There is no statutory law or case law available on the parallel debt. However, in the general view of leading authors in Dutch legal literature, a parallel debt creates a claim of the mortgagee or pledgee which can be validly secured by a right of mortgage or right of pledge.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no specific restrictions on granting security in favour of a foreign lender. The same goes for making repayments to a foreign lender under any finance document. Generally speaking, in both cases, the Money Laundering and Terrorist Financing Prevention Act will apply. Banks, civil law notaries and lawyers involved will have to perform a client due diligence on both national and foreign clients and report to the Netherlands Financial Intelligence Unit any suspicious transaction; that is, transactions that could involve money laundering or terrorist financing.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

No stamp duties or documentary taxes are payable in the case of creation or enforcement of a right of mortgage over real estate.

For the creation of the right of mortgage, a deed of mortgage will need to be executed by a Dutch civil law notary and registered with the Dutch Land Registry. Notarial fees and registration fees will need to be paid.

A right of mortgage is usually enforced by way of a public auction (see **3.6 Formalities when a Borrower Is in Default**). Execution costs will be deducted from the sales proceeds.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under Dutch law, prior to the granting of security, certain considerations need to be taken into account.

- Financial assistance – the DCC includes a prohibition on Dutch public limited liability companies providing financial assistance in connection with the acquisition of their shares. Such prohibition has been abolished for Dutch private limited liability companies.
- Corporate interest – any legal act performed by a Dutch legal entity must be in the corporate interest of such entity. If this is not the case, the act may exceed the entity's corporate power and therefore be nullified by the Dutch legal entity if the counterparty knew, or should have known, that such legal act was not in the entity's corporate interest. The statutory object clause, although an important element, is not in itself decisive. In case law, the Dutch Supreme Court has ruled that a Dutch court should consider, when objectively determining whether a specific legal act should be regarded as exceeding a company's corporate objects, not only the description of the objects in the articles of association is decisive, but all relevant circumstances (eg, the company's commercial interest, group relations, etc). This includes, in particular, whether the interests of the legal entity were served by entering into the transactions. The board of directors of the Dutch legal entity must carefully make (and, ideally, document) the relevant analyses.
- Conflict of interest – it is not permitted for a director of a Dutch company to participate in deliberations and decision-making if they have a direct or indirect personal conflict of interest with the company in respect of the contemplated transaction.

- Spouse's consent – if a natural person (eg, a director), other than in the ordinary course of business, grants a guarantee, surety, accepts joint and several liability, or any other form of personal security as security for the debt of a third party, such person's spouse must give their consent to the granting of such form of security. If such consent is required but has not been obtained, the relevant spouse may annul the granting of the relevant security.

3.6 Formalities When a Borrower Is in Default

Under Dutch law, security rights can be enforced in the event that the borrower is in default in the performance of secured liabilities (ie, a payment default). Any other default would therefore need to result in accelerating the loan to force a payment default.

In case of a payment default, a mortgagee (and a pledgee) has the right of summary execution and, in the case of bankruptcy or suspension of payments, may in principle enforce its security rights as if there were no bankruptcy or suspension of payments (see **3.9 Effects of a Borrower Becoming Insolvent** for nuances).

A right of mortgage can be enforced by way of (i) a public auction (without court order) or (ii) a private sale authorised by the competent Dutch court, all with due observance of the applicable Dutch law provisions. Appropriation by the mortgagee is not allowed, but the mortgagee may bid on the assets in a public auction and, if a private sale is requested and the mortgagee submits a more favourable bid before the end of the hearing of such request, the Dutch competent court may authorise that the assets are sold to the mortgagee.

If the mortgagee wishes to enforce its right of mortgage and sell the property free of leases, the mortgagee must invoke the lease clause (*huurbeding*), which must be explicitly agreed upon in the deed of mortgage. The mortgagee must invoke such lease clause before executing the mortgage. Several formalities must be considered in the enforcement of the lease clause.

Obstacles

A creditor with control over the property (eg, a contractor) may, under certain circumstances, invoke its right of retention which may (subject to certain conditions, and depending on which right is of older date) give such creditor priority over the right of mortgage.

Execution by Other Creditors

There are no additional steps to be taken to give priority of the lender's security interest over the interests of other creditors. If a lower-ranking mortgagee proceeds with enforcement of its right of mortgage (if at all permitted in the context of the applicable financing), the first-ranking mortgagee may take over the execution, but that is not required for it to keep its priority over the other creditors. The first-ranking mortgagee may recover its claim on the borrower from the proceeds of the execution regardless of whether it initiated the execution.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt may become subordinated to newly created debt either (i) by changing the rank of the relevant in rem security rights (this was already possible on the basis of explicit legal provision for rights of mortgage, and recently, as confirmed in Dutch case law, also for rights of pledge), or (ii) pursuant to an intercreditor and/or agreement among the relevant lending par-

ties, which only results in a contractual change in rank.

3.8 Lenders' Liability Under Environmental Laws

In principle, a mortgagee cannot be held liable under environmental laws for pollution of real estate, unless it has been involved in causing the pollution. However, the position of the mortgagee is no different from any other third party involved. This could change, however, if the mortgagee becomes the property owner.

3.9 Effects of a Borrower Becoming Insolvent

Generally speaking, Dutch law security interest created in favour of a mortgagee/pledgee cannot be made void in the case of insolvency of the borrower. There are, however, certain things to consider in case a borrower becomes insolvent.

Impact on Security Rights

Generally speaking, under Dutch law, assets over which a Dutch law or non-Dutch law security right is purported to be created, which are acquired or come into existence after a pledgor has been granted a suspension of payments or has been declared bankrupt, will not become subject to such security right.

With respect to bank accounts, this means that payments that are booked in a pledged account after the pledgor has been granted a suspension of payments or has been declared bankrupt, will not be subject to the security right created by the relevant security agreement and will therefore become part of the bankrupt estate of such pledgor. A pledgee may not enforce a security right over an account in respect of payments that are booked in such pledged account after the pledgee (with whom the pledged account is maintained) should reasonably have been aware that the pledgor would be granted a suspension of payments or be declared bankrupt.

With respect to lease payments, any payments to be made by the lessee under a lease which become due after the pledgor has been granted a suspension of payments or has been declared bankrupt, will not be subject to the security right created by the relevant security agreement and will become part of the bankrupt estate of such pledgor.

With respect to a right of pledge over receivables in general, a pledgee may only collect a receivable subject to a Dutch law right of pledge after the debtor has been notified of such right of pledge. Until notification, the right to collect remains with the pledgor. Payments made by a debtor to the pledgor, or its bankruptcy trustee, prior to notification but after bankruptcy or suspension of payments of the pledgor will form part of the bankruptcy estate. The pledgee has a priority right with respect to the proceeds of such payments but will not be paid until the bankruptcy estate is distributed and will thus have to share in the bankruptcy costs.

Fraudulent Conveyance

The bankruptcy trustee may annul legal acts performed by the insolvent borrower based on fraudulent conveyance (*actio pauliana*) if certain conditions have been met. A distinction is made between voluntarily performed legal acts and non-voluntarily performed legal acts.

Cooling-Down Period/Deadline for Enforcement

As said, a mortgagee and a pledgee may in principle enforce their security rights as if there were no bankruptcy or suspension of payments. A security right gives the lender priority over other creditors; the lender has a priority claim over the

proceeds resulting from enforcement of its security (subject to limited exceptions). If the borrower has been declared bankrupt, then this can even be done without the bankruptcy trustee's co-operation. A court may nonetheless order a two-month general stay, the "cooling down period" (which can be extended by an additional two months), during which security rights cannot be enforced. The pledgee/mortgagee does not need to contribute to the bankruptcy costs.

A bankruptcy trustee has the right to impose a (reasonable) deadline on pledgees/mortgagees to enforce their security rights. If a pledgee/mortgagee does not enforce its security rights by this deadline, then the trustee may take over the enforcement. In that case, the pledgee or mortgagee retains its priority claim on the proceeds from the enforcement sale, but it must bear a proportionate part of the bankruptcy costs (which can be considerable).

Powers of Attorney

Any power of attorney or mandate contained in the finance or security documents, whether or not it is irrevocable, granted by the Dutch borrower, will terminate without notice by force of law upon bankruptcy, and will cease to be effective in case of a suspension of payments of the Dutch borrower or in the event of the Dutch borrower being subjected to an intervention, recovery or resolution measure.

Statutory Priority Right of Dutch Tax Authorities

The Dutch tax authorities have a statutory priority right over equipment and other movable assets (the priority assets) which are intended for furnishing and which are located at the premises of the debtor of certain tax claims in the Netherlands. This statutory priority right prevails over a non-possessory right of pledge over such assets, even if the pledgor is not the debtor of the tax claim.

3.10 Taxes on Loans

No stamp duties or recording taxes are payable in connection with the creation of mortgage loans or mezzanine loans related to real estate. There are also no proposed rules in this regard.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The main instrument for regulating the use of a property is the "environment plan" (*omgevingsplan*). The Environment and Planning Act sets certain environmental boundaries for the environment plan but generally the municipal legislature has a wide margin of appreciation when adopting such a plan.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The most important rules for design, appearance and method of construction of new buildings or refurbishment of an existing building are laid down in the environment plan. This can, among other things, set maximum dimensions for buildings and regulate the appearance of buildings. Certain minimum safety requirements are laid down in the Environment and Planning Act and the Structures (Living Environment) Decree (*Besluit bouwwerken leefomgeving*). A permit for building activities can be required, depending on the details of the building and the provisions of the environment plan.

4.3 Regulatory Authorities

The municipal executive (*burgemeester en wethouders*) is mainly responsible for regulating the development and designated use of individual parcels of real estate. In some instances, the provincial executive or the minister will be the competent authority. Typically, the main restrictions are set forth in the environment plan that applies to the property.

4.4 Obtaining Entitlements to Develop a New Project

An environmental permit is generally required for construction activities and/or to deviate from the environment plan. Third parties can object to the permit, and then appeal with the district court. Further appeal is possible with the Administrative Law Division of the Council of State. Prior to applying for a permit, developers are expected to involve local residents in their plans. In some instances, it is mandatory to follow a certain process of participation by local residents.

4.5 Right of Appeal Against an Authority's Decision

Generally, a decision respecting an application for permission for development or the carrying on of a designated use (of the relevant authority's) is open to objections with the authority itself (sometimes with the involvement of an objections committee). After that, appeal is possible with the district court and further appeal with the Administrative Law Division of the Council of State.

4.6 Agreements With Local or Governmental Authorities

It is typical to enter into a so-called "anterior agreement" with a municipality, in which it is usually agreed that the municipality intends to co-operate with the envisaged development and that the developer bears certain costs. In addition, a developer will need to secure (electricity) grid access of a sufficient capacity by concluding an agreement with the grid operator.

4.7 Enforcement of Restrictions on Development and Designated Use

Typically, restrictions on development and designated use are enforced by means of an administrative order under the threat of a penalty payment. In theory it is also possible that an administrative fine is imposed but this was only made possible by the Environment and Planning Act that entered into force on 1 January 2024.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

In principle, there are no restrictions under Dutch law as to who can hold legal title to real estate in the Netherlands. Consequently, Dutch real estate can be acquired and owned by any individual or legal entity (provided its organisational documents allow this), including foreign individuals or entities.

Dutch law does not provide for a special vehicle for investments in real estate, although there may be a special tax regime available for vehicles investing in Dutch real estate, if certain conditions are met.

The Dutch vehicles commonly used to invest in/hold real estate in the Netherlands are:

- the public limited liability company (NV);
- the private limited liability company (BV);
- the limited partnership (CV); and
- the mutual fund, the "fonds" (FGR).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

NVs/BVs

Both the NV and the BV are companies with limited liability and a capital divided into shares. The shareholders are not liable for the company's obligations; their liability is limited to any amount still owing on their shares.

An NV is subject to the various EU Company Law Directives, which set out certain rules on – among other things – the maintenance and alteration of capital. An NV is the Dutch entity of choice for a listing of shares or other securities on a stock exchange. Although shares in a BV can in principle be listed, this is not done in practice. A BV is subject to fewer of the above-mentioned directives and is governed by simpler statutory rules that offer a large degree of flexibility in the company's governance structure.

NVs and BVs are generally liable for Dutch corporate income tax, at a rate of 25.8% on profits exceeding EUR 200,000. The lower rate is 19%.

CV

A CV is a partnership entered into by one or more general partners and one or more limited partners. A general partner is fully liable for all the CV's obligations, whereas a limited partner is only liable up to the amount contributed or committed to the CV. The business of the CV is conducted by the general partner(s). A limited partner will lose its limited liability if it participates in the CV's management or purports to act in the name of the CV towards third parties.

For Dutch tax purposes, CVs either qualify as "open" or "closed", depending on whether or not unanimous approval is required for replacement and/or addition of limited partners. Open CVs are independently liable for Dutch corporate income tax, just as BVs and NVs. Closed CVs are tax-transparent, meaning that the partners are subject to Dutch taxation with respect to their interest in the CV as if they hold the real estate directly. As of 2025, all CVs will be considered tax-transparent (regardless of approval requirements for admission/replacement of partners)

FGR

The FGR, also known as a "fund for joint account", is a creature of Dutch tax law. It is not considered to be a legal entity or partnership but rather a contractual arrangement, usually between the investors, a manager and a custodian.

Just as CVs, FGRs can qualify either as tax-transparent or open. FGRs are considered opaque if participations are freely transferable. As of 2025, all FGRs will be considered tax-transparent, unless the participations are freely transferable on a regulated market or comparable trading platform.

5.3 REITs

REITs are not commonly available investment vehicles in the Netherlands, but a special tax regime exists for fiscal investment institutions (*fiscale beleggingsinstellingen* or FBIs) that can be considered an equivalent to REITs (see **8.4 Income Tax Withholding for Foreign Investors**). Since it will no longer be possible for FBIs to directly invest in real estate located in the Netherlands in 2025, this regime is not considered relevant for the future real estate market.

5.4 Minimum Capital Requirement

NVs

An NV may issue both bearer and registered shares. Its articles must state the authorised share capital, the number of shares (the number

of shares per class, if applicable) and the nominal value, in euro, of the shares (class).

The incorporation deed must state the amount of the issued share capital, which must be at least 20% of the authorised share capital (or 10%, after the deduction of the nominal value of any treasury shares, if the NV is an investment company with variable capital). The deed must also state the amount paid up on the issued shares at incorporation (to be at least 25% of the issued share capital and at least EUR45,000). The NV and a shareholder can agree that part of the nominal value of the shares issued to that shareholder (up to 75% of the nominal value per share) need not be paid up until the NV calls for payment.

Until the paid-up portion of the share capital amounts to at least EUR45,000 and to at least 25% of the issued share capital as set out in the incorporation deed and until the NV is duly registered in the trade register, the board members are jointly and severally liable, together with the NV, for all legal acts performed in the company's name.

BVs

A BV may only issue registered shares. At all times there must be at least one share with voting rights held by a party other than, and not on behalf of, the BV itself (or its subsidiaries, if any). The articles must state the shares' nominal value (which can be in any currency) and, if the BV has different classes of shares, the nominal value of the shares in each class. The articles may also provide for authorised share capital, but this is not mandatory and, in fact, would restrict a BV's flexibility to restructure its share capital.

The deed of incorporation must state the amount of the issued share capital and the amount paid up on the issued shares. It may be agreed between the BV and a shareholder that payment of all or part of the shares' nominal value will be deferred until the BV calls for payment. Consequently, and because no minimum share capital requirement applies, a BV may be incorporated with an issued share capital as low as EUR0.01, comprising one share with voting rights, and a paid-up share capital of zero.

CVs

Although a CV is not an entity with capital divided into shares, it may issue shares or participations to its partners, which is particularly important if the partners wish the CV to be classified as a real estate vehicle for Dutch real estate transfer tax purposes.

5.5 Applicable Governance Requirements

Governance NVs/BVs

Management board (executive)

NVs and BVs must have a management board consisting of at least one member.

Where an NV or a BV is subject to the "structure regime" its management board members are, in principle, appointed by the company's supervisory board. The structure regime applies if certain conditions are met for three consecutive years.

Individuals and legal entities may be management board members and no requirements as to nationality or residence apply. However, from a tax perspective it may be desirable for at least 50% of the members (preferably individuals) to be resident in the Netherlands and for board meetings to be held in the Netherlands and be attended by all members in person.

The management board is responsible for the company's management.

Both the management board collectively and each board member individually has the power to represent (ie, legally bind) the NV or BV. However, the articles may provide that this power vests only in one or more specific board members or in two or more board members acting jointly. The power to represent the company is unrestricted and unconditional (except in a limited number of cases).

Supervisory board (non-executive)

An NV's or BV's articles may provide for a supervisory board, consisting of one or more members, with the duty to supervise the policies pursued by the management board and the general course of affairs of the company and its business. The supervisory board also advises the management board. Only individuals may be appointed as supervisory board members.

It is mandatory for a "structure-regime" NV or BV to have a supervisory board (or a one-tier board; see below) and special provisions apply to the appointment, duties and powers of the supervisory board of such a company.

One-tier board (executive and non-executive)

Instead of a separate management board and supervisory board, an NV or BV may also have a one-tier board, comprising both executive and non-executive board members.

In the case of a one-tier board, the articles or board rules drawn up pursuant to the articles may provide for the delegation to an individual board member of the authority to adopt board resolutions on the matters falling within that member's sphere of responsibility.

General meeting of shareholders

The general meeting of shareholders is a corporate body formed by all shareholders and all other persons with meeting rights, if any, and has authority over all matters that are not specifically assigned to another corporate body by law or under the articles. At least one general meeting must be convened each year, but in the case of a BV this is not required if, during that year, at least one shareholder resolution is passed without a meeting being held.

Both the management and supervisory boards have the power to convene a general meeting of shareholders; other parties may also be granted this power under the articles. Management and supervisory board members have an advisory vote at all general meetings.

Only shareholders and, if so provided in the articles, holders of a pledge or usufruct on shares, have voting rights.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual entity maintenance and accounting compliance with clear process and procedure is very important for all companies, including investors in real estate. The costs depend on the scope of works required.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The main agreements allowing the use of real estate for a limited period are lease or user agreements.

6.2 Types of Commercial Leases

All leases are subject to the general statutory provisions, which are laid down in Sections 7:201-231 (excluding Section 7:230a), DCC.

Depending on the use of property, a lease of immovable property will be subject to one of the following legal regimes in addition to the above-mentioned general provisions:

- the regime for leases of residential premises;
- the regime for leases of "230a premises"; and
- the regime for leases of "290 business premises".

Leases of premises that are used as a retail, handicrafts or camping establishment or as a hotel, restaurant or café are governed by Section 7:290 et seq DCC. Such premises are therefore referred to here as 290 business premises. A lease of immovable property that is not used as 290 business premises or as residential premises is subject to the regime laid down in Section 7:230a, DCC (eg, office space and warehouses).

The degree to which the lessee enjoys security of tenure varies depending on the regime applicable to the lease.

6.3 Regulation of Rents or Lease Terms

For commercial leases, parties are free to agree on the rent.

For the purposes of the rules on rent in the DCC, residential premises in the Netherlands fall into one of two categories: social housing and "liberalised" (private sector) housing.

Leases of social housing are subject to detailed rules on, among other things, the factors to be taken into account when calculating the rent and the maximum amount of rent payable (a ceiling applies).

In the case of private-sector housing, fewer rules apply and the lessee and lessor are free to agree the rent and services provided.

6.4 Typical Terms of a Lease

Parties are free to draft their own contract, but in the Netherlands, lease contracts are often based on one of the templates drawn up by – and governed by the general terms and conditions of – the Dutch Real Estate Council (ROZ). These templates, which are frequently used in the Netherlands, generally tend to favour the lessor.

Standard lease terms are:

- purpose of the lease;
- designated use;
- term;
- rent and payment terms;
- service charges;
- security; and
- maintenance and repair obligations.

6.5 Rent Variation

Rent is usually subject to (an annual) indexation.

Residential rent indexation may only take place once a year. Furthermore, in regulated residential properties the rent may be indexed by a maximum percentage set by the government.

Furthermore, the 290 business premises regime entitles each of the parties to a judicial rent review at the end of each lease term or, in the case of a lease for an indefinite period, five years after the last review took place. The review will be based on the rent paid for comparable premises in the preceding five years and can therefore lead to either an increase or a reduction in

the rent. The application to the court must be accompanied by a report drawn up by one or more experts appointed jointly by the parties. If the parties are unable to agree on the expert(s) to be appointed, either party can request the court to appoint the expert(s). This statutory right to a rent review is mandatory law and therefore supersedes any contractual provisions, unless such provisions are approved by the court or deviate to the benefit of the lessee.

6.6 Determination of New Rent

Indexation of rent is usually based on the consumer price index (CPI).

6.7 Payment of VAT

Generally speaking, an option to tax letting and leasing is possible for all non-residential real estate (including rights in rem which are treated as a supply or services). The advantage of an option is that the lessor can recover input VAT on costs with respect to the real estate. Under certain conditions, it is possible to integrate the option in the lease. An important condition is that the lease clearly states that the lease will be subject to VAT and contains a declaration in which the lessee declares that the real estate will be used for purposes giving the lessee a right to at least 90% (or 70%) recovery of input VAT.

Generally, the letting of real estate is a relatively passive activity. If, in addition to the more passive letting, other services are offered, the letting may qualify as "letting plus". It is important to determine whether the additional services are embodied in the letting performance or should be regarded as multiple separate services, for which the VAT treatment may differ.

In certain cases, the lessor also charges the lessee service charges when letting real estate. In principle, service charges are taken separately from the rent and are taxed with VAT. Service charges paid by tenants of residential properties are considered to be embodied in the letting performance and are treated the same way for VAT purposes.

6.8 Costs Payable by a Tenant at the Start of a Lease

The payment obligation of a lessee usually consists of rent and service charges plus VAT (compensation).

6.9 Payment of Maintenance and Repair

The general statutory provisions impose only a few maintenance and repair obligations on lessees. In short, the lessee must carry out all minor and day-to-day maintenance, including but not limited to the maintenance of technical installations, the replacement of bulbs, locks, taps and glass, and painting the interior of the premises. Other maintenance and repairs are for the lessor.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications that serve a property occupied by several tenants can in principle be shared (pro rata) via the service charges.

6.11 Insurance Issues

The common practice in the Netherlands is that insurance of the property is taken out by the lessor. The lessor is not obliged to insure furniture and other objects belonging to the lessee that are in the leased premises, however, nor is the lessor obliged to take out business interruption insurance.

Leases for business premises often provide that if a higher than normal premium for fire insurance is charged as a result of the lessee's activi-

ties, the lessee must reimburse the lessor for the amount in excess of the normal premium.

6.12 Restrictions on the Use of Real Estate

Restrictions can be imposed by a lessor on how a lessee uses the real estate. It is market standard, in any case, to agree upon the designated use of the real estate.

6.13 Tenant's Ability to Alter and Improve Real Estate

Lessees are not permitted to change the fixtures and fittings of the leased real estate without the written approval of the lessor. The lessor can impose conditions on such work, and parties can make arrangements about the reversal of any changes at the end of the lease.

6.14 Specific Regulations

Specific regulations apply to residential leases, for example, the Dutch Housing Act gives municipalities the right to regulate short stay through the issuance of a housing regulation, the Minor Repairs (Tenant's Liability) Decree sets out the rules for lessees and lessors regarding minor repairs of the leased real estate and the Good Lessorship Act, which led to (i) the introduction of a basic norm that lessors must adhere to (a "good lessor" norm) and (ii) the assignment of certain powers to municipalities to take enforcement action and the power to introduce a permit requirement for the letting of residential premises in disadvantaged neighbourhoods.

6.15 Effect of the Tenant's Insolvency

By law, either party can terminate the lease contract with due observance of a three-month notice period in the event of the lessee's bankruptcy.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Bank guarantees, parent guarantees and/or security deposits are the most common forms of security provided by tenants.

6.17 Right to Occupy After Termination or Expiry of a Lease

With regard to "230a premises" (see **6.2 Types of Commercial Leases**), mandatory provisions apply with regard to eviction protection for the lessee at the end of the lease.

Pursuant to these rules, if the lessee is given notice to vacate the premises following the end of the term of the lease or, in the case of a lease for an indefinite period, the date on which termination of the lease by notice is to take effect, the lessee cannot be evicted for a period of two months following the date of the notice to vacate the premises. During this period, the lessee can petition the district court to extend this term (up to one year). The court will weigh the interests of the parties in deciding whether to grant an extension. The lessee can subsequently petition for two more extensions (for a maximum of one year each). During the time that the lessee enjoys protection from eviction, the lessor must be paid for the use of the premises.

The eviction protection rules do not apply to lessees that have terminated the lease, explicitly agreed to termination of the lease, or have been ordered to vacate the premises due to a breach of contract.

6.18 Right to Assign a Leasehold Interest

Under Dutch law, the general rule is that a party must have the other party's consent in order to

assign its contractual rights and obligations to a third party.

However, in the case of 290 business premises (see **6.2 Types of Commercial Leases**), special statutory rules enable a tenant that wishes to sell its business under conditions to obtain a court decision authorising the assignment of the lease.

6.19 Right to Terminate a Lease

Termination of a lease can be effected by mutual consent, following notice given by the lessor or by the lessee, dissolution (termination) of the lease in the event of a serious breach or termination in the event of the tenant going bankrupt. In the case of 290 business premises (see **6.2 Types of Commercial Leases**), specific termination grounds apply for the lessor in case of termination.

If the lessor gives notice and the lessee does not agree to the termination, the lease will continue unless and until it is terminated by the competent court.

6.20 Registration Requirements

Leases are not registered in the Netherlands.

6.21 Forced Eviction

Where the lessee is in breach of its obligations under the lease (eg, non-payment of the rent for at least three months), the lessor may dissolve a lease prematurely, resulting in a forced eviction.

6.22 Termination by a Third Party

Termination can be effected by the parties to the agreement and, in the bankruptcy of the lessee, by a bankruptcy trustee.

6.23 Remedies/Damages for Breach

In the event of a tenant breach and termination of a lease, there are no statutory limitations on damages that a landlord may collect or remedies the landlord may pursue outside of charging remaining rent and evicting the tenant.

In case of damages, a landlord can invoke the guarantee that is provided by the tenant (often a bank guarantee or deposit).

7. Construction

7.1 Common Structures Used to Price Construction Projects

Parties can make various agreements on which payment(s) can be based, but construction contracts are generally concluded based on a fixed price.

7.2 Assigning Responsibility for the Design and Construction of a Project

Parties are free to assign the responsibility for the design and construction of a project. Generally, the contractor bears the risk of the work until the moment of delivery.

Several contract formats/general terms exist in the Netherlands, including the so-called UAV and UAV-GC. The latter relates to integrated contract structures. Other variations are building team structures and co-design structures. The applicability of the use of a specific type of structure depends on the complexity of the project and the risk profile of the developer.

It is common in the Netherlands to involve the contractor in the design process as well, in which case the contractor takes partial responsibility for the design and in turn has a preferred position to pitch for the contracting work.

It is worth noting that parties can take out insurance to mitigate the risks relating to the responsibility for design and construction.

7.3 Management of Construction Risk

Parties usually manage the construction risk on a project by agreeing upon indemnifications, representations and warranties, securities, insurances as well as limitations of liability.

7.4 Management of Schedule-Related Risk

To manage schedule-related risk, parties often agree upon a specific payment schedule (by means of which the payment is related to the status of the works) and a penalty clause for late performance/delivery (which penalties can replace the actual damages incurred).

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Additional forms of security to guarantee a contractor's performance on a project, such as step-in arrangements, credit letters, bank guarantees, parent guarantees, escrow arrangements and/or specific payment arrangements, are common.

7.6 Liens or Encumbrances in the Event of Non-payment

Under Dutch law, a contractor working on or still exercising actual control over its work on site of a property, can exercise a right of retention for its unpaid invoices for work done, or suspend working on the development until payments are made.

By means of rather strong right, the contractor can take possession of the property and continue to do so until it gets paid, but parties can deviate from this (so a waiver/restriction is often agreed upon).

7.7 Requirements Before Use or Inhabitation

There are requirements that must be met (under certain conditions) before a project can be inhabited or used for its intended purpose, such as notification of fire-safe use, notification in the sense of the Activities Degree – a report to the competent authority about, among other things, the location, activities, processes and layout, and the performance of a company that must be submitted by specific types of companies – and a valid energy label.

8. Tax

8.1 VAT and Sales Tax

The supply of real estate is exempt from VAT, but exceptions apply:

- the supply of newly constructed real estate is subject to VAT by virtue of law if the supply takes place before or within two years after the asset was first occupied;
- the supply of building land is subject to VAT by virtue of law; and
- if the purchaser of the real estate is entitled to at least 90% deduction of input VAT incurred during the period elapsing between the time of supply and the end of the calendar year following the year in which supply took place, parties may under certain conditions opt for the supply to be subject to VAT.

In addition, the supply of real estate that has been leased out may qualify as a transfer of a going concern. In that case, provided certain conditions are met, the transfer will not be treated as a supply for VAT purposes.

The VAT rate is 21% and VAT is generally levied by the seller. VAT due by the purchaser to the

seller may be recoverable from the Dutch tax authorities if the real estate is used for activities subject to VAT (for example a VAT taxable lease).

In the event VAT is due because parties have opted for a taxable supply, the purchaser must account for the VAT by reporting it as reverse-charged VAT in its VAT return.

If real estate is sold by means of the transfer of shares in a company owning the real estate, no VAT is due on such transfer, since share transactions are generally exempt from VAT.

8.2 Mitigation of Tax Liability

No stamp duties apply in the Netherlands.

The acquisition of real estate located in the Netherlands is generally subject to 10.4% RETT.

In addition, the acquisition of shares in a qualifying real estate company is a deemed acquisition of real estate, which is subject to RETT if the acquirer obtains a "substantial interest" (of at least one third) in such company. A qualifying real estate company is a legal entity, of which at least 50% of the assets consist (or consisted during the preceding year) of real estate, and simultaneously 30% of the assets consist(ed) of real estate located in the Netherlands, provided that the real estate as a whole is (or was) for at least 70% conducive to the acquisition, alienation or exploitation of the real estate.

Under certain conditions, a RETT exemption may apply in case the transfer of real estate is subject to VAT by virtue of law (ie, in case of newly constructed real estate or building land, see above). The RETT exemption may under certain conditions also apply upon the acquisition of shares in a real estate company that owns newly constructed real estate or building land.

8.3 Municipal Taxes

Owners and users of real estate are liable for a variety of local taxes and charges imposed by municipalities, provinces and water boards (which are a distinctly Dutch institution).

Municipalities impose an annual property tax on real estate owners and/or users (at varying rates). In principle, these taxes are based on the property's fair market value. This value (called the "WOZ value") is determined by the local authorities based on the Dutch Property Valuation Act. Taxpayers can file an objection if they do not agree with the assessed WOZ value.

Other local taxes and charges include permit fees, energy tax and sewerage charges, as well as water system levies and pollution levies (the latter two being imposed by the water boards).

8.4 Income Tax Withholding for Foreign Investors

If an investment in Dutch real estate is held by a foreign investor through a Dutch company owning the real estate, dividend withholding tax at a general rate of 15% applies to distributions made by such Dutch entity to the foreign investor. A lower treaty rate may be available. Distributions to qualifying corporate shareholders (with an interest of 5% or more) resident in the EU or jurisdiction that has concluded a tax treaty with the Netherlands, may be fully exempt from dividend withholding tax, subject to certain anti-abuse provisions.

There is a conditional withholding tax on interest and royalties in abusive situations at a rate of 25.8%. Briefly put, abusive situations arise if interest or royalties are paid to an entity in a low-tax jurisdiction, or if there is an artificial construction set up to avoid tax.

Foreign corporate investors as well as Dutch companies investing in Dutch real estate are generally liable for Dutch corporate income tax on rental income and/or capital gains realised from real estate located in the Netherlands, at a rate of 19% on profits up to EUR200,000 and 25.8% on profits exceeding EUR200,000.

A special tax regime exists for FBIs. Under the FBI tax regime:

- real estate income received by the FBI is subject to 0% corporate income tax (and is thus effectively exempt);
- subject to certain conditions, capital gains/losses realised by the FBI may be allocated to a tax-free reinvestment reserve (and are thus also effectively exempt);
- distributions of operating income by the FBI are generally subject to dividend withholding tax, except for distributions from the tax-free reinvestment reserves (certain conditions apply); and
- Dutch or foreign withholding tax payable by the FBI can be reduced under certain conditions.

Certain conditions must be met to apply the FBI tax regime. As of 2025, it is no longer possible for FBIs to directly invest in real estate located in the Netherlands.

Besides the FBI tax regime, special rules apply to qualifying exempt investment institutions (*vrijgestelde beleggingsinstellingen* or VBIs). A VBI is exempt from corporate income tax and dividend withholding tax. However, it is only allowed to invest in financial instruments and not directly in real estate.

Foreign individual investors investing in Dutch real estate are generally liable for Dutch personal income tax in Box 3 (taxable income from savings and investments) of the Dutch Personal Income Tax Act, with a fixed rate of 36% calculated on a notional yield of 6.04%. Actual gains from savings and investments are not subject to tax. Different rules and rates may apply if the real estate investment is attributable to an enterprise carried out by the foreign individual investor.

8.5 Tax Benefits

Annual tax depreciation on Dutch real estate is determined on the basis of (i) cost price of the real estate (minus the part that is allocated to the land, as land is not depreciable), (ii) the residual value and (iii) the economic life of the property. There are no statutory provisions regarding criteria (ii) and (iii). Under Dutch tax law, tax depreciation on real estate that is held as an investment is allowed only to the extent the tax book value of the real estate is higher than the so-called “WOZ”-value, assessed periodically by the municipality determined based on the Dutch Valuation of Immovable Property Act (*Wet waardering onroerende zaken*).

Additional tax deductions may be available for certain environmental and/or energy-friendly investments in Dutch real estate.

Trends and Developments

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Overview

The Dutch real estate market in 2024 is characterised by the following trends and developments:

- sustainability;
- sale-and-leasebacks;
- further development of the industrial, logistic and data centre sectors;
- rise of student housing;
- forward-funding deals;
- alternative lenders; and
- new Environmental and Planning Act.

Sustainability

The importance of sustainability cannot be overstated. All aspects of real estate are touched by it and will be more so in the future. The design and construction of (nearly) energy-neutral new buildings became mandatory in 2021 in the Netherlands. In addition, existing buildings face ever-increasing sustainability demands. As of 1 January 2024 non-residential buildings, in principle, must have an energy label "C" if they are to be rented out. This requirement is likely to be tightened to energy label "A" by 2030. In this context, it is not surprising that property owners are incorporating the production of renewable energy into their assets. This, however, entails new challenges for real estate operators and managers, as they should be wary of new risks such as availability of grid capacity, energy taxes, and investment laws restricting business operations, among other things.

It is not an option for real estate market players to avoid these developments as investors are likely to add value to property sustainability. Some investors will also want to invest only in properties that qualify as a "sustainable investment" under the EU Taxonomy Regulation. This regulation sets out what qualifies as sustainable and what does not. Its aim is to promote transparency and to prevent greenwashing. The thresholds that are set forth by the Taxonomy Regulation are, therefore, likely to become a key factor for investors. It is not surprising that nowadays this is a key aspect in due diligence processes relating to (the acquisition of) real estate.

Furthermore, the implementation of the Corporate Sustainability Reporting Directive (CSRD) will have a significant impact on the real estate sector. Further to the CSRD, (certain) EU businesses are required to report on the environmental and social impact of their corporate activities and the effect of their ESG actions. This means that it will be transparent whether companies have reached their goals and ambitions. The compliance is phased in from 2024–2029, so the first reports will be publicly available in 2025.

These developments unmistakably are also true for real estate finance in the Netherlands. The popularity of sustainable financing options, such as green bonds and loans and sustainability-linked products, aimed at financing environmentally friendly projects, such as energy-efficient buildings or sustainable infrastructure, is strongly increasing. This trend comes with contractual incentives offered by lenders for sustainable real estate projects, such as preferential loan terms and lower interest rates for environmentally certified buildings, and increasingly also defaults linked to not achieving agreed upon sustainability KPIs or other sustainability-linked undertakings. With growing awareness of climate change and environmental concerns, investors and lenders are increasingly seeking opportunities to support sustainable real estate projects, leading to the emergence of innovative financing solutions tailored to promote sustainability in the sector.

Sale-and-Leasebacks

The sale-and-leaseback of real estate involves the owner of a real estate asset selling it to a third party after which that party then immediately leases the asset back for a term at an agreed rent.

Although this trend is not new (it started during the COVID-19 pandemic), we still see that sale-and-leasebacks are on the rise. Some companies are facing difficulties with raising capital, which makes them financially fragile. To limit any negative financial impact, many companies have turned to alternative ways of raising financing, for example, by means of liquidating their real estate assets and leasing them back. In addition, distressed sales and non-performing loans – often the case in this current market – have resulted in various sale-and-leaseback transactions. From an investor's perspective, sale-and-leasebacks are also quite popular as an asset class because stock markets are clearly more volatile.

Other key advantages of sale-and-leaseback transactions include:

- immediate cash injection;
- freed-up capital;
- no relocation of activities;
- debt reduction; and
- increased flexibility.

Further Development of the Industrial, Logistics and Data Centre Sectors

Not only in the Netherlands, but across the European markets, there is growing demand for urban logistics real estate, as well as industrial logistics, due to the constantly growing e-commerce business, combined with the fact that the Netherlands is Europe's logistics hotspot due to its high-quality infrastructure, large ports and central location. There are still many developments in the more southerly part of the Netherlands, which are mostly arranged via a forward-funding structure (see the next section), although many transactions also relate to existing assets.

There is also a strong appetite for data centres in the Netherlands. The data centre market is booming and the Netherlands is often seen as the data hub in the heart of Europe with a unique infrastructure and ecosystem for the data-driven economy. Notwithstanding its growth, the Dutch data centrer market faces various challenges, such as high energy costs, competition for skilled personnel, limited land availability for expansion, power grid congestion and regulatory constraints related to environmental impact.

Rise of Student Housing

The demand for (affordable) student accommodation – particularly in the larger student cities in the Netherlands – is growing and the requirements for accommodation also evolve. More students are looking for an independent, well-equipped room or studio with good amenities (living as a service). This effectively means that the demand for new accommodation and transformation of vacant buildings becomes interesting for various players on the real estate market.

Forward-Funding Structures

In the Netherlands, real estate developments are often acquired in future state of completion. This kind of transaction can be structured as a forward funding, but also as a forward purchase (also known as a "forward sale/forward commitment").

In a forward-funding structure, the sale – and thus the transfer of ownership – occurs prior to the completion of the construction works and

the purchase price is paid upfront, most often in instalments over the construction process.

Contrary to a forward-funding structure, the transfer of ownership in the case of a forward purchase occurs at completion of the construction works. The purchase price will be paid upon completion and the developer or seller is responsible for financing the development. This means that the investor or buyer will neither bear the construction risk nor the risk of insolvency of the developer/seller.

Nowadays, many new developments are acquired by means of a forward-funding structure to limit the involvement of external financiers for the developer and to be more involved in the entire construction process.

Some pros and cons of a forward-funding structure

Due to the early participation of the investor/buyer, it is possible to tailor the development to make sure it matches the envisaged use and the investor/buyer can stay involved with and in control of the development process. Although this is a real advantage, forward funding also has a high-risk profile for the investor/buyer, since they will be exposed if the developer/seller does not perform or becomes insolvent.

To mitigate this, parties usually agree on a condition precedent of definitive permits and appropriate contractual protection mechanisms for the investor/buyer (eg, step-in rights, escrow arrangements or guarantees). In addition, it is also important that a detailed arrangement is made about the payment of the instalments. In most cases, payments are only due based on the status of the works, to limit the financial exposure of the investor/buyer, and the profit margin of the development is paid upon its completion. Furthermore, the investor/buyer is usually entitled to receive interest from a forward funding (a percentage per annum) from the developer/seller over the paid purchase/instalments up to completion, with a penalty being paid in case of late completion.

Alternative Lenders

Non-bank lenders are increasingly active in the Dutch real estate market to finance deals. This seems to be a trend in more jurisdictions as traditional banks are becoming more risk averse, subject to more stringent regulations, and cautious about taking on new clients. This is due to increased scrutiny of banks' compliance policies, as a result of certain scandals. Due to the current economic uncertainties, banks are more carefully managing their balance sheets and shifting to property deals with more certain cash flows, and alternative lenders are looking to fill a gap that continues to widen.

New Environment and Planning Act

On 1 January 2024, a new Environment and Planning Act entered into force, combining numerous old environmental and planning laws into a single Act and various underlying decrees. The legislature's intention for the law is to facilitate developments and to simplify the permitting processes by, for example, facilitating the repurposing of real estate and raising the bar for planning blight claims. It remains to be seen whether these goals will be achieved. The adoption of the law was subject to widespread criticism before it entered into force, even after the entry into force was postponed several times. The first experiences with the Act however seem to indicate that part of the criticism was likely unfounded.

POLAND



Trends and Developments

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Introduction

The Polish real estate investment market in 2023 was predominantly characterised by the consequences of the Russian invasion of Ukraine as well as post-pandemic economic turbulence – both of which brought a significant market slowdown and uncertainty.

The above-mentioned factors, to an extent affecting the wider European and global markets, have resulted in:

- an increase in energy, materials and labour prices;
- a decline in GDP of 0.21% year-on-year (which has now stabilised);
- high inflation (Harmonised Index of Consumer Prices, or HICP) of 10.82%;
- a drop in domestic consumption; and
- increased financing costs.

Consequently, the volume of commercial real estate transactions in 2023 decreased by 68.1% year-on-year to EUR1.8 billion.

According to the latest market forecasts, the unfavourable economic trends of 2023 are expected to reverse (although predictions vary as to how long that process will take) and the outlook for the second half of 2024 brings cautious optimism to the Polish investment market. This is related to the anticipated growth in household consumption, rising incomes and a decrease in global and European interest rates (the Polish investment market is largely financed in euro currency). The volume of transactions (with the industrial and logistics sectors most in demand) is predicted to increase, with intensified activity in the second half of the financial year. Although the volume of transactions may transpire to be lower than the record volumes of pre-pandemic times, investment activity is predicted to remain high in terms of the number of deals but to be dominated by smaller projects.

In addition, the new Polish government – elected in Q4 of 2023 – has announced various new economic programmes as well as amendments to the law and tax system. These are mostly designed to tackle the impact of high inflation, stimulate economic growth and improve conditions on the Polish real estate market (in particular, the residential market).

By way of example, the new government intends to resume work on establishing a legal framework for REIT funds – ie, real estate funds with preferential tax treatment that invest in various types of properties and pay dividends to private investors with certain regulatory protections. If introduced to the Polish system, REITs are likely to boost transaction volumes on the commercial real estate market.

As in previous years, investors, developers, financing banks, tenants and consumers from all parts of the real estate market are paying more attention to ESG. The requirements of institutional buyers have made ESG factors a prerequisite to be considered at the design stage of projects. When searching for the right leasing/investment opportunities, tenants and potential buyers treat ESG issues – and the related reputable certification, such as BREEAM (Building Research Establishment Environmental Assessment Method), which has already been a standard requirement in many sectors for some time – as one of the key commercial elements of the deal, which they are ready to factor in the increased price.

Logistics (Industrial) Sector

Based on strong fundamentals, the logistics sector once again proved to be the most sta-

ble. Although the logistics market experienced a slowdown in 2023 compared with the previous two years, newly completed industrial and logistics space reached 3.7 million square metres – the second-highest result in history. With such a result and considering the almost 3 million square metres of space under construction, Poland is one the fastest-developing countries in Europe in terms of industrial and logistics supply.

Total leasing activity was higher than expected and stood at 5.7 million square metres, constituting the third-highest recorded level in the history of the market (only 15% lower than in 2022). 2023 also brought some landmark transactions on the leasing market. Specifically, three new transactions for space exceeding 100,000 square metres were signed in Warsaw, Silesia and Wrocław.

In 2023, industrial and logistics transactions accounted for 51% of the total investment market in Poland. This includes a transaction in which Nrep acquired 80% of shares in one of the leading logistics developers and investors in Poland, 7R. In 2023, as in previous years, the construction of many projects began as a result of co-operation between fee developers (providing know-how and co-ordination/management of the construction and leasing of the project for a fee) and passive investors (providing the equity) on the basis of development management agreements.

Some market players with the capacity to both invest equity and develop projects independently have decided to act as fee developers in some new projects avoiding the land/construction risks. The new pricing reality has encouraged some of those logistics developers whose business is to keep assets in operation to acquire standing assets rather than develop assets independently. Given the rising development costs and limited availability of land in attractive locations, acquiring standing assets has become an attractive alternative for many of these developers.

2022 accounted for unprecedented rent increases of approximately 20-30% in the logistics/production market. Given the relatively high availability of new space and stabilisation of construction and financing costs, it is expected that in 2024 – as in 2023 – rents are expected to remain stable and no significant rental increases are forecast. Currently, headline rents in prime locations stand at EUR5.5 per square metre per month and average EUR4.4 per square metre per month.

As companies active in the market – both from the e-commerce and production sectors – extend their supply chains and many new companies enter the market relocating their productions capabilities to Poland, there is a constant demand for logistics and production space. Owing to the high demand for out-of-home parcel delivery services, Poland is currently the regional leader in e-commerce, with a 4% share in the total European e-commerce spending. In contrast to other CEE and Western countries, the e-commerce share in total retail spending is currently higher than during the closure period, and this trend continues to grow.

The above-mentioned trend is expected to increase as many companies decide to locate their production facilities in Poland – ie, closer to their sales markets (nearshoring/friendly shoring) – owing to disruption in the supply chain related to the COVID-19 pandemic and the war in Ukraine. This can already be seen in the market. Poland, with its still relatively low labour costs and good transport links, is considered

one of the best locations for nearshoring/friendly shoring in CEE.

Residential Sector

Due to the increase in financing and construction costs, the housing market saw a significant decline in the sale of apartments and of mortgage loans at the beginning of 2023. Nevertheless, a reversal of this trend in the sale sector was observed throughout the remainder of 2023, owing to the introduction of the 2% safe credit government programme designed to stimulate housing demand in the form of a subsidy equal to the difference between 2% and the average fixed mortgage rate.

This 2% government programme led to an increase in new mortgages and transactions in the resi-for-sale market. Although the value of new transactions is still below the record levels of 2021, there has been a positive change in the mortgage market. However, this has also led to an increase in apartment prices (average asking prices increased by 17% year-on-year between the end of 2022 and end of September 2023 in the largest metropolitan areas). The government announced a new subsidy programme at the beginning of 2024, which is intended to result in greater affordability of owner-occupied apartments.

However, the increase in prices is not accompanied by a corresponding increase in projects under construction and the number of construction permits issued (23% lower in Q1-Q3 2023 than in the same period in 2022). This may indicate that developers are taking a more conservative approach to customer demand, but it also relates to the shrinking availability of residential land in Poland.

The development of the private rented sector (PRS) in Poland is heavily dependent on the mortgage lending situation in the resi-for-sale market. Given that the average rent in Poland at the end of Q3 2023 was approximately PLN1,150 higher than the average mortgage payment (assuming a 2% government subsidy), the mortgage market prevails among individual investors and does not encourage developers to seek alternative revenue sources among PRS investors.

Currently, the Polish residential market is still dominated by owner-occupied apartments, with only 13% of the population living in rented accommodation. Although an institutional build-to-rent sector is emerging, it is still in the early phase of development despite dynamic growth in recent years (both in terms of construction and investment activities). As a result, build-to-rent premises accounts for approximately 1% of the entire residential stock for lease in the main Polish cities.

Irrespective of the factors hindering or delaying the development of the PRS market in Poland, an increased number of PRS projects were completed in 2023 (with the existing stock in Q3 2023 standing at approximately 15,000 units, compared to circa 8,000 units in Q3 2022, giving a year-on-year increase of 83%). Although the number of announced PRS projects under construction remains stable (circa 10,000 units), some PRS projects have been abandoned at the design phase (the number of planned projects decreased from approximately 35,000 to 27,000 units). In view of the dwindling availability of attractive land, some investors are increasingly interested in converting office and retail buildings into PRS buildings.

The main challenges for PRS investors in terms of finance are high construction and land acquisition costs (the cost of constructing 1 square metre of a new multi-family building have increased by 50% in the past seven years) and financing costs (given the fact that tenants typically only accept rent paid in Polish zloty, while financing is generally available in euro – although some PRS operators have been testing euro-denominated rent structures). A number of legislative changes may affect the PRS market and the viability of business models. These include newly adopted zoning regulations and changes in the technical requirements for buildings, such as the minimum size of the residential premises. Despite these challenges, the PRS market is still perceived as attractive and – according to surveys conducted by commercial advisors – more than 20% of investors in the CEE region are considering investments in the PRS sector. The potential of this market is also confirmed by very low vacancy rates in the existing PRS stock.

The student housing market has strong development foundations as the demand for student accommodation remains high (due to – among other things – the growing number of foreign students, the decreasing affordability of accommodation on rental market and the increasing popularity of modern private student dormitories already operating on the market). The latest announcement of the joint venture transaction between Signal Capital Partners, Griffin Capital Partners and Echo Investment for the launch of a new student housing platform (which awaits merger clearance at the time of writing (April 2024)) supports this trend.

In respect of senior housing, the institutional market is currently at a very initial stage. However, according to the latest research (eg, the report prepared by CBRE in co-operation with Greenberg Traurig entitled "Senior Housing in Poland"), there is an increased interest in this market among investors, who are currently assessing the market's potential and investment opportunities. Owing to demographic changes, it is expected that the senior housing sector will boom in the coming years. The authors will therefore monitor future developments in this area with curiosity.

Office Sector

The office sector accounted for 20% of the investment volume in 2023. Sellers who have decided to market office assets from their portfolios are generally reluctant to sell at the higher yields being offered by potential buyers. This price conflict usually leads to a situation where the seller decides to keep the asset and carry out certain quality improvements to prepare the asset or portfolio of assets for a more favourable market – for example, in terms of ESG aspects, technical conditions, and tenant mix. While such demanding market circumstances usually discourage more cautious, regulated investors with a more conservative approach, they at the same time attract opportunistic buyers looking for strategic purchases; in this respect, 2023 brought new players to the Polish market. The above-mentioned sellside-buyside price expectation mismatch is expected to stabilise in the near future.

The limited new supply of office space (approximately 61,000 square metres in Warsaw) has already been almost fully leased and approximately 221,000 square metres is currently under construction in Warsaw. Within the planned office investments, a new category of properties undergoing refurbishment is becoming increasingly visible on the market, posing an alternative to completely new office space.

In terms of vacancy rates (currently averaging 10.38% in Warsaw), we are witnessing a two-speed market. While buildings more than ten years old and in less prime locations can have a vacancy rate of more than 20%, only 3% of space is available for lease in prime locations in the centre of Warsaw. Due to this supply gap and the limited opportunities for tenants to relocate to a more suitable space (particularly those tenants requiring more space for their operations), it is expected that the renegotiation of concluded lease contracts will intensify.

Other major cities are experiencing record-breaking occupier activity, with around 740,000 square metres being leased in 2023. However, the supply of new offices and pending construction activities remain at lower levels than in previous years. Given the foregoing and the high tenant activity, the vacancy rate is expected to decrease in the upcoming quarters. In 2023, the highest supply of new office space in cities was in Wrocław and Kraków, whereas Warsaw ranked third.

In line with the trend evident in previous years, the expansion of flex office operators areas continues to attract interest. In Warsaw, more than 50% of the buildings delivered in the past eight years offer flex space and the flex office market continues to grow.

Currently, tenants from business services as well as manufacturing and energy sectors are very active on the leasing market and – together with landlords – create new office standards. A number of companies relocating their business to new offices are simultaneously reducing space (owing to hybrid and remote models of working).

Retail Sector

In recent years, the retail sector in Poland has been dominated by retail parks in terms of newly completed space. In 2023 and early 2024, a total of approximately 70 new retail projects opened, adding more than 470,000 square metres of gross leasable area (GLA) to the total stock.

Strong development activity has been observed in retail parks, with an area below 10,000 square metres GLA and "convenience" projects (usually not exceeding 5,000 square metres GLA). Continuing the recent trend, the developers have clearly shifted their interest towards towns and smaller cities. Retail space in towns and smaller cities (under 100,000 inhabitants) accounts for around a quarter of the total retail stock in Poland. Compared with Western Europe, coverage of modern retail projects (calculated per 100 inhabitants) in Poland is significantly lower, which also encourages developers and investors to fill this gap.

This shift towards towns and smaller cities and the retail park format is also clearly visible in the retail space currently under construction. By the end of 2023, almost 45% of the approximately 500,000 square metres GLA of new retail space under construction was located in towns and smaller cities, and 75% was designed in the retail park format.

Although the retail market has recently been dominated by smaller retail formats, some activity in respect of shopping centres is also underway, particularly in the regions; however, this is not yet visible in the investment or leasing volume. Operators of large shopping centres are currently carrying out a number of revitalisation, recommercialisation and rebranding projects. Older shopping centres designated for redevelopment and to be sold at competitive prices will

be an attractive alternative for more opportunistic investors.

In larger shopping centres, tenants are increasingly implementing an omnichannel strategy – ie, simultaneously developing hybrid online and in-store sales. As consumers value the comfort of e-commerce and the opportunity to see a product in person in a "brick and mortar" shop, omnichannel fulfils the ROPO (Research Online, Purchase Offline) trend. To some extent, the ROPO trend and the associated change in consumer habits has also revived leasing activity on the high street, as more and more tenants are willing to open a store in this format.

Lower inflation and rising purchasing power (linked to the improved financial condition of Polish households) are expected to further boost consumer growth. This, together with the growth of the omnichannel format, will have a positive impact on retail sales. The attractiveness of the Polish retail market is also confirmed by the increasing number of new brands opening their first stores in Poland. At the end of 2023, the number of new brands entering the market was the highest since the outbreak of the pandemic, which is also an optimistic sign for the market.

Renewable Energy Sector

The energy market in Poland, which strongly influences and intersects with the real estate market, offers a wealth of opportunities and plays a significant role in the Polish economy. A key area of growth is the renewable energy sector, with investment in wind and solar power on the rise. In 2023, Poland once again set a record for electricity production from renewable energy sources (RES). At end of 2023, Poland's solar capacity reached around 17 GW (a 15% year-on-year increase) and wind power reached almost 10 GW (a 40% year-on-year increase).

Increasing the share of RES electricity in energy production is one of the biggest challenges for Poland as part of the energy transition. RES are growing in number, and transmission and distribution networks have difficulties managing this potential. This has led the Polish transmission system operator (Polskie Sieci Elektroenergetyczne SA) to focus on expanding the network infrastructure. Such expansion is not only necessary to meet the current demand but is also a forward-looking measure. It is a crucial step towards accommodating future growth in the energy market and ensuring Poland's energy security.

In terms of legislative changes, the market has called for further liberalisation of the Act on Investments in Wind Power Plants. According to the current provisions of that Act, wind turbines must be located at a minimum distance from the nearest buildings of ten times the height of the installation, unless the local zoning plan specifies another distance (but not less than 700 metres). The liberalisation of the Act would unlock a vast amount of land for potential turbine development and it is expected to facilitate the expansion of wind energy in the country, accelerating the transition to a greener energy mix. Plans to reduce the above-mentioned minimum distance to 500 metres have already been announced by the new government.

On the legislative front, the Act on Spatial Planning and Development has undergone dynamic and significant changes during the past year. Almost 70% of Poland is affected by the key changes. In theory, streamlining the planning process and the amendment of the Act on Spatial Planning and Development was expected to make land development more efficient and enable faster responses to the needs of the energy sector. In practice, implementation has

been hampered by problems ranging from a lack of financial resources for municipalities to a shortage of specialists and unclear regulations. Nonetheless, the amendment provides for some facilitation in implementing RES during the transition period and is generally viewed positively by the market.

Notwithstanding the foregoing, 2023 brought some landmark RES investments, such as the commencement of the operation of a solar farm in Przykon with a capacity of 200 MW – the second largest investment of its kind in Poland, located on 270 hectares. After its planned extension, it will be the largest solar farm in CEE.

As the energy market in Poland is evolves and changes, Power Purchase Agreements (PPAs) – in particular, virtual Power Purchase Agreements (vPPAs) – are gaining importance as a key instrument to support decarbonisation, ESG goals and the development of renewable energy. PPAs allow for the purchase of energy at predetermined prices, which is driven by the desire for price stability and the need to secure RES in Poland. They provide long-term price stability, facilitate the financing of new energy projects, and help companies meet their sustainability goals. PPAs promote renewable energy by enabling projects to be developed and financed externally, secured by revenues from long-term contracts, thereby contributing nationally and globally to the reduction of the carbon footprint and the energy transition of economies. In 2023, some landmark PPAs were signed with international corporations such as Orange and Mondelez International, securing the energy supply for their operations.

PORTUGAL

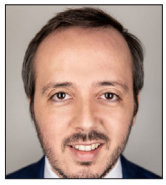


Trends and Developments

Contributed by:
Francisco Lino Dias, Teresa Madeira Afonso, Diogo Neves and Maria Sanches Afonso
PLMJ

PLMJ is a law firm based in Portugal that combines a full service with bespoke legal craftsmanship. For more than 50 years, the firm has taken an innovative and creative approach to producing tailor-made solutions to defend the interests of its clients effectively. The firm supports its clients in all areas of the law, often with multidisciplinary teams and always acting as a business partner in the most strategic decision-making processes. With the aim of being close to its clients, the firm created PLMJ Colab, its collaborative network of law firms spread across Portugal and other countries with which it has cultural and strategic ties. PLMJ Colab makes the best use of resources and provides a concerted response to the international challenges of its clients, wherever they are. International collaboration is ensured through firms specialising in the legal systems and local cultures of Angola, China/Macao, Guinea-Bissau, Mozambique, São Tome and Príncipe and Timor-Leste.

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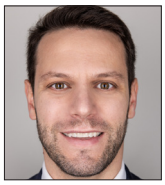


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Portuguese Economy at a Glance

According to 2023's previsions, both the EU and the Portuguese Public Finance Council foresaw a substantial slowdown of the Portuguese economy, with a projected growth of 1% (EU forecast) and 1.2% (Portuguese forecast). This forecast relied on the expected stagnation of private consumption as a consequence of the higher interest rates.

However, the Portuguese economy outperformed projections and proved its resilience with a GDP growth of 2.3% for the whole year. Although the third quarter of 2023 was in decline (-0.2%), the final quarter of 2023 revealed a growth of 0.8%, therefore avoiding the Portuguese economy entering a technical recession (when two consecutive quarters of negative economic growth are registered).

In terms of the annual evolution of the main aggregates, exports were the biggest driver of economic growth, having increased by 4.2% in 2023. Domestic demand grew by 1.4% and private consumption contributed the most to this trend, with a rise of 1.6% compared to 2022. Public consumption grew by 1.2% and investment rose by 0.8%.

In fact, data show that the Portuguese economy continues a real convergence process with the EU, having grown more than double the rate of the euro area and the EU (0.5% growth) in 2023.

In 2024 and 2025, it is expected that the Portuguese economy will most probably continue to grow above the European average – albeit at a lower rate. On an annual basis, the Portuguese GDP is expected to grow 1.2% in 2024 and 1.8% in 2025 against 0.9% in 2024 and 1.7% in 2025 in the EU.

As with more than half of the world's population this year, Portugal also went through elections in 2024. The result of these elections led to the appointment of a minority government, which will have to crunch the numbers with the opposing political parties to ensure that government stability will not be deeply affected.

The Harmonised Index of Consumer Prices (HICP) inflation rate decelerated significantly to a 2023 aggregate of 5.3% (year-on-year) (compared with 7.8% in 2022). Annual HICP inflation is expected to drop to 2.3% in 2024 and 1.9% in 2025 in line with the euro area.

With the flattening of the inflation curve, European Central Bank interest rate cuts are expected.

Outlook for the Real Estate Market

The Portuguese real estate market took a "wait and see" approach in 2023. In fact, according to estimates by some of the leading real estate consultants operating in Portugal, there was a contraction in the volume of real estate transactions – with a decline of approximately 50% compared to 2022. Nevertheless, around 70% of these investments came from international investors, which reflects the attractiveness of the Portuguese real estate market to international players.

In commercial markets – more specifically, in transactions involving industrial and logistics (I&L) assets – the market has matured, with demand increasing and diversifying. Despite the short supply, operators are beginning to select assets in different locations, which allowed the sector to diversify and expand. Office transactions accounted for around 10% of the commercial market.

Although there was a general decline compared to 2022, there was an increase in the volume of property transactions in the hospitality sector, which exceeded the figures recorded in 2019 (pre-pandemic period). Hospitality sector accounted for around 40% of the total commercial market. Revpar (revenue per available room) grew by 16%, to EUR72.1, and the occupancy rate (per room) stood at 66%. Portuguese hotels recorded approximately 70 million overnight stays, which reflects an increase of around 10% compared to 2022. In Lisbon there was an occupancy rate of around 75% and in Oporto there was an occupancy rate of around 71%.

In 2023, there was a downturn in purchase and sale activity in the residential market. Compared with 2022, there was a drop of around 15% in the number of residential properties sold in Portugal. There was also marked pressure on prices in the residential market – with an average price increase of around 5% – as a result of demand considerably outstripping supply. This scenario raises numerous challenges in terms of access to housing.

Another consequence of the shortage of supply is the increase of rent in all sectors. Prime office rent has reached a maximum of EUR28 per square metre per month. In the I&L sector, rents reached EUR4.75 per square metre per month. In the retail sector, rents increased by approximately 9%.

The first half of 2024 is still expected to be characterised by some stagnation, followed by a gradual recovery during the second half, with an increase in the volume of investments of up to 15% compared to 2023.

In the commercial market, in transactions involving I&L assets, secondary areas are expected to grow exponentially – given the growing demand and saturation in conventional areas.

The hospitality sector is expected to remain a sector of strong interest to investors.

Investment in shopping centres is expected to increase and, as far as offices are concerned, it is estimated that around 40% of the offices planned for 2024 and 2025 are already pledged.

In the residential sector, there will continue to be a shortage of supply compared to demand – despite the approval of the Urban Planning SIMPLEX (detailed below), which will have a considerable impact on speeding up and reducing bureaucracy in urban planning procedures.

Sustainable investments that comply with ESG standards are gaining momentum and significant investments of this nature are to be expected in 2024.

Portuguese Real Estate Legal Ecosystem

Housing remains the hot topic in Portuguese real estate for 2024. The Portuguese government has identified the housing crisis as one of the main pillars for intervention and introduced a multitude of legislative reforms with impact on the Portuguese real estate market. Those reforms will require all stakeholders and legal advisers to update their legal knowledge, adapt their perspectives and manage ongoing transactions.

New legislation

Mais Habitação programme

As anticipated, the *Mais Habitação* ("More Housing") legislative programme – comprising a series of structural measures, including several tax measures that revolve around the challenges and solutions to the housing crisis – was

approved (Law 56/2023) and published on 6 October 2023.

Some of the key aspects are listed below.

- The registration of new local lodging establishments, in the form of flats and accommodation establishments within an autonomous unit of a building, is suspended. However, there is an exception for properties located in inland areas, properties included in the Revive Nature Fund and in the Autonomous Regions of Madeira and the Azores.
- It is no longer possible to apply for this type of residence permit through the following types of investment:
  (a) transfer of capital in an amount of EUR1.5 million or more;
  (b) acquisition of real estate with a value of EUR500,000 or more; and
  (c) acquisition of real estate the construction of which has been completed for at least 30 years or located in an urban rehabilitation area and carrying out rehabilitation works on the real estate acquired, in an overall amount of EUR350,000 or more.
- The initial rent for new residential leases for properties for which there have been lease agreements signed in the five years prior to the entry into force of the law may not exceed the value of the last rent charged for the same property in a previous agreement, with a coefficient of 1.02 applied.
- A scheme will be created to support the development of housing for affordable rental and student accommodation, by creating lines of funding and by concession of public land and buildings.
- Income from residential leases will now benefit from a reduced personal income tax rate of 25% (compared to the previous rate of 28%). The reduced personal income tax rates applicable to rental income from residential leases, determined according to the duration of the contracts, are revised as follows:
  (a) =/>5 years and <10years – 15% personal income tax rate (additional reductions of 2% apply, up to a limit of 10%, for each renewal of equal duration);
  (b) =/>10 years and <20years – 10% personal income tax rate; and
  (c) =/> 20 years – 5% personal income tax rate.
- Buildings in full ownership or autonomous units allocated to the Lease Support Programme may be eligible for property transfer tax exemption (on acquisition of land for construction) and municipal property tax for three years from the year of purchase, inclusive, which can be renewed at the owner's request for a further five years.
- The Landlord and Tenant Desk (*Balcão do Arrendatário e do Senhorio*, or BAS) has been created to replace the current National Letting Desk (*Balcão Nacional do Arrendamento*, or BNA) to handle the special eviction procedure and injunctions in the field of leased property, and provision is made for the respective procedures.

Urban Planning SIMPLEX

Included in the *Mais Habitação* programme, Decree Law 10/2024 was published on 8 January 2024 to reform and simplify town and country planning procedures and certain related matters (SIMPLEX).

In this context, several pieces of legislation have been amended, such as the Legal Framework for Urban Development and Construction (*Regime Jurídico da Urbanização e Edificação*, or RJUE), the General Regulations for Urban Buildings (*Regulamento Geral das Edificações Urbana* s, or RGEU), the Legal Framework for Territorial

Management Instruments (*Regime Jurídico dos Instrumentos de Gestão Territorial*, or RJIGT), the Law on the General Principles of Public Land, Spatial Planning and Urban Planning Policy and the Legal Framework for Urban Rehabilitation. These can be summarised as follows:

- simplifying licensing procedures, with some relevant operations being dependent on a mere prior communication (*comunicação prévia*), rather than an ordinary and usually more lengthy licensing procedure;
- the use permit certificate has been abolished, so it is no longer necessary to present such a document when transferring ownership of urban property;
- the authorisation to carry out the urban development operation will now be proof of payment of the respective fees and there will no longer be such a thing as a "building permit certificate" (*alvará de licença de construção*);
- when signing a public deed for the acquisition of ownership of a building or unit intended for residential use, it is no longer necessary for the notary to certify the existence of the technical data sheet for the dwelling and that it has been handed over to the buyer;
- with regard to the technical rules for the preparation of urban construction projects, it has been established that these will be defined by the competent personal orders and as part of the development of the Construction Code by 1 June 2026; and
- mechanisms have been introduced for a simplified procedure of reclassification of rural land as urban land – namely, if the land is intended for the establishment of activities of an industrial, warehousing or logistics nature and related support services or for dry ports for cost-controlled housing or residential use.

All these measures are expected to bring a new dynamism to the real estate market.

Rent updates for 2024

In 2023, a law was passed that set a cap of 2% on rent increases in 2023 for lease agreements that are subject to the legal annual update coefficient for rents (which includes all leases that provide for a specific rent update or in the absence of a specific regulation). This law placed strict limits on the situations in which the legal coefficient would normally apply. The legal coefficient results from the variation of the consumer price index and is provided for in the New Urban Leasing Rules (*Novo Regime do Arrendamento Urbano*, or NRAU). If it were to be applied in 2023 to the different types of leases (both urban and rural), the rent increase coefficient would have been of 1.0543 (5.43%).

However, such limitation will not take place for 2024 and the legal annual update coefficient of 1.0694 (6.94%) will apply (Notice No 20980 A/2023 published in the Official Gazette), unless otherwise agreed by the parties.

Alongside the above, Decree Law No 103-B/2023 of 9 November has reinforced the application of extraordinary and temporary support measures for families in the context of housing, previously approved by the Decree Law No 58/2023 to mitigate the effects of inflation and rising interest rates on housing credit. This legal regime provided for:

- support for the payment of rent from a lease or sublease of first dwellings, corresponding to the difference between the value of the rent and the amount that would be paid if the effort rate was 35% of the average monthly value of income up to a maximum amount of EUR200 per month; and

- support for the payment of loan agreements for own and permanent housing, corresponding to a percentage (75% or 50%, depending on the income bracket) of the difference between the present value of the indexer and the value of the indexer at the start of the loan plus three percentage points, with a minimum of three percentage points, up to a maximum amount of EUR720.65 per year – in the case of an effort rate of 50% or more, the bonus can cover the difference between the present value of the indexer and the threshold of three percentage points.

As stated, the extraordinary and temporary support measures were reinforced to accommodate the legal annual update coefficient for 2024. Therefore, the monthly amount of the support is calculated – as from 1 January 2024 – on the basis of the monthly rent value updated by a coefficient of 1.0494 (4.94%).

2024 State Budget

Property transfer tax brackets update

The 2024 State Budget provided for an update of 5% on the progressive brackets of the property transfer tax (*Imposto Municipal sobre as Transmissões Onerosas de Imóveis*, or IMT) applicable to housing urban properties.

Non-habitual resident tax regime

The non-habitual resident (NHR) tax scheme that allowed individuals to benefit from a special tax status for a period of ten years was revoked. Nonetheless, it is still applicable to the ongoing tax schemes and to individuals who become tax residents until 31 December 2024, under certain requirements.

National System of Cadastral Information and the Cadastral Charter

New rules governing the land register were approved in August 2023, with emphasis on the creation of the National System of Cadastral Information (*Sistema Nacional de Informação Cadastral*, or SNIC) and the Cadastral Charter. The purpose is the creation of a tool that allows citizens and organisations to know exactly the location of their buildings and exercise their rights and duties safely.

If the inherent difficulties of its implementation can be resolved, it may become a very valuable resource for the flexibility and safety of real estate transactions, especially those involving rural properties.

PUERTO RICO



Law and Practice

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Pietrantoni Mendez & Alvarez LLC was founded in 1992 to render top quality, timely, cost-effective and personalised legal services. The firm has a broad and diversified real estate, banking, corporate and commercial law practice. Its attorneys regularly advise clients on real estate, banking, corporate and commercial transactions in the context of Puerto Rico's unique legal environment and have extensive experience in preparing legal documentation for complex commercial real estate transactions that comply with the requirements of applicable Puerto Rico and US laws and regulations. The firm represents local and foreign clients in connection with the acquisition and disposition of real properties and businesses in Puerto Rico and, in some cases, in Latin America and the Caribbean. Clients in the real estate area come from a wide array of economic sectors and the firm has participated in many of the largest and most complicated real estate transactions in Puerto Rico.

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1. General

1.1 Main Sources of Law

The main sources of real estate law in Puerto Rico are the Civil Code, the Real Property Registry Act, the Notarial Law, and Supreme Court of Puerto Rico jurisprudence.

1.2 Main Market Trends and Deals

The higher cost of capital, higher interest rates and geopolitical tensions have resulted in a slowdown in M&A, real estate, and other commercial transactions in Puerto Rico during the past year. The top target industry sectors in Puerto Rico during the past year were energy transition projects, PPP projects and hospitality-tourism transactions.

The energy sector was driven mostly by the Federal Emergency Management Agency and Community Development Block Grant (CDBG) funding as part of the Puerto Rico Electric Power Authority (PREPA)'s 2024 Integrated Resource Plan and the ongoing process to restructure PREPA's debt under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). The principal PPP project for 2023 was the award of the PPP contract for the rehabilitation, maintenance and operation of highways PR-52, PR-53, PR-66 and PR-20. This transaction closed in December 2023. Hospitality-tourism transactions consisted principally of the sale of existing hotel facilities and resorts, including the acquisition of distressed assets and strategic purchases. Transactions in this sector were driven mostly by existing tourism tax incentives in Puerto Rico.

The private equity market also remained strong in Puerto Rico during 2023. Transactions in this sector consisted mostly of the sale of privately owned mature companies based in Puerto Rico in transactions that were driven principally by the tax incentives under the Private Equity Funds Act that was codified in the Puerto Rico Incentives Code, known as Act 60. As a result, several local private equity funds were organised and have capital available for investment.

1.3 Proposals for Reform

There are currently no legislative proposals that would have a significant impact on the real estate market in Puerto Rico.

2. Sale and Purchase

2.1 Categories of Property Rights

The fee simple estate, leasehold estate, and mortgage rights are the principal categories of property rights that can be acquired under Puerto Rican law. Other real property rights, such as easements, usufructs, options, rights of first refusal, and surface rights are also recognised under Puerto Rican law.

2.2 Laws Applicable to Transfer of Title

Transfers of title to real estate are mainly governed by the Civil Code, the Real Property Registry Act, and the Notarial Law. Special laws, such as the Condominium Act, the Condohotel Act and the Timeshare Act may also be applicable depending on the type of property in question.

Transfers of title to hotel and industrial projects are generally not subject to special laws, but such transfers may be benefited by laws relating to tax or other governmental incentives for the development and/or operation of such projects. Residential properties may be subject to certain consumer protection laws and regulations, particularly if the transferor is the developer of the residential project. The authors note that, unless a given statute specifically excludes Puerto Rico from its application, federal laws – including the Truth-in-Lending Act, the Real Estate Settlement Procedures Act and other similar consumer protection laws – may apply to transfers of title in Puerto Rico.

2.3 Effecting Lawful and Proper Transfer of Title

Lawful and proper transfers of title to real estate in Puerto Rico are effected by a public deed executed before a notary public. Deeds need to be executed in person before a notary public. No new procedures that were implemented during the COVID-19 pandemic remain in effect.

Although recordation is technically not required in order to effect a valid transfer of title to real property, it is customary – and recommended – that transfers of title be recorded in the Registry of Property of Puerto Rico because of the protections that recordation confers to the parties. Title insurance is common in Puerto Rico in commercial and most residential transactions.

2.4 Real Estate Due Diligence

As a part of their due diligence, buyers of real estate in Puerto Rico typically search government records to determine the status of title, real property taxes, zoning and land use, flooding, and environmental conditions. It is not uncommon for buyers to also perform an on-site physical inspection of the property and to include the preparation of surveys, soil studies, environmental assessments, and structural condition reports as part of their due diligence.

2.5 Typical Representations and Warranties

Representations regarding title, property tax status, environmental conditions, pending or threatened condemnation or litigation proceedings, leases and other third-party occupancies, and structural conditions are most typical in commercial purchase–sale transactions of real property in Puerto Rico. Sometimes, depending on the relative bargaining strength of the parties, some of these representations are qualified by the "knowledge" of the seller. Unless waived by express agreement of the parties, Puerto Rico laws provide statutory warranties in the sale of real estate that cover title and hidden defects in the property being transferred. Additionally, statutory warranties that are broader in scope apply to the sale of residential real estate by its devel-

oper. Such broader warranties cover non-critical construction defects that a seller of real property, in the absence of an agreement to the contrary, would not otherwise necessarily be obligated to correct. Remedies for breach of representations include rescission and damages.

2.6 Important Areas of Law for Investors

Purchasers of real estate in Puerto Rico should always consider the tax consequences of their investment and the type of investment vehicle that is utilised. It is also important to consider the impact of environmental laws if contamination is present or suspected. In the case of new construction and development, it is essential to account for possible land use and zoning restrictions affecting the real property.

2.7 Soil Pollution or Environmental Contamination

Under environmental laws applicable in Puerto Rico, if the buyer is unable to establish that the contamination is not attributable to its action or inaction, then the buyer may be held liable for environmental pollution or contamination of real property. Therefore, it is important that the buyer establish a baseline of the environmental condition of the property prior to acquiring the real estate assets by undertaking a thorough environmental assessment of the property conducted by a qualified expert. It is significant to note that, in addition to local environmental laws, US federal environmental laws and regulations are also applicable in Puerto Rico.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Real property in Puerto Rico is classified by the Puerto Rico Planning Board (or, in certain cases, by the autonomous municipalities) under publicly available land use and zoning classifications, which establish the different uses that are permitted to be given to the property. Under certain circumstances, project-specific variances may be granted by the relevant permitting authorities after following established procedures (which, among other things, may require public hearings).

2.9 Condemnation, Expropriation or Compulsory Purchase

Public taking or condemnation of private property is possible in Puerto Rico for public purposes. The process requires the government to establish the value of the property as just compensation for the taking by means of an independent appraisal. Upon depositing the corresponding amount with the expropriations court, title is automatically transferred to the condemnation authority. However, the property owner has the right to contest the valuation in a judicial proceeding and – if successful – to recover a higher value if accepted by the court.

2.10 Taxes Applicable to a Transaction

Stamp taxes, recording fees and notarial fees are typically applicable in a transaction for the purchase and sale of real property in an asset deal. Unless the parties reach a different agreement, the transferor of real property will typically pay the stamp taxes with regard to the original of the deed of purchase and sale, and the transferee will pay the stamp taxes with regard to the certified copy of the deed and the applicable recording fees.

Stamp taxes and recording fees are not applicable in the case of a transaction for the total or partial transfer of shares or other equity interests in a property-owning entity. Additionally, a partial exemption for stamp taxes and recording fees may be available in the case of tourism development projects.

The Internal Revenue stamp taxes for the original of the deed of transfer are calculated at the rate of USD2 for the first USD1,000 or fraction thereof, and USD1 for every USD1,000 thereafter, based on the purchase price of the real estate. The Internal Revenue stamp taxes for the certified copy (which is the document that is actually filed for recording) are calculated at the rate of USD1 for the first USD1,000 or fraction thereof, and USD0.50 per USD1,000 thereafter. Legal Assistance stamps are also required to be affixed to the deed and are calculated at.0001 times the purchase price for the original of the deed of sale and half of that amount for the certified copy.

The fees for recording a deed of purchase and sale in the Registry of Property are calculated at the rate of USD2 per USD1,000 (or fractions thereof) for the first USD25,000, and USD4 per USD1,000 for amounts in excess of USD25,000, plus a filing fee of USD15.50. The calculation of recording fees is based on the greater of the purchase price of the real estate and the sum of all the amounts that are secured by the mortgages that encumber the real estate at the time of the sale. In addition, the Notarial Law mandates payment of a notarial tariff to be calculated on the basis of the stated amount of the transaction – for example, the purchase price or the amount of the mortgage. For transactions with stated amounts not exceeding USD10,000, the applicable notarial tariff is USD150. With regard to transactions with stated amounts between USD10,000 and USD5 million, the parties may negotiate the notarial tariff, but in no event may the tariff be greater than 1% of the transaction amount or less than 0.5% of the transaction amount. For transactions with stated amounts of more than USD5 million, the parties are free to negotiate the notarial tariff but the tariff in those cases will never be less than USD25,000.

2.11 Legal Restrictions on Foreign Investors

There are no local legal restrictions on foreign investment in real estate. However, it is important to note that any federal laws restricting foreign investment in the USA are also applicable in Puerto Rico.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Commercial real estate acquisitions in Puerto Rico are principally financed by commercial banks located in Puerto Rico or the mainland USA. There have been some financings with alternative sources such as insurance companies and private capital firms.

3.2 Typical Security Created by Commercial Investors

Lenders in Puerto Rico will typically require a real property mortgage and a security interest over personal property assets (including rents and other contract receivables generated by the property) in order to secure the repayment of commercial loans for the acquisition or development of real estate.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no Puerto Rico restrictions on the granting of security to foreign lenders or on repayments made to foreign lenders under a loan agreement. Although each case must be examined in light of its particular facts and circumstances, interest payments made to non-Puerto Rican lenders are generally not subject to a Puerto Rican withholding tax unless the payor and the recipient are related parties.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The stamp taxes and recording fees payable in connection with the granting and cancellation of mortgages are similar to those payable with regard to transfers of title.

The Internal Revenue stamp taxes for the original of the deed of constitution and the deed of cancellation of mortgage are calculated at the rate of USD2 for the first USD1,000 (or fractions thereof), and USD1 for every USD1,000 thereafter, based on the amount of the mortgage plus an additional amount equal to 10% of the mortgage to cover protective advances. The Internal Revenue stamp taxes for the certified copies are calculated at the rate of USD1 for the first USD1,000 (or fractions thereof), and USD0.50 per USD1,000 thereafter. Legal Assistance stamps are also required to be affixed to the deeds and are calculated at .0001 times the amount of the mortgage plus an additional amount equal to 10% of the mortgage to cover protective advances for the deeds of constitution and cancellation of mortgage (and half of that amount for the certified copies).

The fees for recording the deeds of constitution and cancellation of mortgage in the Registry of Property are calculated at the rate of USD2 per USD1,000 (or fractions thereof) for the first USD25,000 and USD4 per USD1,000 for amounts in excess of USD25,000, plus a filing fee of USD15.50. The calculation of recording fees is based on the amount of the mortgage. In addition, the Notarial Law requires payment of a notarial tariff to be calculated on the basis of the amount of the mortgage transaction. For transactions with stated amounts up to USD10,000, the applicable notarial tariff is USD150.00. With regard to transactions with amounts between USD10,000 and USD5 million, the parties may negotiate the notarial tariff, but in no event may the tariff be greater than 1% of the transaction amount or less than 0.5% of the transaction amount. For transactions with mortgage amounts of more than USD5 million, the parties are free to negotiate the notarial tariff but the tariff in those cases will never be less than USD25,000.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no special legal rules or requirements (such as “financial assistance” or “corporate benefit” rules) applicable in Puerto Rico that must be complied with in order for a debtor to give a valid lien over real estate assets. However, third parties granting security for the benefit of others must account for fraudulent transfer and fraudulent conveyance challenges that may be available under the Puerto Rican Civil Code and US federal bankruptcy statutes. If successful, these challenges may result in the lender’s loss of its security over the real estate assets.

3.6 Formalities When a Borrower Is in Default

Under Puerto Rican law, a real property mortgage is not duly constituted or effective unless it has been recorded in the Registry of Property. Therefore, before enforcement of a real property mortgage lien is sought, the secured party should confirm that the mortgage has in fact been recorded in the land records. Priority among real property liens is generally determined on the basis of the order of filing of the corresponding lien instruments in the Registry of Property. However, it is significant to note that there is a statutory preferential lien for unpaid property taxes.

Enforcement of a real property mortgage lien in Puerto Rico is accomplished pursuant to a

judicial proceeding filed in the local court corresponding to the jurisdiction where the mortgaged property is located. Alternatively, if federal jurisdictional requirements are met, the foreclosure action may also be brought in the United States District Court for the District of Puerto Rico. Since it is an ordinary civil action, the judicial foreclosure proceeding includes all of the different stages of legal actions set forth in the Rules of Civil Procedure (including, for example, the filing of a complaint, discovery, trial, etc). With regard to enforcement of a mortgage lien on real property that is the principal residence of the debtor, the lender and the debtor are first required to participate in compulsory mediation proceedings for the purpose of attempting to reach an agreement that would permit the debtor to retain ownership and possession of the residence. However, the mediation proceedings do not obligate the parties to reach such an agreement, but often cause delays in completion of foreclosure of the mortgage lien.

3.7 Subordinating Existing Debt to Newly Created Debt

Under Puerto Rican law, existing secured debt may be subordinated to newly created debt by agreement among the parties. There is also a statutory, preferred lien for unpaid real property taxes to which a mortgage lien will always be subordinate. It is also important to point out that the United States Bankruptcy Code applies in Puerto Rico and that US bankruptcy courts have broad discretion, under certain circumstances, to subordinate the claims of competing lienholders.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing a lien on real property in Puerto Rico may be liable under environmental laws if it exercises sufficient control over the contaminated property and/or the owner of the property so as to be deemed responsible for the environmental condition of the property.

3.9 Effects of a Borrower Becoming Insolvent

As a general rule, insolvency alone will not void a security interest in real estate under Puerto Rico law. However, if a borrower grants a lien when it is insolvent and does not receive equivalent value in exchange, the lien may be voided or set aside under the fraudulent transfer provisions of the Puerto Rican Civil Code or the fraudulent conveyance provisions of the United States Bankruptcy Code.

3.10 Taxes on Loans

In Puerto Rico, there are no rules, regulations or requirements – whether existing, pending or proposed – compelling lenders or borrowers to pay any recording or similar taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The public policy of the Commonwealth of Puerto Rico with regard to land use and the development and conservation of natural resources is set forth in a Land Use Plan, which was adopted by the Puerto Rico Planning Board and approved by the Governor of Puerto Rico. The Land Use Plan establishes land classifications for the entire territory of Puerto Rico, which are general categories of land use based on the land's characteristics and values (ie, urban soil, rustic soil, soil that may be urbanised, etc). Also, at a central level and complementing the Land

Use Plan, there is the Joint Regulation for the Evaluation and Issuance of Permits related to Land Development and Use (the "Joint Regulation") and other regional plans governing particular geographical regions, and sectorial plans addressing specific issues or needs within a particular sector that require a more detailed analysis. These plans may establish both land classifications and zoning districts. A zoning district is established based on the underlying land classification but governs more specific development parameters, such as permitted uses, density, building heights, lot sizes, setbacks, and occupation areas, among others.

There is another layer of land use and planning instruments adopted at the level of the municipality (a smaller self-governing division within Puerto Rico) – of which the primary is the Municipal Ordainment Plan. Municipal Ordainment Plans set forth the land use and development policies at the municipal level and may also establish land classifications and zoning districts within the municipality. Municipal land use and planning instruments must be consistent with the current Land Use Plan and, if not, must be revised to achieve such consistency.

The Land Use Plan and other central government instruments generally have precedence over the Municipal Ordainment Plans and other municipal-level instruments.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design, appearance and method of construction of new buildings or refurbishment of existing buildings are typically subject to requirements established under the zoning district where the new building or existing building is located. The zoning districts are established under the applicable regional, sectorial or municipal-level plans and regulations. These plans and regulations and a central government regulation called the Joint Regulation specify the controls and parameters applicable to each district, which include building height, setbacks, occupation areas, parking areas, fences, and signs, among other things. The determination of which of these zoning regulations applies to a specific project depends on the nature and location of the project.

In addition, technical construction requirements apply to all buildings and refurbishments of buildings under the Puerto Rico Building Code, a central government regulation. Other central government regulations governing technical requirements may also apply depending on the nature and location of the particular project.

4.3 Regulatory Authorities

The Puerto Rico Planning Board and the Office of Management of Permits (OMP) are the central government agencies with jurisdiction over land use and development permitting. The jurisdiction of these agencies over a project depends on the type of project and permit under consideration, with the Planning Board generally having jurisdiction over more complex projects. In some cases, however, a municipality may have the primary authority to issue certain land use or development permits if the municipality has a Municipal Ordainment Plan and if the authority to issue these permits has been transferred from the central government agencies to the municipality. The legal instruments that apply in the evaluation or processing of permits by these agencies include the Land Use Plan, any applicable regional, sectorial or municipal plans and regulations, and the Joint Regulation, depending on the circumstances.

The Planning Board has exclusive jurisdiction over certain projects requiring changes in zoning that are of regional impact or that do not meet use or density/intensity requirements in their zoning district, among other things. In a process known as a site location consultation, the government may approve these types of projects and authorise waivers of use, density/intensity and other requirements, if applicable conditions are met. A site location consultation typically contains general parameters related to the proposed project, such as overall density, proposed uses and the proposed master plan.

The OMP or the municipality, in turn, typically consider lesser permits, including:

- non-discretionary construction permits (for projects strictly complying with all applicable requirements in the corresponding zoning district);
- construction consultations (for projects requiring one or more waivers of applicable construction requirements under the corresponding zoning district); and
- approvals for projects involving lot divisions and urbanisation or subdivision type projects, addressing primarily infrastructure development requirements.

The construction consultations and permits address the specific allocation of density, building heights, lot sizes, setbacks, and occupation areas, among other things. The construction permit is the final permit that must be obtained prior to actual earth movement for building construction (other than the earth movement for infrastructure, which may be covered in the lot division/urbanisation/subdivision approval). Other permits addressing environmental and natural resource impacts may also be required prior to construction.

Once the construction is completed and before commencing operations, a project must obtain a Single Permit from the OMP or the municipality, as applicable. The Single Permit consolidates the use permit, sanitary licence, fire prevention certification, and other licences that could apply based on the specific activities taking place at the building or facility.

4.4 Obtaining Entitlements to Develop a New Project

All permit proceedings are commenced by filing an application before the relevant agency. Upon filing of the application, the applicant typically is required to install one or more signs at the project site notifying the public of the application and where to submit comments. Except for non-discretionary construction permits, applicants may also be required to notify the property owners that are contiguous to or within a wider radius of the project site, depending on the type of permit requested.

During the permitting process, the applicant must seek comments from the agencies with jurisdiction about the project (including public utilities, highway and transportation authorities, environmental and natural resource agencies, among others), and the requirements of these agencies may be imposed as permit conditions. The applicant must also obtain a certification from the OMP that the project meets certain regulatory environmental review requirements to ensure that a thorough assessment of the environmental impact of the project has been performed.

The agency may hold a public hearing to consider the application, which may be mandatory or discretionary in some cases. Any interested person may submit written comments in favour or against the permit to the permitting agency

during the specified comment period and may also appear at the public hearing, if any, and provide verbal or written comments at such time in favour of or against the project. During the permitting process, a third party may also request that the agency grant it the right to participate as an intervenor, which the agency may approve if the party meets certain requirements. As an intervenor, the third party would be afforded the status of a party to the proceedings.

After the hearing, or completion of all necessary steps to evaluate the project (as applicable), the agency will evaluate all the information in the record and issue a decision, approving or denying the permit.

4.5 Right of Appeal Against an Authority's Decision

Every applicant of a project who is denied an application for a permit to develop or use real property has the right to appeal the determination within the specified legal/regulatory timeframes. Generally, the applicant has the option of requesting the permitting agency to reconsider its determination or seeking judicial review of the determination by a court with jurisdiction. The applicant may also choose to exercise both options – by seeking reconsideration first and, if denied, pursuing judicial review.

4.6 Agreements With Local or Governmental Authorities

In order to obtain development permits or approvals, an applicant is required to seek and obtain the recommendations regarding the project from the various agencies with jurisdiction over the matter. Among the agencies typically consulted during this process are municipal governments, utility suppliers (which in Puerto Rico are government-owned), and agencies with jurisdiction over natural resources and the environment, public highway and transportation systems and cultural, historical or archaeological resources, among other things.

It is not uncommon for a public utility provider, such as an electric power service provider or the water and sewer service provider, to include conditions on improvements to be made by the applicant in order to obtain the desired services in its recommendations. Sometimes these conditions may require the applicant to make capital investments. The parties may find it necessary or convenient to enter into an agreement specifying their respective obligations, including any infrastructure development and capital commitments from the parties, commitments from the utility regarding the capacity to be supplied, procedures for the connection of different phases of a project, and any negotiated terms for the payment of connection fees, among other things.

An agreement may also be necessary with the highway and transportation authority to address necessary highway infrastructure improvements and the payment of impact fees (as applicable). In the case of projects that impact natural resources, the applicant may be required to reach an agreement with the natural resource protection agency to address mitigation or compensation requirements, which in some cases may include the transfer of lands for preservation. Agreements with other agencies may be required in order to address their recommendations or as a pre-condition to obtain development permits or implement a project.

4.7 Enforcement of Restrictions on Development and Designated Use

Each ongoing construction project must have an independent inspector designated by the owner to periodically inspect it. The inspector must be a licensed architect or engineer in Puerto Rico.

The inspector who is required to submit monthly reports to the owner and inform the owner of any non-compliance issues. Depending on the circumstances, the inspector may also be required to notify non-compliance issues to the OMP, file a complaint against the project at the OMP, or request the stay of the construction work from a court with jurisdiction, among other things. At the conclusion of construction, the inspector must submit a certification to the OMP to the effect that the completed project complies with the requirements of the applicable permit or approval.

The OMP may initiate enforcement action against a person or entity found to be in violation of applicable land use and zoning requirements or permits. There are two mechanisms through which the enforcement process may be initiated:

- the filing of a complaint by a third party; or
- the commencement of an investigation by the OMP.

The complaint may be filed by any member of the public or by any other government agency. An investigation is then commenced. If the investigation indicates that violations exist, the agency may:

- issue an administrative order requiring the cessation of unauthorised activities, imposing administrative fines, or taking other regulatory actions to address the non-compliance; or
- seek an injunction in court to revoke the violator's permits, order the cessation of unauthorised activities, or demolish structures, among other things.

The OMP may also refer the matter to other agencies with jurisdiction, depending on the nature of the violations.

The OMP is also empowered to conduct physical inspections, based on an inspection programme, of any properties subject to decisions, permits or authorisations issued by the agency in order to assess compliance and issue reports of their findings.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The most common forms of ownership vehicle for commercial real estate assets in Puerto Rico are the corporation and the limited liability company. Puerto Rico does have legislation that allows for the establishment of REITs (further details of which can be found in **5.3 REITS**).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Corporations and limited liability companies are constituted by registering their organisational documents with the Department of State of Puerto Rico. Registration fees are USD150 in the case of corporations and USD250 in the case of limited liability companies. Forms for the obtention of an employer identification number and election of the tax treatment for such entities are typically filed with the corresponding taxing authorities simultaneously with their formation with the corresponding taxing authorities. Other governmental filings may be necessary, depending on the particular business activities in which such entities will engage.

5.3 REITs

Puerto Rico does have legislation that allows for the establishment of REITs, which provide important tax benefits; however, owing to restrictive income and ownership tests, this vehicle has not been widely used in Puerto Rico. A REIT,

which may take the form of a corporation, limited liability company, partnership or trust, is an entity that owns and operates income-producing, commercial real estate and is owned by 50 or more investors.

5.4 Minimum Capital Requirement

There is no statutory minimum amount of capital required in order to establish any of the entities used to invest in real estate in Puerto Rico.

5.5 Applicable Governance Requirements

Corporations are governed by the provisions of their by-laws and articles of incorporation. The decision-making authority over the governance of a corporation is vested in its board of directors and, under certain circumstances, the stockholders. Puerto Rico law does not establish a required structure for the governance of limited liability companies. A limited liability company is governed in accordance with the provisions of the operating agreement entered into by its members.

5.6 Annual Entity Maintenance and Accounting Compliance

Corporations and limited liability companies are required to pay an annual fee of USD150 in order to be in good standing and maintain their status as registered entities authorised to conduct business in Puerto Rico. Corporations are also required to file an annual report with the Department of State, which must include the financial statements of the corporation for the corresponding year. The financial statements filed with the annual report must be audited by an independent certified public accountant in Puerto Rico if the annual gross revenues of the corporation exceed USD3 million.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The most common arrangement that Puerto Rican law provides for the temporary occupancy and use of commercial real estate is the lease. Other arrangements, which are rarely utilised, are the surface right and the usufruct.

6.2 Types of Commercial Leases

There is only one type of commercial lease commonly in use in Puerto Rico, although the terms of each lease vary according to the agreement of the parties.

6.3 Regulation of Rents or Lease Terms

Rents and lease terms on commercial leases are freely negotiable by landlord and tenant in Puerto Rico. Of course, no contractual arrangements in Puerto Rico, including leases, may violate the general prohibition against agreements that are contrary to the laws, morals or public order.

6.4 Typical Terms of a Lease

The length of the lease term under a commercial lease in Puerto Rico can vary according to the needs and desires of the parties. However, agreements that provide for unusually long lease terms (eg, 99 years) may be scrutinised as disguised sales.

Maintenance and repair obligations under commercial leases in Puerto Rico are typically allocated between landlord and tenant, depending on the type of repair in question. By way of example, structural repairs are generally the responsibility of the landlord, whereas most non-structural repairs must be undertaken by the tenant.

Rent payments under commercial leases are generally payable on a monthly basis.

6.5 Rent Variation

The amount of rent payable under a lease of commercial property in Puerto Rico is usually increased over the term of the lease, particularly in the case of leases covering a term of more than two to three years.

6.6 Determination of New Rent

Rental increases can be negotiated as predetermined fixed amounts or calculated, at the time of the increase, on the basis of an established index (such as an inflation or consumer price index).

6.7 Payment of VAT

VAT is not payable on rents in Puerto Rico.

6.8 Costs Payable by a Tenant at the Start of a Lease

In some cases, landlords of commercial property in Puerto Rico will require the tenant to pay a month's or two months' rent in advance and/or a security deposit equivalent to one month's rent.

6.9 Payment of Maintenance and Repair

In multi-tenant properties such as shopping centres and office buildings in Puerto Rico, the cost of maintenance and repair of common areas is commonly shared by all of the tenants proportionately (usually calculated on the basis of the proportion that the area leased by each tenant bears to the total leasable area of the property).

6.10 Payment of Utilities and Telecommunications

Utility and telecommunications expenses that relate solely to the leased premises are typically paid by the tenant. Those expenses, as they relate to the common areas of a multi-tenant property, are allocated among all of the tenants on a proportionate basis.

6.11 Insurance Issues

The cost of insurance under a lease of commercial property in Puerto Rico is most often assumed by the tenant. However, in the case of single-tenant properties, the landlord may opt to obtain and pay for insurance directly but include the cost in the rent to be paid by the tenant.

6.12 Restrictions on the Use of Real Estate

It is typical in Puerto Rico for the landlord to impose restrictions in the lease agreement as to the uses that can be given to leased property by its tenant. Zoning and land use regulations, as well as unlawful noxious uses, can also serve as limitations.

6.13 Tenant's Ability to Alter and Improve Real Estate

Landlord and tenant are free to stipulate in the lease agreement the applicable conditions that will apply to alterations that the tenant is permitted to undertake in the leased premises. It is most common for a tenant to be permitted to make non-structural improvements to the property but not structural alterations – although agreements to the contrary are possible. In most cases, the landlord will reserve the right to approve all alterations (structural and non-structural). Conditions as to the types of alterations that a tenant may make vary – usually depending on the type of property involved – but, in all cases, a prudent landlord will require that all alterations and improvements be made in accordance with applicable laws.

6.14 Specific Regulations

There are no statutory or regulatory restrictions in Puerto Rico that apply to leases of different categories of real estate.

6.15 Effect of the Tenant's Insolvency

Under Puerto Rico law, the insolvency of the tenant will not have an impact on the validity of the lease – although the parties may provide in the lease agreement that a tenant's bankruptcy or insolvency will be considered as an event of default. However, pursuant to federal bankruptcy laws applicable in Puerto Rico, a bankruptcy trustee may elect to reject (and, therefore, terminate) or assume a lease of a tenant that has filed for protection under Chapter 11 of the United States Bankruptcy Code. Additionally, when a defaulting residential tenant is insolvent, the legal process for eviction has certain additional requirements (as discussed in **6.21 Forced Eviction**).

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The most common type of security offered by tenants under commercial leases in Puerto Rico is a security deposit, usually equivalent to one month's rent, which is kept by the landlord throughout the term of the lease. In the event that the tenant fails to perform a monetary obligation, the landlord uses the deposit to satisfy the tenant's unpaid obligation. The tenant is typically required to replenish the security deposit if used by the landlord before expiration of the lease term. Tenants may also offer a bond issued by a surety company, or a guaranty from a solvent affiliate, in order to guarantee its obligations under the lease.

6.17 Right to Occupy After Termination or Expiry of a Lease

Under Puerto Rican law, a tenant is required to vacate the leased property upon expiration of the stipulated term of the lease. If the tenant does not vacate upon expiration and the landlord does not object to the tenant's occupancy, then the tenant will be deemed to be occupying the leased property on a month-to-month basis under the same terms and conditions of the expired lease. However, knowledgeable landlords typically include a holdover clause in their lease agreements which provides that, if a tenant's occupancy continues after expiration of the lease term, the applicable rent will increase considerably (eg, by 150–200%). This type of provision serves to discourage holdover tenancies.

6.18 Right to Assign a Leasehold Interest

The lease agreement will usually stipulate if tenant is permitted to assign the lease or to sublease the leased premises. Landlords typically include provisions in the leases requiring their consent for the assignment of the lease (including upon a change of control of tenant) or for tenant to enter into a sublease.

6.19 Right to Terminate a Lease

The lease agreement will usually stipulate which tenant defaults will permit the landlord to terminate the lease and evict the tenant. Typically, any default by the tenant in complying with any of its obligations set forth in the lease agreement will give landlord the right to terminate the lease – although the agreement normally provides the tenant with a cure period to remedy a default. Bankruptcy and insolvency are also customarily included as tenant defaults giving rise to landlord's remedies under a commercial lease, but the landlord's ability to terminate a lease after a

tenant files for bankruptcy may be limited by the United States Bankruptcy Code.

6.20 Registration Requirements

In Puerto Rico there are no execution formalities for leases. A lease of real property for a term of six years or more is, by exception, recordable in the Registry of the Property of Puerto Rico as an encumbrance affecting title to the real property. A lease of real property for a term of less than six years may also be recorded in the Registry of the Property of Puerto Rico by mutual agreement of the parties.

In order to have access to the Registry of the Property, a lease agreement must either be:

- executed directly in deed form before a notary public in Puerto Rico; or
- set forth in a private document that may be:
  - (a) executed in Puerto Rico and thereafter ratified and elevated to deed form before a notary public in Puerto Rico; or
  - (b) executed by the parties before a notary public outside of Puerto Rico and thereafter protocolised by a notary public in Puerto Rico.

In each of the above-mentioned three methods described, the public deed is prepared by a Puerto Rico notary public in accordance with the form requirements of the PR Notarial Act.

Lease Recordation Costs

Stamp taxes

The PR Notarial Act requires that internal revenue stamps be cancelled on the original and the certified copy of the aforementioned deeds. The Internal Revenue stamp taxes for the original are calculated based on the transaction amount at the rate of USD2 for the first USD1,000 (or fractions thereof) and USD for every USD1,000 thereafter. The Internal Revenue stamp taxes for the certified copy are calculated at the rate of USD1 for the first USD1,000 (or fractions thereof) and USD0.50 per USD1,000 thereafter. The transaction amount used to calculate the Internal Revenue stamps for a lease agreement is based on the aggregate rent to be paid during the entire term of the lease, including any extension options.

Recording fees

The fees for recording a deed in the Registry are calculated at the rate of USD2 per USD1,000 (or fractions thereof) for the first USD25,000 and USD4 per USD1,000 for amounts in excess of USD25,000, plus a filing fee of USD25.50. The amount used to calculate the recording fees for a lease agreement is based on the aggregate rent for only the first 15 years of the lease.

Notarial tariff

In addition, the Notarial Law mandates payment of a notarial tariff to be calculated on the basis of the stated amount of the transaction (eg, the purchase price or the amount of the mortgage). For transactions with stated amounts not exceeding USD10,000, the applicable notarial tariff is USD150. With regard to transactions with stated amounts between USD10,000 and USD5 million, the parties may negotiate the notarial tariff, but in no event may the tariff be greater than 1% of the transaction amount or less than 0.5% of the transaction amount. For transactions with stated amounts of more than USD5 million, the parties are free to negotiate the notarial tariff but the tariff in those cases will never be less than USD25,000.

6.21 Forced Eviction

Under Puerto Rico law, a tenant may be evicted pursuant to a summary judicial proceeding if an event of default has occurred under the lease

agreement. The proceeding requires that a hearing be held within ten days after the date on which the eviction suit is filed with the court by the landlord. Thereafter, the judge must issue a ruling within ten days after the date of such hearing. In practice, however, the eviction process may actually take longer than the foregoing periods set forth in the statute. This is particularly so with regard to the eviction of residential tenants that are insolvent families, which requires giving notice of the judicial order to the Department of Family and can only occur after 20 days from the date of such notice. Furthermore, in such cases, a representative of the Department of Family must be brought as a necessary party to the eviction proceeding.

6.22 Termination by a Third Party

A lease may be terminated by a governmental authority in Puerto Rico, using its powers of condemnation and expropriation, as a result of the taking of the leased property for a public purpose. However, the government must always pay just compensation to the affected parties, which is often the subject of litigation making the length of the entire process uncertain and unpredictable.

6.23 Remedies/Damages for Breach

There are no statutory limitations on damages in the event of a tenant's breach and termination of a lease. As indicated in **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations**, the most common type of security offered by tenants under commercial leases in Puerto Rico is a security deposit. If the tenant fails to perform a monetary obligation, the landlord may use the deposit to satisfy the tenant's unpaid obligation.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common types of contractual arrangements in Puerto Rico between the owner of a construction project and the contractor are:

- "stipulated sum" in which the basis of payment is a fixed price; and
- "cost plus" in which the basis of payment is the cost of the work plus a fee for the contractor.

Under the "cost plus" arrangement, the contractor's fee can be a fixed amount or alternatively a percentage of the cost of the project. "Cost plus" contracts sometimes provide for a guaranteed maximum price such that the amount to be paid by the owner of the project to the contractor never exceeds a predetermined amount.

7.2 Assigning Responsibility for the Design and Construction of a Project

There are a variety of methods commonly used in Puerto Rico for assigning responsibility for the design, construction and administration of a project. Design, which is the initial step, must always be undertaken by one or more architects who are licensed in Puerto Rico. The construction of the project itself may be arranged under a single contract with a licensed general contractor or under a number of separate contracts with specialised contractors whose work is co-ordinated by the project architect or a construction manager. Finally, the design and construction functions may also be combined under a single approach commonly known as "design-build", where the owner of the project contracts with a single entity that provides design, construction and contract administration services for the project.

7.3 Management of Construction Risk

Construction risk in Puerto Rico is typically managed contractually in the project agreements by means of warranties, indemnification provisions and limitations of liability. Of course, the effectiveness of these devices is dependent on the solvency of the obligated parties. To the extent possible, when the solvency and experience of one of the parties is in question, the counterparty will seek to obtain guarantees from sureties or third-party guarantors. As a general rule, these devices are fully enforceable to the extent not found to be contrary to public policy.

7.4 Management of Schedule-Related Risk

The most common method that owners of construction projects in Puerto Rico utilise in order to manage schedule-related risk is the establishment of milestone dates for the different phases of a project. Project contracts will typically include monetary penalties for failure to comply with the milestones in a timely manner, as well as monetary rewards for early completion.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is customary in Puerto Rico, particularly in the case of large projects, for owners (and their lenders) to require project contractors to provide payment and performance bonds. Although less common, letters of credit and completion guaranties from affiliates and/or principals may also be required in order to cover the risk of a contractor's failure to perform under its project contract.

7.6 Liens or Encumbrances in the Event of Non-payment

Puerto Rican law does not provide project contractors with so-called mechanic's or materialmen's liens if a project contractor is not paid the amount due. A contractor who is not paid must bring an action in court in order to recover amounts owed. However, the Puerto Rican Civil Code does give labourers and materialmen (including, for example, sub-contractors) who have not been paid by the project contractor a direct cause of action against the owner of the project to the extent of any amounts owed by the owner to the project contractor. Such right does not constitute a lien on any property.

7.7 Requirements Before Use or Inhabitation

In Puerto Rico, once a project is completed, the project inspector (who must be a licensed architect or engineer) must certify to the permitting agency that the construction has been undertaken in accordance with the government-approved plans and specifications for the project. The completed project must also be inspected and approved by the Puerto Rico Health and Fire Departments for compliance with the applicable fire and health codes. Once all required inspections, approvals and certifications have been submitted to the permitting agency, a final use permit is issued allowing for the occupancy and use of the completed project.

8. Tax

8.1 VAT and Sales Tax

There is no VAT (or equivalent) applicable to the sale or purchase of real estate in Puerto Rico.

8.2 Mitigation of Tax Liability

The conveyance of real estate in Puerto Rico is recorded in the Registry of Property, which results in the payment of recordation fees and stamp taxes. Transactions involving the purchase of the shares or other ownership interests in an entity (rather than the purchase of the

assets of the entity) may be used to mitigate the recordation fees and stamp taxes, as the transfer of ownership interests is not subject to those costs.

8.3 Municipal Taxes

Real property taxes are payable by the owner of real property in Puerto Rico. The tax rate varies depending on the municipality in which the property is located and ranges from 8.08% to 11.83%. The real property tax is imposed on the value of the property, as assessed (based on the replacement cost as of 1957) by the Municipal Revenues Collection Center (*Centro de Recaudacion de Ingresos Municipales*, or CRIM) and is payable semi-annually on July 1st and January 1st of each year. Real property tax exemption may be available under certain Puerto Rico tax incentives legislation (eg, tax incentives covering manufacturing, tourism, and other eligible activities).

Also, any for-profit entity engaged in a trade or business in Puerto Rico is subject to a municipal licence tax (a gross receipts tax or "patente") imposed on gross revenues generated within the municipalities in which the entity conducts its business. The municipal licence tax rate varies depending on the municipality, but ranges from 0.2% to 0.5% of gross revenues in the case of non-financial businesses.

8.4 Income Tax Withholding for Foreign Investors

A foreign corporation that is not engaged in a trade or business in Puerto Rico is subject to Puerto Rico withholding income tax on its fixed or determinable annual or periodic gross income (eg, rental income) from Puerto Rico sources at a flat tax rate of 29%, which is fulfilled through withholding at source by the payor of the income. The foreign corporation may, however, elect to treat income derived from real estate located in Puerto Rico (whether the income is rent or gain from the sale or exchange of the property) as income effectively connected with a Puerto Rico trade or business (the "Election"), which would allow the lessor to avoid being subject to the 29% flat tax regime. Instead, the lessor would be required to file a Puerto Rico income tax return in order to declare the Puerto Rico rental income and claim all expenses associated with the production of such income, with the net rental income subject to tax in Puerto Rico at regular corporate income tax rates (up to 37.5%).

In the case of the sale of real property located in Puerto Rico by a foreign corporation that is not engaged in a trade or business in Puerto Rico, the purchaser of the real property asset is required to withhold 25% of the excess of the selling price over the sum of the seller's acquisition cost of the property plus certain other items specifically provided under the law. However, if the foreign corporation has made the election, the gain from the sale of the real property would be taxed at:

- gradual (up to 37.5%) income tax rates for real property considered inventory; or
- preferential (20%) income tax rates if the real property is a trade or business asset or an investment property.

8.5 Tax Benefits

Income from certain real estate owned by a REIT in Puerto Rico is subject to preferential Puerto Rican income tax treatment. In general, if the REIT makes dividend distributions in an amount equal to at least 90% of its net income during a taxable year, the REIT will not be subject to the regular Puerto Rican corporate income tax rates otherwise applicable. Taxable dividends distrib-

uted by the REIT would be subject to a 10% Puerto Rican income tax withholding at source. Real property used in a trade or business or to produce income may be depreciated over its useful life.

ROMANIA



Law and Practice

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Mușat & Asociații is a leading, full-service Romanian law firm that has been advising leading national and international companies, governmental authorities, financial institutions and investment funds for over 30 years. The firm has 17 partners and more than 100 dedicated lawyers. Its market-leading real estate practice has a strong record of advising developers, retailers, investors, financial institutions and funds on a wide range of matters, including the acquisition of land, construction and maintenance, permitting aspects, residential, office and commercial projects, mixed-use scheme developments and asset management work. The practice has extensive experience in helping real estate developers navigate the intricacies of local laws and optimise transaction outcomes with thorough due diligence and insightful strategic advice. The firm assists major retail market leaders with various real estate mandates, and the practice's expertise on transactional and financial briefs is of particular benefit to international consultancies and investment companies.

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1. General

1.1 Main Sources of Law

The main sources of real estate law in Romania are as follows:

- the Romanian Constitution, as further amended, supplemented and republished;
- the Civil Code, which entered into force on 1 October 2011;
- Law No 71/2011 for the enforcement of the New Civil Code;
- Land Law No 18/1991, as further amended, supplemented and republished;
- Law No 50/1991 on authorisation of construction works, as further amended, supplemented and republished;
- Law No 10/1995 on quality in constructions, as further amended;
- Law No 112/1995 on the legal regime of dwellings transferred within the state property, as further amended;
- Law No 7/1996 on cadastral works and the real estate publicity system, as further amended, supplemented and republished;
- Law No 10/2001 on the legal regime of real estate abusively taken over between 6 March 1945 and 2 December 1989, as further amended, supplemented and republished;
- Law No 350/2001 on territorial planning and zoning, as further amended and supplemented;
- Law No 165/2013 on measures to complete the process of restitution in kind or by equivalent of properties abusively confiscated during the communist regime in Romania;
- Law No 17/2014 on several measures regulating the sale and purchase of agricultural lands located in extra-urban areas; and
- Law No 312/2005 regarding the acquisition of ownership rights over real estate by foreign citizens, stateless persons and foreign legal entities.

1.2 Main Market Trends and Deals

As anticipated, 2023 saw a dynamic energy sector, with a focus on sites for photovoltaic developments and wind projects reuniting both local developers and active foreign players. In the office segment, well-located and ESG-compliant buildings were highly sought after from a sustainability perspective, considering the prioritisation of aligning real estate investments with broader societal and environmental goals.

The most recent real estate deals have proved a sense of consolidation and economic stability despite tougher fiscal and political predictability, especially in the industrial and logistics market, where investors continue to show great interest in leasing activity due to Romania's visible position as a regional distribution hub. The retail segment was the leader in commercial property transactions, followed by office, industrial and hotel properties, reflecting an attractive and vibrant market.

Even though the increase in financing costs has indeed impacted trading volume, the Romanian real estate market currently ensures a stable environment for investors, who remain positive and are looking to expand their portfolios with great confidence over the long term. While interest rates and rising inflation continue to be the primary concerns, a certain alleviation is anticipated during 2024, leading to reduced pressure on the construction sector.

The Romanian real estate market is expected to progressively embrace highly technological solutions to keep up with the digitalisation of the traditional investment landscape, especially in relation to the transfer of ownership through the tokenisation of land. As regards alternative sources of financing, both investors and developers are increasingly turning to real estate investment platforms, along with traditional bank financing.

1.3 Proposals for Reform

The Civil Code stipulates that the ownership right over properties will only be considered as having been acquired after it is registered in the Land Book.

However, this provision is not yet in force; it will become applicable country-wide only after the completion of the cadastral works for each territorial administrative unit. Until then, the registration of real estate rights ensures opposability towards third parties, and the Land Book provisions have an informative effect.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights include several attributes: possession, use and disposition. In addition to exclusive ownership, common ownership (two or more persons holding quotas over the property) is also possible, which can be either co-ownership, where the quotas are divided, or joint ownership, where the quotas are undivided.

The attributes of property rights are as follows:

- the usufruct right – using an asset owned by another person and benefiting from its products;
- the right of use – using an asset owned by another person and benefiting from its products only for family and own needs;
- the right of habitation – similar to the right of use, but applicable where the property is a dwelling;
- the easement right – owning a plot of land (the dominant tenement) and having certain rights in connection with another person's plot of land (the servient tenement); and
- the superficies right – owning or constructing a building on another person's land and also using the relevant land.

In addition, assets that constitute the public or private property of the municipality or the Romanian state can be used on the basis of a concession right.

2.2 Laws Applicable to Transfer of Title

In addition to the main sources of real estate law, the following legal provisions should be taken into account regarding transfer of title:

- Law No 36/1995 regarding notaries public, as subsequently amended;
- Company Law No 31/1990, as subsequently amended; and
- the Romanian Fiscal Code.

Romanian law does not include specific laws for different types of real estate; the applicable laws will be the same, regardless of whether the transfer of title concerns a property in the residential, industrial, office, retail or hotel sector. Notwithstanding the general rule, certain specific conditions must be fulfilled in order for certain types of real estate to be validly transferred (agricultural land, patrimonial assets, etc), to be assessed on a case-by-case basis.

2.3 Effecting Lawful and Proper Transfer of Title

There are several ways to carry out a lawful and proper transfer of title:

- transfer agreement authenticated by a notary public;
- donation;
- inheritance;
- adverse possession;
- accession;
- public tender procedure; and
- court ruling.

After the completion of the cadastral works per administrative unit, the acquisition of the property right will be conditional upon the registration of the relevant transaction in the Land Book. Until then, the registration is only enforceable against third parties. This is especially important if, for example, there are two or more buyers of the same real estate, who have concluded different agreements with the same owner by which ownership exclusive rights have been transferred. The rule is that, if acting in good faith, the first to register the right in the Land Book has the preferred title.

In light of the laws that applied to real estate during the communist regime, investors could be exposed to certain risks, so some choose to protect their investments by concluding insurance policies. This practice is on the rise but is not yet common in Romania.

2.4 Real Estate Due Diligence

As a precautionary measure, buyers usually perform real estate due diligence before purchasing a property, covering fiscal, legal, technical and/or environmental matters. The purpose of the legal due diligence is to identify and anticipate any impediments. Buyers are interested in analysing the validity of the ownership chain, permitting aspects, environmental legal issues, corresponding corporate approvals, etc. The lawyer's role is to recommend appropriate solutions to protect the title and, if necessary, to assist the parties in implementing them.

2.5 Typical Representations and Warranties

Romanian legislation obliges the seller to provide warranty against eviction (meaning any loss of possession or ownership rights over the property, in whole or in part, due to a successful claim in court by a third party to a real right over the property) and against hidden defects (existing or caused before/at the time of handover, but which could not be discovered by a diligent buyer without specialised assistance).

The warranties against eviction and against hidden defects are not limited in time. The parties may agree to exclude or limit the seller's liability, but it is forbidden to exclude or limit liability if the damage is caused by an act committed intentionally or through gross negligence.

Moving forward, the parties may agree on additional representations and warranties, depending on the specifics of the deal and the conclusions of the due diligence report. For example, a commercial real estate transaction may include warranties relating to the absence of any litigation and restitution claims, compliance with any environmental regulatory requirements or compliance with urban planning and building permits.

If the seller does not observe its contractual obligations, the buyer is entitled to apply to the competent courts for the following:

- in case of eviction – termination of the contract, refund of the purchase price and payment of damages; or
- in case of hidden defects – their removal, asset replacement, corresponding reduction of the purchase price or termination of the contract.

The parties may agree that one party's failure to comply with certain obligations entitles the other party to terminate the contract by written notice. In this way, court intervention is not necessary.

2.6 Important Areas of Law for Investors

Investors should first focus on the ownership title and chain, so the history of the real estate must be assessed in order to identify potential restitution claims or other aspects, such as related encumbrances or existing litigation.

In a sale by public tender of properties owned by the Romanian state or its administrative bodies, specific legal procedures must be performed and related conditions complied with.

The use, limits and conditions of construction are established by or depend on the city planning and construction regulations (zoning and general plans, urbanism certificates, building permits, etc), the environmental approvals and the rules applicable in order to protect historical monuments and archaeological sites.

Separately, the taxes and possibilities of financing the asset must be taken into consideration.

2.7 Soil Pollution or Environmental Contamination

The "polluter pays" principle is applied in Romania, which means that the person who caused the pollution is liable for the damage it has caused. If the buyer of a real estate asset did not cause the pollution or contamination, they need to prove that it was generated before the title transfer, by the previous owner or tenant.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The urbanism certificate details the legal, economic and technical regime of the lands and constructions existing in a specific area at the date of the request. The zonal urban plan (PUZ) is the regulatory instrument through which the integrated urban development of certain areas is co-ordinated.

These documents establish the permitted use of a piece of real estate and the conditions and restrictions to be observed in order to build, and are the preliminary documents to a building permit, which, in turn, provides much more specific

parameters to be observed while carrying out construction works.

Investors are able to enter into specific development agreements with relevant public authorities in order to facilitate a project, as Romanian legislation provides for the possibility of establishing public-private partnerships under specific public procurement conditions.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation can only take place for works of public utility, and only in exceptional circumstances. Therefore, real estate can be transferred from private property to public property in exchange for direct and prior compensation paid by the state to the owner.

In any disagreement, the court decides on the expropriation and establishes the compensation amount. If there is disagreement over the compensation amount, the court will decide on it.

2.10 Taxes Applicable to a Transaction

According to Romanian legislation, no stamp duty or transfer taxes are charged for direct transfers of real estate made by companies. The only fees to be paid are those for the notary public services (the amount varies depending on the value of transaction) and registration with the Land Book (0.5% of the purchase price for legal entities). These are usually paid by the buyer, but the parties are free to agree otherwise.

In an indirect transfer of real estate (shares deal), Trade Register fees must be paid.

2.11 Legal Restrictions on Foreign Investors

Individuals and companies from the EU or EEA that are resident in Romania have the right to buy land under the same conditions as Romanian citizens and companies. Non-EU or non-EEA resident persons and companies have the right to purchase land in Romania for the purpose of establishing a secondary residence or a registered office. EU or EEA citizens and companies can purchase agricultural land or forests that are in the Romanian territory. Other persons and companies, and stateless persons domiciled in a non-EU country, have the right to purchase agricultural land outside the city limits under conditions governed by international treaties, based on reciprocity.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

In general, the main investors in the Romanian real estate market are large private companies. Following the trends of recent years, debt financing is the most popular form of financing.

In addition, the legislation provides a number of facilities that encourage development, including a tax exemption for reinvested profit. However, even if it is not reinvested, corporate tax has a fixed rate of 16%. Moreover, no fees (building tax or property tax) are charged for buildings and land that are part of industrial and technological parks.

3.2 Typical Security Created by Commercial Investors

Mortgage Over Real Estate

In order to be valid, a mortgage agreement should meet the following requirements:

- the amount for which it is constituted can be reasonably determined on the basis of the mortgage deed;

- it identifies the parties;
- it indicates the cause of secured obligations;
- it accurately describes the mortgaged property; and
- it is authenticated by a notary public.

To be enforceable against third parties, mortgages must be registered in the Land Book.

It is important to mention that an asset mortgage also includes any products, rents, constructions, improvements and movable assets naturally linked to the respective immovable asset. Separately, the financing party may be interested in movable mortgages, mortgages over the shares of the holding company, and mortgages over proceeds or bank accounts.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

As a general rule, Romanian legislation does not provide restrictions on granting security over real estate to foreign lenders, nor are there any restrictions on repayments being made to a foreign lender under a security document or loan agreement.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Since the immovable mortgage agreement must be authenticated by a notary public, a notary fee is paid by the mortgagor, the amount of which depends on the value of the secured amount.

Another fee must be paid for registering the mortgage in the Land Book (RON100 for each asset plus 0.1% of the amount of the secured debt). The assignment contract regulating the transfer of a debt secured by a real estate mortgage must also be authenticated by the notary public in order to be valid. The fee for this service is calculated by applying 0.45% to the value of the assigned debt.

In a receivables assignment agreement, the registration fee for mortgages with the Land Book is fixed at RON100.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are legal rules that must be complied with before an entity can give valid security over its real estate assets – financial assistance rules, corporate benefit rules, etc.

Romanian law does not allow a joint stock company to advance funds, make loans nor provide guarantees for the subscription or acquisition of its own shares by a third party. However, this provision does not apply to transactions concluded by credit institutions and other financial institutions in the normal course of their business, nor to transactions involving the purchase of shares by or for the company's employees, provided that such transactions do not result in a decrease in net assets below the cumulative value of the issued share capital and of the reserves that cannot be distributed according to the law or the constitutive act.

The unilateral undertaking by a company of an obligation – granting a guarantee and creating security, especially in favour of a third party – that reduces its patrimony without obtaining a certain form of consideration in return is a violation of the principle according to which the main purpose of setting up a company is to generate profit. In this case, there is the risk that the security interest or guarantee may be challenged by a third-party creditor.

In addition, if the benefit received by the guarantor/security provider is not proportionate to

the risk undertaken, there is a higher risk that the transaction will be void for corporate benefit grounds.

Corporate compliance rules are also relevant. For instance, certain transactions can only be carried out with the approval of an extraordinary general meeting of shareholders.

3.6 Formalities When a Borrower Is in Default

In order to start the foreclosure procedure, the creditor must have an enforceable title, and the debtor's obligation must be certain, payable and due.

The rank of the real estate mortgage is determined by the order of applications for registration in the Land Book. A recorded lender has priority over the interests of unsecured creditors and also over the interests of secured creditors whose mortgage ranks are subsequent.

Romanian legislation stipulates that the enforcement of a real estate mortgage is led by a bailiff. The procedure is supervised by the court and mentioned in the Land Book. Moreover, the enforcement of a real estate mortgage is subject to the rules of traditional enforcement. Ideally, the procedure shall last at least 60 days from the date of registration of the request for enforcement with the bailiff, provided that the court approves enforcement in time, the bailiff identifies the assets and the debtor does not request/obtain a suspension of enforcement.

Moreover, a government emergency ordinance has provided for measures to grant facilities for loans granted by credit institutions and non-bank financial institutions to certain categories of borrowers, the guarantee by the Romanian state through the Ministry of Finance of the payment of interest on mortgage loans contracted by individual borrowers, and the enforceability of the debt title identifying the payment obligations of individuals benefiting from the facility.

In recent years, loan restructurings/extensions and forbearance agreements have become more prevalent, reflecting lenders' understanding of current market conditions, as well as their willingness to constructively negotiate with borrowers confronted with financial difficulties or circumstances beyond their control. However, lenders may end up exploring the foreclosure option as a last resort.

3.7 Subordinating Existing Debt to Newly Created Debt

In certain circumstances, existing secured debts may become subordinated to newly created debt by operation of law (if a lower ranking creditor pays a superior creditor the amount of the debt, it succeeds to the rank of the superior creditor) or by agreement of the parties. In a debtor's insolvency, the order of creditor debt recovery is established by law – any subordination agreements are no longer taken into account.

3.8 Lenders' Liability Under Environmental Laws

With regard to pollution or environmental contamination, Romania adopts the "polluter pays" principle, which means that the person who caused the pollution is liable for the damage it has caused. Therefore, the lender will only be liable if it is proven that they caused the pollution.

3.9 Effects of a Borrower Becoming Insolvent

According to the insolvency legislation, the security interests created by a borrower in favour of a lender will not become void if the borrower becomes insolvent. However, no inter-

est, increase or penalty of whatever nature or accessory expense may be added to claims arising before the date of opening of the insolvency proceedings, except for privileged claims.

Where a reorganisation plan is confirmed, the interests, increases or penalties of whatever nature or accessory expenses for the obligations arising after the date of opening of the general proceeding shall be paid according to the documents they result from and to the payments schedule. Where the plan is unsuccessful, they shall continue to be due until the opening of bankruptcy. Accordingly, the insolvency legal provisions stipulate that secured claims are recorded in the final table of receivables up to the market value of the security, as established by the valuation report.

For claims preceding the date of the opening of the insolvency proceedings, the lender will lodge its receivable claim along with the proofs of debt within a term set in the decision concerning the opening of the proceedings, under the sanction of losing its right to recover the receivables.

3.10 Taxes on Loans

General rules for interest deductibility rules are in place, so borrowing costs incurred in a fiscal period that exceed the deductible threshold of EUR1 million are deductible for CIT purposes up to the limit of 30% of the calculation base. The non-deductible exceeding borrowing costs can be carried forward indefinitely. The limitation also applies to any debt-related costs in connection with loans granted by financial institutions.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The main regulations and plans applicable to strategic planning and zoning are:

- Law No 350/2001 regarding urban planning;
- the general urban plan (PUG);
- the zoning urban plan (PUZ); and
- the detailed urban plan (PUD).

These plans are technical documents drawn up for the regulation and development of a locality (PUG), a determined area (PUZ) or a specific location (PUD).

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

General

The design, appearance and method of construction of new buildings and the refurbishment of existing buildings are regulated by Law No 50/1991 regarding construction works and Law No 10/1995 regarding quality in construction works.

Procedure

According to Law No 50/1991, as a general rule, construction works are allowed only on the basis of a building permit. In order to receive such permit, an urbanism certificate is required. This document contains the rules and parameters that have to be followed and complied with by the designer of the construction, and may not deviate from the requirements set forth by the urban planning documentation of the respective area.

Exceptions

However, the legislation also provides for exceptions to the rule of mandatory building permits, including:

- repairs to fences, when their shape and the materials from which they are made do not change;
- repairs to roofs or terraces, when their shape does not change;
- repairs and replacements of interior carpentry;
- repairs and replacements of exterior carpentry, if the shape, dimensions of the gaps and the carpentry are kept, including in the situation when the materials from which the respective works are made are changed;
- plasters, paints and interior floors; and
- repairs to plasters, paints and plywood if the facade elements and the colours of the buildings are not modified.

The rules are stricter regarding historical monuments or lands and constructions located within protection zones.

Legal Obligations

According to Law No 10/1995, in order to obtain quality constructions, it is mandatory to achieve and maintain the following applicable fundamental requirements throughout the existence of the constructions:

- mechanical resistance and stability;
- fire safety;
- hygiene, health and environment protection;
- safety and accessibility;
- protection against noise;
- energy saving and thermal insulation; and
- sustainable use of natural resources.

4.3 Regulatory Authorities

The main legislation that applies to the development and designated use of individual parcels of real estate is:

- Law No 10/1995 regarding quality in construction works;
- Law No 50/1991 regarding construction works; and
- Law No 350/2001 regarding urban planning.

Depending on the circumstances of each case, the building permit can be issued by the presidents of the county councils, the mayors of municipalities, localities or communes, or the mayors of the sectors of Bucharest. The zonal urban plan and the detailed urban plan are approved by the local councils.

There are some situations when the consent of the neighbours is required – eg, for construction works that are necessary to change the designated use of existing buildings, or for the development of buildings with a use that differs from the neighbouring buildings. If the neighbours refuse to issue the consent, a court decision can take its place.

4.4 Obtaining Entitlements to Develop a New Project

As a general rule, a building permit is required in order to develop any new project or complete any major refurbishment. The procedure to be followed in order to obtain the building permit is as follows:

- obtaining the urbanism certificate;
- obtaining the point of view of the competent authority for environmental protection for investments that do not require the performance of an environmental impact assessment procedure;

- notifying the competent public administration authority regarding the maintenance of the application for obtaining, as a final act, the building permit, for investments that require the performance of an environmental impact assessment procedure;
- obtaining the permits and approvals required in the urbanism certificate and also the environmental approval;
- preparing the technical documentation;
- submitting the documentation to the competent public administration authority; and
- obtaining the building permit (to be issued within 30 days of the filing of the application).

There may be additional requirements, on a case-by-case basis.

The public should be involved in all steps of the decision process related to the urban planning and designated use of the territory. The public has the right to object and, if the response is not favourable, to challenge the administrative act issued by the authorities.

4.5 Right of Appeal Against an Authority's Decision

The beneficiary, any interested person or interested social bodies may request the issuing local public administration authority to revoke the administrative act. If the authority's response is unfavourable, any interested person may challenge the building permit or the rejection of the application, as the case may be, in court. An interested person may be a person whose application for a building permit was rejected, as well as any other person who may claim an interest.

4.6 Agreements With Local or Governmental Authorities

Romanian legislation regarding public procurement, the provision of services and concessions allows the conclusion of development agreements with the public authorities.

Agreements with utility providers must be concluded during the construction works, as well as after the completion of the construction works.

4.7 Enforcement of Restrictions on Development and Designated Use

The State Inspectorate of Construction and the local authorities supervise the construction works and sanction any violation of the rules established by law or by the building permit.

In addition, any interested person can notify the authorities of irregularities related to the construction works, and can challenge the administrative acts issued by the authorities.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Romanian companies are regulated mainly by Companies Law No 31/1990 and may be categorised according to several criteria, with the most important being nationality and legal form.

Companies that are incorporated and have their registered headquarters in Romania have Romanian nationality, regardless of the nationality or nature of their shareholders (ie, private individuals or legal entities, Romanian shareholders or other nationality shareholders).

When incorporating a company in Romania, its founders may choose between five types of companies:

- general partnership (*Societate in nume colectiv* or SNC);

- limited partnership (*Societate in comandita simpla* – SCS);
- partnership limited by shares (*Societate in comandita pe actiuni* – SCA);
- limited liability company (*Societate cu raspundere limitata* – SRL); or
- joint stock company (*Societate pe actiuni* – SA).

The SRL is the most common form of company incorporated in Romania, mainly due to the liability of shareholders being limited to the amount of share capital subscribed, and to its plain management rules and corporate structure.

Investments that entail the holding of real estate assets in Romania may also be carried out via alternative investment funds specialising in real estate. Addressing both retail and professional investors, their incorporation has to take the form of a joint stock company.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

All Romanian companies (as well as certain individuals or other legal entities expressly provided by law) must register with the Romanian Trade Register prior to commencing trading operations, with the date of such registration being the date when the company is granted legal personality by virtue of law.

The capacity to establish a company is, nevertheless, conditional upon the fulfilment of certain legal requirements: individuals should not have been legally declared unfit, incapable or liable of criminal offences such as breach of trust, forgery, use of forgery, etc, and must have clean fiscal records, while legal entities should be legally registered and operating in the country where their main headquarters are located, with clean fiscal and criminal records.

An SRL may be established by one to 50 shareholders, while joint stock companies should have at least two shareholders, with no restriction on the maximum number of shareholders. Bearer shares are not permitted under Romanian law.

Generally, income from the transfer of real estate is taxed at the following tax rates applicable on the transaction value, depending on the period for which the property was owned/held:

- 3% for constructions of any kind and their related lands, as well as on lands of any kind without constructions, held for a period of up to three years inclusive; and
- 1% for such buildings that are held for a period longer than three years.

However, natural persons who consistently obtain income from real estate transactions may be required to register as a PFA (*persoana fizica autorizata*), meaning that the natural person is authorised to perform economic activity. Under Romanian legislation, this is considered as income from independent activities and will be taxed as follows:

- 10% income tax;
- social insurance contribution (pension) of 25%; and
- health insurance contribution of 10%.

If the threshold of RON300,000 is exceeded, a VAT registration will also be required.

For SRL/joint stock companies, the applicable corporate tax rate is generally 16%. However, a Romanian legal entity can opt for the application of micro-company revenue tax in lieu of the standard CIT if it cumulatively meets the following conditions as of 31 December of the previous year:

- the revenues derived did not exceed the Romanian leu equivalent of EUR500,000;
- the share capital is owned by persons other than the state and administrative-territorial units;
- it is not under dissolution, followed by liquidation;
- at least 80% of its total revenues are generated from activities other than consulting and management activities, except tax consultancy;
- it has at least one employee, except tax consultancy; and
- it has associates/shareholders that hold more than 25% of the value/number of participation titles or voting rights and is the only legal entity established by the associates/shareholders to apply the provisions related to the micro-company.

5.3 REITs

REITs are not really available in Romania. There are real estate investment vehicles, but these do not rely on the institution of a trust. The following options are available locally:

- alternative investment funds, which are regulated entities and have a real estate-focused investment policy and may appeal to the general public for investments;
- closed SPVs, which are non-regulated, ad hoc Romanian companies generally attracting a limited number of investors, do not appeal to the general public, and may be organised as joint stock companies or limited liability companies;
- issuers, which are regulated – ie, companies admitted on a regulated market focusing purely on real estate development; and
- crowdfunding vehicles, which have to comply with crowdfunding rules.

The Romanian legal framework is as follows:

- Law No 243/2019 on the regulation of alternative investment funds and for amending and supplementing certain regulatory acts regulates alternative investment funds;
- Law No 24/2017 on issuers regulates the activity of issuers on a regulated market; and
- Law No 244/2022 on the establishment of measures implementing Regulation (EU) 2020/1.503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1.129 and Directive (EU) 2019/1.937, regulates the activity of funding through crowdfunding.

Foreign investors should also pay attention to FDI regulations, as certain investments in real estate may also trigger FDI review.

5.4 Minimum Capital Requirement

There is no minimum share capital for SRL, SNC and SCS. The minimum share capital for SA and SCA is RON90,000. The Romanian government may adjust the minimum level of the share capital, not more frequently than once every two years, according to the exchange rate, so that this amount is the equivalent of EUR25,000.

As a general rule, work/industry contributions from shareholders to the limited liability or joint stock companies' share capital are not allowed.

The shareholders of a limited liability company are required to pay 30% of the amount of the subscribed share capital no later than three months after the date of incorporation, but before commencing operations in the name of the company, and the balance of the subscribed share capital will be paid within 12 months from the date of incorporation for the cash contribu-

tion, and no later than two years from the date of incorporation for the contribution in kind. On the other hand, general partnerships and limited partnerships are required to pay the subscribed registered capital in full upon incorporation.

5.5 Applicable Governance Requirements

The most frequent forms of business in Romania are joint stock companies and limited liability companies. The statutory bodies of a limited liability company are as follows:

- the general meeting of shareholders (for limited liability companies with more than one shareholder) or the sole shareholder, in which case the sole shareholder shall exercise the powers of a general meeting of shareholders;
- one or more directors; and
- the auditors/*cenzors,* as the case may be. For limited liability companies set up by one to 15 shareholders, the appointment of *cenzors* is not mandatory. If *cenzors* or auditors are not appointed, the control of the operations will be performed by the shareholders who are not already acting as company directors.

A limited liability company can be managed by a sole director, or by more directors acting independently or by joint signature. The directors of a limited liability company can be both individuals and/or legal entities, regardless of their citizenship or nationality, and may be either shareholders or persons outside the company.

Joint stock companies may choose between two management systems: the classic one (unitary system) and the dualist management system.

If the unitary system of management is chosen, joint stock companies are managed by one or several directors, always in uneven numbers, organised as a board of directors. Entities that are legally obliged to have their financial statements audited must have at least three directors.

Under the dualist system, the company is managed by a directorate and a supervisory council. The directorate is formed by one or several members and exclusively exercises the management of the company, performing useful and necessary deeds for the accomplishment of the object of activity, except those under the competence of the general shareholders' meeting and the supervisory council. Among other functions, the supervisory council exercises continuous control over the directorate's management of the company.

Directors do not need to be Romanian citizens. Managers of a joint stock company under the unitary system, and members of the directorate under the dualist system, are individuals. A legal entity may be appointed as director or member of the supervisory council. If a board of directors runs a company, one of them must be appointed as Chair of the Board.

5.6 Annual Entity Maintenance and Accounting Compliance

It is difficult to estimate the annual entity maintenance and accounting compliance costs, since the fees of the local accounting/tax compliance providers depend on the volume of activity of each relevant entity (eg, different fees apply depending on the number of invoices issued in a month).

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The right to use a piece of real estate for a limited period of time without buying it can be acquired via:

- a free-use agreement for a property (*contract de comodat*);
- a concession agreement;
- a lease agreement;
- a lease of a dwelling; or
- a lease of agricultural land.

6.2 Types of Commercial Leases

In Romania, there are three types of lease:

- a lease agreement;
- a lease of a dwelling; and
- a lease of agricultural land.

6.3 Regulation of Rents or Lease Terms

Rent is one of the terms of a lease agreement that can be freely negotiated between the parties.

In the context of the COVID-19 pandemic, the Romanian government adopted some measures to sustain the business sector, including the postponement of payment of rent and utilities for, but not limited to, small and medium enterprises. The measures were applied during the state of emergency, but could only be benefitted from when certain cumulative conditions were met. Under certain conditions, tenants who were economically affected during the state of emergency had the possibility to defer on request the payment of rent for the use of buildings registered as offices, workplaces or dwellings.

Rent payments were made by the competent territorial tax authority to the account of the landlords at the tenants' request. Tenants who benefitted from deferment had to pay the deferred amounts, representing the amount of rent paid by the authorities to the landlord, to the competent territorial tax body by 31 December 2020.

6.4 Typical Terms of a Lease

Length of Lease Term

Romanian legislation provides for a maximum duration of a lease agreement (49 years), but no minimum. If the parties establish a longer duration, it will be automatically reduced. If the parties did not provide an expiry date but did not intend to conclude the agreement for an indefinite period, the duration may be determined on the basis of the provisions of the Civil Code.

Maintenance and Repairs

The costs of any major and necessary repairs are paid by the landlord. The expenses related to the day-to-day maintenance of the property are paid by the tenant. As an alternative, these may initially be borne by the landlord and then recharged to the tenant.

Rent Payment

Unless the parties agree otherwise, the rent is paid according to the common practice. If there is no common practice, the rent is paid as follows:

- in advance for the entire duration of the contract, if it does not exceed one month;
- monthly, if the duration of the lease is longer than one month but less than one year; or
- quarterly, if the duration of the lease is at least one year.

However, the parties may agree on a different payment schedule.

COVID-19

During the lockdown imposed in response to the pandemic, certain measures were implemented to help those tenants in need, mostly related to postponing rent payments; this is currently freely negotiated between parties. Therefore, the parties may agree on clauses depending on the area of interest (eg, rent abatements in the event of future pandemics, construction build-out/supply chain issues, force majeure definitions), in order to secure the agreement and prevent potential risks caused by the COVID-19 pandemic.

6.5 Rent Variation

Unless the parties agree otherwise, the rent remains the same for the entire duration of the lease.

In Romania, the indexation of the rent is not mandatory, remaining at the choice of the parties. However, such clauses are common in long-term lease agreements.

It is important to mention that the courts may modify the parties' rights and obligations in light of exceptional and unforeseen events.

6.6 Determination of New Rent

The parties may agree for a rent change to be carried out under certain conditions and on the basis of specific calculation methods. It is important to note that many leases provide for an annual indexation of the rent, whereby the amount is changed according to certain economic indicators.

6.7 Payment of VAT

The rental of real estate property located in Romania is generally VAT exempt without deduction rights. However, the right to opt for VAT (19% standard rate) may be exercised under certain conditions.

6.8 Costs Payable by a Tenant at the Start of a Lease

Although security deposits for rent are not required by law, they are common in practice. The same applies to fit-out works performed by the tenant.

In addition, in order to be enforceable against subsequent owners, the lease must be registered in the Land Book and the tenant has to bear the related fee. This is useful, but not mandatory. The tenant has to pay no further additional costs at the beginning of a lease.

6.9 Payment of Maintenance and Repair

For the maintenance and repair of the common areas (eg, parking lots and gardens), each tenant pays an amount proportional to its leased area.

6.10 Payment of Utilities and Telecommunications

The payment of utilities and telecommunications costs can be freely negotiated by the parties.

If there are several tenants occupying a property, the general cost of utilities is usually paid by the landlord and re-invoiced to the tenants based on their consumption. As for telecommunications, each tenant normally concludes agreements directly with these suppliers.

6.11 Insurance Issues

The landlord usually concludes a building insurance policy and an insurance policy for natural disasters, with the latter being imposed by current legislation with regard to dwellings and residential units. The tenant usually concludes insurance policies relating to the assets and business within the leased premises (assets, activity, persons).

COVID-19

Some tenants have recovered some costs under their business interruption insurance policies, as per the strict provisions therein. However, many insurance companies have re-evaluated their policies in order to add exclusions in case of COVID-19-related loss of business, or to expressly provide limited coverage for certain business interruption related to COVID-19.

6.12 Restrictions on the Use of Real Estate

The tenant must use the leased property prudently and diligently, according to the purpose provided in the agreement or the use presumed on the basis of certain circumstances (eg, previous use of the property). Otherwise, the landlord may claim damage compensation and even, as the case may be, termination of the contract.

Under certain conditions, changing the leased property designation requires the approval of the neighbours.

6.13 Tenant's Ability to Alter and Improve Real Estate

If the tenant modifies the property or uses it in such a way as to cause damages, the landlord can claim compensation and, as the case may be, terminate the contract. The landlord has the right to keep the improvements to the property made without prior approval and cannot be obliged to compensate the tenant for such. It is the landlord's choice to request the tenant to return the property to its original condition or the payment of compensation for any damage caused.

6.14 Specific Regulations

The rules established by the Civil Code apply to lease agreements, while the law provides for specific provisions for dwellings, most of which create additional protection for the tenant. Agreements for the use of agricultural land (*contractul de arendă*) also fall under certain specific legal provisions.

6.15 Effect of the Tenant's Insolvency

According to the insolvency legislation, any agreements in progress are considered to be maintained at the date of the opening of the insolvency procedure, while any contractual clauses terminating ongoing contracts, forfeiting the benefit of the term, modifying the contract to the detriment of the debtor or declaring early enforceability for the reason of the opening of proceedings shall be deemed unwritten.

However, in order to increase the value of the debtor's patrimony, the judicial administrator/liquidator may terminate any agreement, unexpired leases or other long-term agreements within a limitation period of three months from the date of the opening of the insolvency procedure, as long as such agreements have not been fully or substantially performed by all parties involved. In this situation, the agreement is considered terminated as of the date of the notification sent by the judicial administrator of the debtor (tenant) to the landlord.

The insolvency legislation also entitles the other contracting party (landlord) to notify the judicial administrator/liquidator of the termination of the agreement. The judicial administrator/liquidator must respond within 30 days, under the sanction of the contract being considered terminated at the end of such term. Accordingly, the judicial administrator/liquidator will no longer be able to request the performance of the contract.

If the insolvency administrator/liquidator requests the performance of the contract, they shall state quarterly in the activity reports wheth-

er the debtor has the funds necessary to pay for the rent.

On a separate matter, for claims that are dated before the opening of the proceedings, the landlord will lodge its statement of receivable along with the proofs of debt within the term set out in the decision to open the proceedings.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The most common forms of rent security that protect the landlord against the failure of the tenant to fulfil its obligations are:

- rent deposits;
- bank guarantees; and
- parent company (corporate) guarantees.

6.17 Right to Occupy After Termination or Expiry of a Lease

As a general rule, the tenant does not have the right to continue to occupy the relevant real estate after the expiry or termination of a commercial lease. If the tenant continues to occupy the premises and fulfil its obligations after the expiry date, without any opposition from the landlord, the lease is automatically renewed for an indefinite period, under the same conditions, including those related to guarantees.

6.18 Right to Assign a Leasehold Interest

If it is not expressly prohibited by contract, the tenant may conclude a sublease or even assign the lease. These agreements may cover all or a portion of the leased premises.

Any prohibition on subleasing also includes a prohibition on assigning the lease, but a prohibition on assigning the lease does not include a prohibition on subleasing.

6.19 Right to Terminate a Lease

If the duration is indefinite, any party may terminate the agreement by notifying the other party. The legislation stipulates the notice period that must be observed. When one of the parties to the lease does not perform its obligations arising from this agreement without justification, the other party has the right to terminate the lease, with compensation, if applicable, according to law.

If the property is completely destroyed or can no longer be used for its designated use, the agreement shall terminate ipso jure. If the impossibility of using the property is only partial, the tenant may claim either the termination of the lease or a proportional reduction of the rent, depending on the circumstances. If the defects of the real estate or the disturbance in law are so serious that the tenant would not have concluded the lease if they had known of them, the tenant may terminate the contract, in accordance with the law.

If the performance of necessary repairs impedes the tenant's use of the leased premises, the tenant may terminate the agreement. If the tenant modifies the real estate (or its designated use) or uses it in such a way as to cause damages to the landlord, the latter can claim compensation and, as the case may be, terminate the contract.

There are also specific provisions regarding the lease of a dwelling and the lease of agricultural land.

However, the parties may also agree to other termination clauses.

6.20 Registration Requirements

Although Romanian legislation does not impose such an obligation, the lease must be registered in the Land Book in order to be enforceable against subsequent owners. As a general rule, the tenant covers the fee related to this service (RON75).

For agreements concluded after 1 January 2023, taxpayers who obtain income from the transfer of the use of their personal property, other than agricultural land rental income and income from the rental of rooms located in personally owned dwellings for tourism purposes, are required to register the agreement concluded between the parties, as well as any subsequent addenda, with the competent tax authority within 30 days of its conclusion/change. Such requirement is mandatory for natural persons, but optional for legal persons.

6.21 Forced Eviction

When the tenant fails to perform its obligations arising from this agreement without justification, the landlord has the right to terminate the lease and claim compensation, if applicable.

Upon prior written notification, and if the tenant refuses to leave the premises voluntarily, an eviction is carried out on the basis of a court decision. In addition, the tenant must pay the rent due until the date of the effective vacation of the premises.

6.22 Termination by a Third Party

There are certain circumstances that allow the public authorities to terminate a lease agreement by expropriation – for reasons of over-riding public interest at a local or national level. More specifically, any lease agreement shall terminate ipso jure in the course of expropriation procedures, on the final judgment date.

If the leased property is registered in the Land Book, the agreement must also be recorded with the Land Book in order to be enforceable against any subsequent owner; otherwise, the subsequent owner may terminate the lease. For properties that are not registered, the agreement must have a certified date prior to that of the transfer in order for the lease to be enforceable against any subsequent owner.

6.23 Remedies/Damages for Breach

As mentioned in **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations**, certain forms of security can be provided to a landlord to protect against a failure by the tenant to meet its obligations. In order to cover the damages, the security deposit will be retained in full or in part, depending on the case. If the damage exceeds the security deposit, the lessor can obtain compensation by a court decision.

7. Construction

7.1 Common Structures Used to Price Construction Projects

In principle, the development agreement concluded between an investor and a contractor provides for the following three possible options to price a construction project.

- The estimated price, in which the costs of the project or the provided services are subject to an estimation, and as a consequence any increase of costs must be justified by the contractor. The beneficiary is not obliged to pay the increased price, unless this increase results from works or services that were not foreseen by the contractor at the conclusion of the contract.

- The price set depending on the level of works or services, in which case the contractor has a legal obligation to inform the beneficiary regarding the state of works, the services provided and the costs incurred.
- The standard price, in which the contract is concluded for a global price, where the costs are not subject to any kind of modification, regardless of the circumstances that may arise during the development of the project.

The investor/developer should also consider any additional costs, such as may be caused by obtaining all the necessary legal permits required to start construction (eg, building permit).

7.2 Assigning Responsibility for the Design and Construction of a Project

Under Romanian legislation, construction works are undertaken by a contractor, while the design project of a construction is prepared by an architect and the civil engineer. The responsibility is divided between the contractor, the architect and the engineer. The contractor is liable for the quality of the work (eg, hidden defects of the construction or any other faults in the construction that may arise from improper execution of the project), whilst the architect or engineer is liable for any defects that may arise from a faulty design in the construction project.

7.3 Management of Construction Risk

The Romanian Civil Code provisions are as follows.

- There is a general guarantee for hidden defects, whereby the contractor guarantees the beneficiary for any hidden defects over a period of three years starting from the receipt of the project, or starting from the date when the defect was revealed (provided that the defect is discovered within the initial three-year period). A hidden defect is defined as a defect that could not be discovered or foreseen by a prudent and diligent buyer.
- Based on the freedom of agreement principle established under the law, the parties may agree on conventional guarantee terms, so a limitation of liability is possible. It will, however, not operate for those defects that were or should have been known to the contractor.
- Guarantees for hidden defects are subject to special regulations.

Law No 10/1995 on quality in constructions states that a ten-year guarantee is provided with regard to the liability of the constructor and other participants in the construction process (eg, architect, authorised site manager, developer, designer). Such individuals can be held liable for hidden defects that arise from their fault, such as defects that may affect the structural elements of the construction (the ten-year term runs from the project's receipt).

The buyer of a construction with hidden defects may file a liability complaint for hidden defects to court within three years from the receipt of the project or the date the defect was discovered.

7.4 Management of Schedule-Related Risk

The schedule of the construction project is usually subject to clear milestone and completion dates, which are agreed upon by the parties prior to the beginning of the construction. A common method used to sanction the constructor if the milestone or completion dates are not observed is delay penalties, usually backed by a guarantee. In this regard, the parties assess in advance, by means of a penalty clause, the extent of the damage suffered as a result of the delay in the execution of the obligation.

If the delays in the execution of the obligations are serious and substantially affect the works, the termination of the contract is also an option, although this is an undesirable outcome considering the implications that may arise from it.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Additional guarantee clauses for the proper execution of the works are as follows:

- successive deductions of 5% to 10% of the corresponding value of the invoices issued by the contractor, during the execution of the contract – the amounts charged as a guarantee will usually be refunded to the contractor after the final reception; and
- a letter or bank guarantee representing 5% to 10% of the total value of the works.

7.6 Liens or Encumbrances in the Event of Non-payment

According to the Civil Code, the contractor benefits from a legal mortgage on the works, constituted and preserved in accordance with the law, in order to secure payment of the price due for the work. Without any formality, the mortgage extends to the construction and its accessories, even if they are subsequent to the constitution of the mortgage.

7.7 Requirements Before Use or Inhabitation

The receipt of the works represents the final procedure that must be fulfilled before the construction can be commissioned. This procedure is performed by the Reception Committee (eg, a representative of the Competent Public Authority, a representative of the investor, a representative of the State Inspectorate in Constructions and one to three specialists in the field of constructions), whose purpose, inter alia, is to verify compliance with the provisions of the building permit, the execution of the construction works in accordance with the contract and the completion of all the construction works.

The construction can be put into use only after the receipt of the works is completed and the reception report has been signed by all the Reception Committee members.

8. Tax

8.1 VAT and Sales Tax

The sale and purchase of real estate property located in Romania is generally VAT exempt without a deduction right, except for new buildings and plots of land that can be built upon, which are generally subject to 19% VAT. Moreover, the right to opt for VAT (19% standard rate) for transactions that are generally VAT exempt may be exercised under certain conditions.

The supplies of real estate, if subject to VAT, fall under the reverse-charge mechanism if both the buyer and the seller are registered for VAT purposes in Romania. In such cases, neither the seller nor the buyer is obliged to pay VAT to the state budget. Furthermore, no VAT would be triggered if the real estate is transferred by way of a transfer of a going concern that is outside the scope of VAT.

As of 1 January 2024, the supply of buildings as part of the social policy, including the land on which they are built, is subject to the reduced rate of 9% (previously 5%). The delivery of housing as part of the social policy is understood to cover housing with a usable surface area of a maximum of 120 sq m, exclusive of household annexes, the value of which, including the land on which the housing unit is built,

does not exceed RON600,000, exclusive of VAT. This reduced rate applies only to homes that, at the time of delivery, can be lived in as such (the definition of "housing that can be lived in as such at the time of delivery" has been also modified).

8.2 Mitigation of Tax Liability

As a general rule, the mitigation of real estate property transfer tax occurs if a sale, merger or demerger of shares of an entity owning real estate is implemented, rather than a simple sale of real estate. In cross-border share transactions, the provisions of the double tax treaties concluded by Romania with other countries should be observed, since in certain cases the sale of shares of companies whose assets consist mainly of real estate located in Romania may shift the taxation of the sale of shares to Romania.

8.3 Municipal Taxes

No municipal tax is paid on the occupation of business premises. However, subject to limited exceptions, real estate used for paid tourist accommodation attracts a special tax for tourism established by each city council, which is collected from the tourist.

Municipal taxes (property taxes – building tax or land tax) also apply to the ownership of real estate and certain other limited real rights (ie, lease, concession, administration or use of public or private property of the state or of the administrative-territorial units). There are certain exemptions from property tax, but they are generally limited to non-profit, religious organisations, educational institutions, hospitals, governmental institutions, persons with disabilities, etc.

8.4 Income Tax Withholding for Foreign Investors

Rental income or revenue from the sale of real estate paid to non-residents represents Romanian-source income and is subject to Romanian taxation, based on the same rules as apply for the following:

- Romanian companies – 16% profit tax applied to the difference between the rental income and the expenses incurred for realising this income, or 16% applied to the sale price minus (i) the expenses for acquiring, constructing or refurbishment, out of which the depreciation value is excluded, and (ii) the commissions, taxes and other amounts paid with respect to the sale; and/or
- individuals – 3% of the transaction value for buildings of any kind and land relating thereto, as well as on land of any kind without buildings, held for a period of up to and including three years, and 1% of the transaction value for such properties that are held for more than three years.

These rates are subject to the provisions of any applicable tax treaty. There is no withholding tax for the buyer.

8.5 Tax Benefits

As a general rule, if the owner of the property is a company subject to Romanian corporate income tax, depreciation is allowed (on a straight-line basis) on the acquisition value of the buildings. Plots of land are not eligible for tax depreciation.

SINGAPORE



Law and Practice

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1. General

1.1 Main Sources of Law

The Singapore legal system is based on the English common law system. Singapore land law falls under two systems:

- the Registration of Deeds Act 1988, where lands are typically known as "unregistered land"; and
- the Land Titles Act 1993 or the Land Titles (Strata) Act 1967, where lands are registered and known as "registered land".

The system of land registration for registered land is adopted from the Torrens system of land registration.

There is legislation governing areas specific to real estate, such as:

- permitted use (the Planning Act 1998);
- development and construction (the Building Control Act 1989);
- management of strata units in flats and buildings (the Building Maintenance and Strata Management Act 2004); and
- taxes relating to transactions involving real estate (the Stamp Duties Act 1929).

1.2 Main Market Trends and Deals

Demand in the housing market has remained resilient. To moderate investment demand and prioritise owner-occupation for locals, the government introduced higher rates of additional buyer's stamp duty for residential property purchases. The government also focused on ramping up public housing supply in 2023, and on delivering many construction projects that had been delayed by the COVID-19 pandemic. As such, the residential market showed signs of easing throughout 2023, with both public and private housing experiencing overall slower price growth.

Against a backdrop of inflation, high interest rates and geopolitical tensions, there was some slowdown in the commercial real estate market in 2023, although office rents for Grade A office premises showed an increase from 2022 to 2023 and there were still large-scale transactions of commercial real estate.

Notable large private transactions in 2023 include:

- the SGD652.2 million acquisition of a 50% stake in the NEX suburban mall by Frasers Centrepoint Trust and Frasers Property Limited from Mercatus Co-operative, a unit of NTUC Enterprise;
- the SGD538 million en-bloc acquisition of a commercial building known as Shenton House by Shenton 101 Pte Ltd;
- the SGD525 million sale of Parkroyal Kitchener Hotel by UOL Group Limited to Worldwide Hotels Group;
- the SGD441 million acquisition of VisionCrest Commercial by a joint venture comprising TE Capital Partners, Metro Holdings and LaSalle Investment Management; and
- the SGD313.5 million joint acquisition of a logistics portfolio of five assets (at 21 Changi North Way, 6 Chin Bee Avenue, 4 and 6 Clementi Loop, 3 Pioneer Sector 3 and 30 Toh Guan Road, Singapore) by Hillhouse Capital from ESR-LOGOS REIT, representing Hillhouse Capital's first major industrial purchase in Singapore.

The government's imposition of higher additional buyer's stamp duty on residential properties has redirected some investor interest from residential to commercial assets. Asset classes such

as hospitality, co-living, retail and office properties remain popular. Notwithstanding rising inflation and increases in interest rates, there was sustained interest in industrial assets, spurred by demand from the logistics and advanced manufacturing sectors. In particular, with the advance of Industry 4.0, there is growing focus on warehouses, business parks and data centre facilities with improved automation, optimisation and energy efficiency, with many industry players choosing to upgrade existing older assets to suit these needs.

Apart from instruments and deeds registered or to be registered under the Land Titles Act 1993, the Land Titles (Strata) Act 1967 and the Registration of Deeds Act 1988, there is currently no explicit legislation in Singapore governing the use of digital instruments or "tokens" to transact real estate generally. Some "proptech" companies have used or offered blockchain platforms that enable investors to tap into funding for real estate, mainly for the purpose of raising funds or projects outside of Singapore.

In January 2023, the Singapore Land Authority (SLA) announced the appointment of a vendor for the development of the Digital Conveyancing Portal (DCP), which is scheduled to be completed by 2026. The DCP is intended to streamline the existing conveyancing process for public and private housing as well as commercial and industrial properties by providing a consolidated online platform, making such processes paperless and facilitating e-payments and digital document submissions. The DCP is expected to be implemented over three phases, with the first phase to be completed by the second quarter of 2024.

1.3 Proposals for Reform

The Code of Conduct for Leasing of Retail Premises (the Code of Conduct) was released in March 2021 and sets out guidelines on what constitutes fair practice in relation to tenancy agreements of qualifying retail premises. In an effort to facilitate compliance, the Code of Conduct includes a checklist template to accompany retail tenancy agreements and a step-by-step guide to file deviations. The objectives of the Code of Conduct are to have mandatory guidelines to guide landlords and tenants to a fair and balanced negotiation of tenancy agreements and to provide a governance framework for compliance and dispute resolution.

The Lease Agreements for Retail Premises Act 2023 (LARPA) came into effect on 1 February 2024, making it mandatory for all landlords and tenants of retail leases in Singapore to comply with the Code of Conduct. The LARPA also sets out a dispute resolution framework for parties to file complaints regarding non-compliance, and provides for the appointment of members of the Fair Tenancy Industry Committee and its specific functions, including the reviewing and updating of the Code of Conduct as well as the monitoring and promotion of compliance by landlords and tenants.

2. Sale and Purchase

2.1 Categories of Property Rights

Legal and equitable interests may be created in respect of property rights. Legal interests in relation to real estate include an estate in fee simple, a statutory land grant and a leasehold estate. Equitable interests include interests derived under an agreement in relation to land (eg, a purchaser's rights under an agreement for

sale and purchase or a lessee's rights under an agreement for lease).

2.2 Laws Applicable to Transfer of Title

For the transfer of title of registered land, the transaction must be effected in a form prescribed under the Land Titles Act 1993 and registered with the Land Registry.

Under the Residential Property Act 1976, there are restrictions on foreign ownership of vacant land or landed residential property. Except for landed homes in Sentosa Cove (situated on Sentosa Island), where ownership by foreigners (who are not Singapore permanent residents) is generally allowed with approval, any purchase of landed residential property by a person who is not a Singapore citizen (including a Singapore permanent resident) is subject to the approval of the government. Subject to certain rules and conditions, foreign developers may acquire landed residential property to develop for sale. There is generally no law against a foreigner purchasing Singapore commercial property but, with effect from 20 July 2023, foreigners who intend to purchase land zoned as or property permitted for "Commercial & Residential" use may only do so with the approval of the government.

2.3 Effecting Lawful and Proper Transfer of Title

As noted in **2.2 Laws Applicable to Transfer of Title**, transfers of title to registered land are effected by way of the registration of transfer instruments with the Land Registry. All transfers of registered land are recorded in the Land Register, administered by the Registrar of Titles. Title insurance is not common in Singapore, although in recent years it has been relied on in a number of transactions.

As safe management measures put in place for the COVID-19 pandemic have been lifted, there are now no prohibitions against physical meetings. Accordingly, the completion of documentation and the closing of real estate transactions have not been hampered.

2.4 Real Estate Due Diligence

Buyers usually carry out title searches, which can be conducted online. Where the land is unregistered, title must be deduced by inspection of the title documents. Buyers of large buildings will typically carry out a building audit and a technical inspection of the real estate (either internally or by the appointment of consultants) to ascertain the state, condition and structural soundness of the buildings, and encroachment surveys on the land. For industrial land, it is not uncommon for the buyer to carry out (or in some cases require the seller to carry out) an environmental study to determine whether there are any environmental contaminants on the land.

Buyers also carry out legal requisition searches with various government agencies and statutory bodies, which may reveal matters that affect the real estate (eg, notices of government action against the property, roads, drainage lines, reserves, railway lines or schemes, zoning and approved use).

Buyers will usually review sellers' documents relating to, inter alia, title, tenancy information (if applicable), services contracts and building warranties.

2.5 Typical Representations and Warranties

There is no legislation specifically requiring the provision of seller's warranties. Real estate is traditionally sold on an "as-is-where-is" basis – ie, the seller does not generally provide any

representations or warranties regarding the real estate.

Where commercial properties are large or transactions are complex, buyers will negotiate with sellers to provide warranties. The scope and extent of the warranties will depend largely on the bargaining power of the sellers and buyers. Typical seller warranties include the following:

- good title to the property;
- there being no outstanding notices from government agencies;
- related contracts being valid, binding and enforceable; and
- there being no breach of approved use.

The continuance of the COVID-19 pandemic did not result in any significant insistence by parties on new representations and warranties in transactions.

If there is a breach of a warranty, the buyer's remedies will be governed by the agreement negotiated between the seller and the buyer. It is typical in commercial real estate transactions for parties to agree on a timeframe for the expiry of the seller's liability and on a limit on the amounts that may be claimed against the seller for breach of its representations and warranties. As the requirements and bargaining positions of parties will vary between transactions, there is no customary timeframe for the expiry of seller's representations and warranties. Similarly, there is no standard cap on a seller's liability for breach, although in many transactions the cap on breach of warranty on title to the property may be an amount equivalent to the purchase consideration.

Representation and warranty insurances have been used in some transactions, but have not always found favour with many parties, given the premiums to be incurred.

2.6 Important Areas of Law for Investors

An investor in real estate should consider:

- the laws governing the ownership of real estate (eg, prohibitions against foreigners purchasing "residential property" as defined under the Residential Property Act 1976 and terms and conditions that may be imposed where the approval of the state or a statutory board is required for a purchase and subsequent sale);
- the laws governing the usage (or proposed usage) of the real estate; and
- zoning requirements.

As a significant portion of land ownership in Singapore is derived under leases from the state or statutory boards, it is important to consider specific restrictions imposed under the terms of the relevant lease (eg, prevailing policy with respect to subletting caps and rights of first refusal granted to the lessor in the case of a subsequent sale). In addition, where an investor intends to purchase land for development, laws and regulations relating to rights of development and terms and conditions imposed on approvals granted for development should be considered. Taxation laws (eg, stamp duties imposed on purchases as well as subsequent sale and property tax) should also be taken into account.

2.7 Soil Pollution or Environmental Contamination

An owner or occupier will generally be liable for any pollution. Accordingly, a buyer will become responsible once they become the owner, even if they did not cause the pollution or contamination.

While the Environmental Protection and Management Act 1999 distinguishes between an owner and an occupier (including a lessee), in most circumstances both are liable in the event of pollution. There are also statutory presumptions where, in the case of a discharge of toxic substances or hazardous substances into water, it is presumed that the occupier is at fault.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can submit legal requisitions to the Urban Redevelopment Authority (URA), and the replies will indicate the prevailing master plan zoning of the land and the approved use.

Prior to the development of land, a developer must submit applications to the URA for planning approval. A buyer or developer may submit an outline application before making plans for the redevelopment of land. The outline application is a broad proposal to test the allowable land use, plot ratio, building height and building form on a development site.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Land Acquisition Act 1966 allows the State to acquire land compulsorily where it is needed:

- for any public purposes;
- by any person, corporation or statutory board for any work or an undertaking that, in the opinion of the Minister for Law, is of public benefit or public utility, or is in the public interest; or
- for any residential, commercial or industrial purposes.

The acquisition process will commence with the publication of a notice of intended acquisition in the Government Gazette, after which the Collector of Land Revenue will cause a notice to be published in major newspapers, and notices will be sent to persons interested in the real estate. Thereafter, the Collector of Land Revenue will, inter alia, ascertain the persons interested in the real estate and their rights thereto, and make an award of compensation, which must take into account the market value of the real estate compulsorily acquired.

The Collector of Land Revenue may then acquire or take possession of the real estate, upon making the award of compensation, by posting an appropriate notice.

Other than the Land Acquisition Act 1966, legislation such as the Street Works Act 1995 and the Sewerage and Drainage Act 1999 empowers statutory boards to enter private lands and take possession of or vest lands or part thereof for public purposes. Aggrieved owners may submit appeals according to the process set out in the relevant legislation.

2.10 Taxes Applicable to a Transaction

Buyer's Stamp Duty

In a property purchase, the buyer is obliged to pay buyer's stamp duty (BSD) based on the acquisition price or market value of the property (whichever is higher). Since 15 February 2023, the top marginal BSD rates are 6% for residential properties and 5% for non-residential properties. For a mixed-use or mixed-zoning property, the BSD rates of up to 6% and 5% apply on residential and non-residential components respectively. The market value of residential and non-residential components can be determined by a professional valuer.

Additional Buyer's Stamp Duty

Depending on the profile of the buyer, an additional buyer's stamp duty (ABSD) of between 5%

and 65% of the acquisition price or market value of the property (whichever is higher) is also payable for the purchase of residential property. In addition to the new 65% ABSD rate for entities, which came into effect on 27 April 2023, housing developers are also subject to an additional non-remittable ABSD rate of 5%, but a 35% rate may qualify for the remission of ABSD for the acquisition of residential property for development and sale, subject to certain terms and conditions.

In addition, with effect from 27 April 2023, acquisitions of residential property by a trustee to hold on trust are chargeable with ABSD (Trust) at the rate of 65%. While such ABSD (Trust) is payable upfront upon the transfer of residential property into a living trust, trustees may, within six months of the date of execution of the instrument, apply to the Inland Revenue Authority of Singapore (IRAS) for a refund based on the difference between the ABSD (Trust) rate of 65% and the ABSD rate corresponding to the profile of the beneficiary with the highest applicable ABSD rate.

Seller's Stamp Duty

Seller's stamp duty (SSD) is payable by the seller for the disposal or sale of residential and industrial property if the property was sold within a period of up to three years after the acquisition thereof. Depending on the holding period of the property, the rate of SSD payable for the sale of industrial property ranges from 5% to 15% of the sale price or the market value of the property (whichever is higher), and the rate of SSD payable for the sale of residential property ranges from 4% to 12% of the sale price or the market value (whichever is higher).

Licensed housing developers are not required to pay SSD when selling residential units that they have developed.

Where there is a transfer of shares, stamp duty – typically borne by the buyer – is payable on the actual price or net asset value of the shares, whichever is higher. The rate is 0.2%, or SGD0.2 for every SGD100 (or part thereof). Exemptions may apply in certain circumstances (eg, transfers between associated companies).

Additional Conveyance Duty

Where there is a transfer of equity interests in a property-holding entity (residential PHE) whose primary tangible assets, owned directly or indirectly, are residential properties in Singapore, additional conveyance duty (ACD) may be payable on the transfer.

The ACD regime applies to the acquisition and disposal of equity interests in a residential PHE by an entity that is considered a significant owner of the residential PHE, or that becomes one after the acquisition. Since 10 May 2022, transfers of equity interests in PHEs into living trusts will also attract ACD (Trust).

If applicable, ACD is imposed on both the buyer and the seller in a transaction. ACD for buyers can range up to 71% of the value of the equity interests transferred for transfer instruments executed on or after 27 April 2023. ACD is payable in addition to the prevailing stamp duty of 0.2% for the transfer of shares in companies (see above). ACD for sellers is 12% of the value of the equity interests transferred. Sellers are not exposed to ACD if the equity interests disposed have been held for more than three years.

The rates described above will similarly apply in the case of partial ownership transfers.

Goods and Services Tax

The sale of non-residential real estate is subject to goods and services tax (GST), currently at

the rate of 9% with effect from 1 January 2024. The sale and purchase of residential property is exempt from GST.

2.11 Legal Restrictions on Foreign Investors

As mentioned in **2.2 Laws Applicable to Transfer of Title**, the Residential Property Act 1976 sets out restrictions on foreign ownership of residential property in Singapore, but there are some exemptions. Non-Singaporeans and non-Singapore entities may acquire approved condominium units or flats. Subject to other rules, foreign developers may acquire residential property for the purpose of developing it for sale.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are traditionally financed by loans from banks and financial institutions. Notwithstanding interest generated by crowdfunding – and, in some cases, direct lending of debt funds, particularly to small and medium-sized enterprises – direct bank lending and corporate debt issuance remain the predominant sources of financing for large commercial acquisitions.

3.2 Typical Security Created by Commercial Investors

An investor (who is the borrower) will typically grant a mortgage on real estate to a lender or lenders.

Where separate title to real estate has been issued, an investor may provide security by way of a mortgage, which will be registered against the title in the land register.

Where separate title has not been issued, an investor may provide security by way of an assignment of rights under the relevant contract for sale (eg, a building agreement or a sale and purchase agreement in respect of real estate). The assignment of the contract will be executed together with a mortgage over real estate, which is executed in escrow and held by the lender until separate title to the real estate has been issued, when the mortgage is then registered.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Generally, Singapore companies are not restricted from providing security over real estate to foreign lenders, nor from making loan repayments to a foreign lender, and there are no exchange controls in Singapore. However, the title to some leasehold real estate may require the lenders or mortgagees to be financial institutions permitted under the laws of Singapore to lend to the borrower.

Financing in the context of the "lending of moneys" is a regulated activity subject to the jurisdiction of certain statutes. Express approval will have to be obtained if a foreign lender who is not licensed under the Banking Act 1970 or the Monetary Authority of Singapore Act 1970 engages in the lending of moneys.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Stamp duty is payable where security is created over real estate or shares, subject to a cap of SGD500. A registration fee is payable for the registration of the mortgage.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under the Companies Act 1967 (CA), a public company or a company whose holding company

or ultimate holding company is a public company is prohibited from directly or indirectly providing financial assistance in connection with the acquisition of shares in the company or shares in the holding company or ultimate holding company, including the provision of real estate assets as security.

With some exceptions, the CA also prohibits companies from giving security for loans, quasi-loans or credit transactions made to another company if the directors of the first company hold 20% or more of the total number of equity shares in the latter company.

The CA requires a director to "at all times act honestly and use reasonable diligence in the discharge of the duties of his office". The directors of a company have to ensure there is a corporate benefit in providing any security over its real estate assets, particularly if the real estate assets are provided in a group borrowing context. Any exercise of the directors' power to grant security outside of the director's fiduciary duties may be subject to challenge by the liquidator and other creditors.

Title documents may contain restrictions with respect to giving security over real estate.

3.6 Formalities When a Borrower Is in Default

Generally, security over real estate can be enforced upon default by a borrower through the following methods:

- the appointment of a receiver;
- obtaining possession of the real estate (eg, by court order or by consent) and subsequently exercising the power of sale; or
- foreclosure.

Where the exercise of power of sale is in respect of real estate held under a lease issued by the JTC Corporation (JTC), the real estate can only be sold subject to the JTC's prior consent and in accordance with the terms imposed. Some real estate held under a lease from a statutory board prohibits the security holder from exercising its right of foreclosure if said security holder is owned by a foreign government.

The time it takes to successfully enforce and realise on real estate security will vary depending on the type of real estate security, the mode of enforcement, whether any consents of any authority or third party will be required and whether there are any issues or objections raised by borrowers or other creditors.

In the case of registered land, the Land Titles Act 1993 confers priority according to the order in which security interests are registered.

The COVID-19 (Temporary Measures) Act 2020 was promulgated in 2020 following the COVID-19 pandemic, and provided temporary relief against the enforcement of legal action for certain "scheduled contracts" entered into or renewed before 25 March 2020. However, such moratorium on enforcement action is no longer applicable.

Foreclosure of mortgaged properties was not high in 2023 as safeguards on lending have been put in place to prevent borrowers from taking on too much debt.

3.7 Subordinating Existing Debt to Newly Created Debt

The usual methods of subordination are structural subordination and contractual subordination (ie, turnover subordination and subordination of rights of payment in the event of the debt-

or's insolvency). The efficacy of subordination arrangements remains open to question in Singapore, although it is likely that these arrangements will be upheld as long as the general body of unsecured creditors is not prejudiced thereby.

3.8 Lenders' Liability Under Environmental Laws

While the Environmental Protection and Management Act 1999 (EPMA) distinguishes between an owner and an occupier (including a lessee), in most circumstances both are liable in the event of pollution. There are also statutory presumptions under the EPMA, such as the presumption that the occupier is at fault where toxic substances or hazardous substances are discharged into water.

The definition of "occupier" under the EPMA is very broad and includes any "person in occupation of the premises or having the charge, management or control thereof". It may include a mortgagee who has taken possession of the real estate.

3.9 Effects of a Borrower Becoming Insolvent

Under the Companies Act 1967, a company granting security over real estate will be required to file a statement containing the particulars of the charge created with the Accounting and Corporate Regulatory Authority, if the charge is created in Singapore, within 30 days of the creation of the security. If this requirement is not met, the security is void against a liquidator and any creditor of the company.

Liquidators and judicial managers have the power to apply to court to set aside pre-liquidation transactions that are deemed to be at an undervalue or that constitute an unfair preference. Under the Insolvency, Restructuring and Dissolution Act 2018, the claw-back period is three years for undervalue transactions and one year for transactions constituting an unfair preference, calculated backwards from the date of commencement of liquidation. Where an unfair preference was given to an associate of the company, the claw-back period extends to two years prior to the commencement of liquidation.

3.10 Taxes on Loans

As mentioned in **3.4 Taxes or Fees Relating to the Granting and Enforcement of Security**, stamp duty is payable where security is created over real estate or shares, subject to a cap of SGD500, and a registration fee is payable for the registration of the mortgage.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The URA administers the Planning Act 1998 and its subsidiary legislation. The Planning Act 1998 regulates the development of land in Singapore according to a master plan, which is a statutory land use plan renewed every five years. Development and building works in Singapore require the planning permission of the URA, except for minor development and building works that are exempt from the requirement for planning permission.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

All building works require building plan approvals, except works (such as insignificant building works) that are exempt under the Building Control Act 1989 (BC Act). The approval process for building works is an ongoing process involving

engagement with the Building and Construction Authority via a qualified person (QP) – either an architect registered under the Architects Act 1991 or a professional engineer registered under the Professional Engineers Act 1991.

The requirements imposed will depend on the building works concerned and the building/area in which such works are to be carried out. The works should also fulfil the prime objective of safety, amenity and matters of public policy in general, as guided by the BC Act, its regulations and various codes. The BC Act also requires the licensing of builders, particularly those performing specialist works.

Approvals will also have to be obtained from other government authorities for compliance with requirements such as height restrictions, access to and from public roads, discharge of waste, sewerage or surface water, and fire safety.

4.3 Regulatory Authorities

The URA regulates the use of developments, through the Planning Act 1998 and subsidiary legislation. There are allocated permissible uses for each property type. The Building and Construction Authority is the principal agency that regulates developments in Singapore, through approvals of building plans.

The development of a parcel of real estate will have to comply with various pieces of legislation and regulations on different aspects, such as development planning and control, building and structural safety, fire safety, environmental control, utilities (water, electricity and gas supply) and workplace safety and health.

4.4 Obtaining Entitlements to Develop a New Project

The development application typically commences with the owner/developer appointing a QP. After the QP submits a development application to the URA for planning permission, the common types of planning permission that may be granted are provisional permission and a grant of written permission. Permissions may be unconditional or subject to such conditions as the URA deems fit, with reasons being given in writing. Conditions may include granting permission for a specified period and/or restrictions on the height, design, appearance or siting of buildings.

In addition, all building works require building plan approval, including the refurbishment of an existing building, except for those exempted under the BC Act.

There is no formal process for a third party (eg, a member of the public) to intervene in the planning permission process or the building plan approval process.

4.5 Right of Appeal Against an Authority's Decision

Where the URA rejects an application for planning permission, an appeal to the Minister for National Development may be made within 60 days of the date of notification of the decision.

Where any application made for the approval of plans of any building works is refused, or is granted by the Commissioner of Building Control subject to terms and conditions, an aggrieved applicant may appeal to the Minister for National Development against the decision within 14 days of being served with notice thereof.

4.6 Agreements With Local or Governmental Authorities

Generally, subject to obtaining the relevant permits/approvals, an owner/developer would be able to develop a project without any requirement to enter into additional agreements with the relevant authorities to facilitate the project. An owner/developer is at liberty to enter into a separate agreement with a utility supplier for the provision of utilities.

4.7 Enforcement of Restrictions on Development and Designated Use

In general, where there appears to be a breach of planning control, the relevant authority has the right to enter the real estate and to serve a notice on the owner or occupier requiring them, inter alia, to provide information relating to use of the real estate. Once a breach is ascertained, the relevant authority has the right to serve an enforcement notice, which may require, inter alia, the alteration, demolition or removal of any building or works. The possible penalties for non-compliance are fines and/or imprisonment.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Investment in real estate assets can be made by individuals, companies, partnerships (including limited liability partnerships), business trusts or REITs.

Generally, limited liability companies are considered to be the entities that best protect owners (shareholders) from personal liability while retaining the right to control the operations. They also provide an alternative to a direct asset sale by way of sale of their shares.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

There are no particular requirements to be included in the constitution of a company used to invest in real estate. Singapore companies used to invest in real estate will generally have the capacity and authority to acquire and deal with real estate as express objects in their constitution. Similarly, the deeds of trust constituting business trusts or REITs will provide for the capacity and authority to acquire and deal with real estate.

Companies and business trusts are subject to a corporate tax rate of 17%, and listed Singapore REITs may qualify for tax transparency treatment (see **5.3 REITs**).

5.3 REITs

In both private and public forms, REITs are vehicles used for investment in Singapore real estate. Except for prohibitions on foreigners purchasing "residential property" as defined under the Residential Property Act 1976, there is no restriction on foreign investment in REITs.

Listed Singapore REITs may qualify for tax transparency treatment if they distribute at least 90% of their specified table income derived from Singapore real estate. Qualifying unit holders receiving distributions from such listed Singapore REITs will not be subject to Singapore withholding tax. In particular, qualifying unit holders who are individuals will be exempt from Singapore income tax on such distributions. Resident corporate unit holders will be subject to tax on such distributions at the corporate tax rate of 17%, while non-resident corporate unit holders will be subject to a final withholding tax rate of 10%.

5.4 Minimum Capital Requirement

There is no minimum capital required to set up a Singapore company. However, if a company intends to obtain a licence under the Housing Developers (Control and Licensing) Act 1965, it has to comply with the minimum paid-up capital requirements.

5.5 Applicable Governance Requirements

A company will have a sole director or a board of directors. The company must have at least one director who is ordinarily resident in Singapore. The business of the company must be managed by the directors, or under their direction or supervision, and the directors may exercise all the powers of a company, except any power that the Companies Act 1967 or the constitution of the company requires the company to exercise in a general meeting.

5.6 Annual Entity Maintenance and Accounting Compliance

Compliance costs will depend on the service provider(s) appointed.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Other than ownership of real estate, arrangements for the occupation and use of real estate include leases and licences. The law also recognises easements that grant limited rights (eg, right of way) and *profit à prendre*, which allows the right holder to take or use something on the land, such as the cutting down and removal of timber.

6.2 Types of Commercial Leases

Commercial leases can generally be divided according to their use – eg, office, retail and industrial leases.

6.3 Regulation of Rents or Lease Terms

The terms of a lease (including rent) are freely negotiable between the parties. However, a set of guidelines – namely the Code of Conduct for Leasing of Retail Premises (Code of Conduct) – was proposed by the Fair Tenancy Pro Tem Committee (which comprises key representatives from landlord and tenant communities, industry experts and academia) in 2021 to guide tenants and landlords of "qualifying retail premises" to ensure a fair and balanced position in negotiations of leases. Compliance with the Code of Conduct has been made mandatory under legislation for retail lease agreements that are entered into on or after 1 February 2024. Please refer to **1.3 Proposals for Reform**.

6.4 Typical Terms of a Lease

There is no fixed duration for the length of a lease; it depends on the needs of the lessee and the agreement made between the lessor and lessee.

The tenant is typically responsible for the upkeep of the property and is required to maintain and repair the real estate, preserving it in good condition. The tenant's failure to comply with this covenant will constitute a breach of a term of the lease, for which the landlord will be entitled to enter the premises to carry out necessary works and to recover the costs of so doing from the tenant.

Rent is typically payable monthly in advance.

No significant changes in lease terms have been issued by major landlords to deal with future

pandemic events, construction build-out or supply chain issues. However, in some negotiated leases, parties may provide for longer timeframes to cater for potential construction or supply chain delays.

6.5 Rent Variation

Whether the rent remains unchanged or is variable during the length of the lease term depends on the agreement between the lessor and lessee.

6.6 Determination of New Rent

The rent may be varied at a fixed rate or may be pegged to an index, such as the consumer price index or the prevailing market rent. The exact mechanism is up to the parties to negotiate.

6.7 Payment of VAT

GST is payable on rent, except in the case of leases of residential properties, which are exempt from GST.

6.8 Costs Payable by a Tenant at the Start of a Lease

The tenant usually pays the stamp duty chargeable on the lease and a security deposit as security against breach of terms of the lease. They may also be required to pay service charges or charges for the hire of furniture and fittings and the landlord's legal costs and/or administration fees.

6.9 Payment of Maintenance and Repair

Landlords are generally responsible for the costs of maintaining and repairing common areas shared by several tenants.

6.10 Payment of Utilities and Telecommunications

Tenants will arrange with and pay suppliers directly for the supply of utilities and telecommunications. If separate metering for utilities is not possible for the leased premises, or if the landlord is purchasing electricity in bulk for the entire property, the landlord will arrange for the supply of utilities to the leased premises and apportion the charges for utilities to the tenants.

6.11 Insurance Issues

The tenant will bear the cost of insuring the real estate that is the subject of a lease. A landlord will usually require the tenant to take up the policy in the joint names of the landlord and the tenant.

A public liability insurance policy is typically required to be taken up to cover claims arising from personal injury, death or property damage or loss. A tenant may also be required to insure all of their property at the leased premises against damage by fire and other risks, and to insure all plate-glass windows and doors of the leased premises for the full insurable value.

There is no clear data on whether tenants have claimed or been successful in claims against business interruption policies arising from the government-imposed "circuit breaker" in 2020 where "non-essential" business premises were ordered to be closed for more than a month.

6.12 Restrictions on the Use of Real Estate

The Planning Act 1998 permits various uses for various premises. Accordingly, in a lease, a landlord will stipulate the permitted use and require a tenant not to use the premises other than for the permitted use or the use approved by law.

6.13 Tenant's Ability to Alter and Improve Real Estate

Upon entry into a new lease, the landlord will commonly allow the tenant to undertake fitting-

out works during a prescribed fitting-out period, subject to compliance with conditions such as approval of plans for the fitting-out works. These conditions are sometimes set out in a handbook.

6.14 Specific Regulations

Specific regulations that apply to the different categories of real estate generally pertain to their uses. The landlord of commercial real estate approved for one use class may only lease premises for that use class. Similarly, a light industrial building cannot be utilised for general industrial use without prior approval for such change of use.

The Rental Waiver Framework (RWF) introduced as part of legislative relief measures in response to the COVID-19 pandemic came into force on 5 October 2021 and applied, subject to certain criteria, for the benefit of eligible small and medium-sized enterprises and specified non-profit organisations renting qualifying commercial properties. However, the period for the submission of applications under the RWF has now expired.

6.15 Effect of the Tenant's Insolvency

If the tenant becomes insolvent, leases will generally provide that the landlord will be entitled to terminate the lease and exercise the right of re-entry to the premises. Leases will also provide that the landlord is entitled to use the security deposit and apply it towards unpaid rent and other outstanding obligations.

Under insolvency legislation, there are limitations on the landlord's possible remedies in the event of the insolvency of the tenant. If bankruptcy or compulsory liquidation proceedings have commenced, legal proceedings against the tenant will require leave of court. A landlord will have to file a claim with the official assignee or the liquidator for outstanding rents and monies owed under the lease. There may also be issues as to whether the landlord is entitled to use the security deposit, as the security deposit may be considered part of the tenant's assets to which all creditors are entitled.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A landlord will collect a security deposit, payable by way of cash, banker's guarantee or both (and sometimes a parent-company guarantee), at the commencement of a lease to secure against non-performance or default on the part of the tenant with respect to its obligations under the lease.

6.17 Right to Occupy After Termination or Expiry of a Lease

If a tenant continues to occupy the real estate after the expiry or termination of a lease without the consent of the landlord, that would constitute a breach of the terms of the lease. Unless otherwise specified in the lease, a tenant remaining in the property after the termination of a lease will be chargeable with double rent (or double value). The landlord may also be entitled to claim for mesne profits.

To ensure the tenant vacates the leased premises on the date originally agreed, the landlord must clearly specify this in the lease; it must be expressed that the landlord does not consent to the tenant remaining in the property after the expiry or termination of the lease.

6.18 Right to Assign a Leasehold Interest

Leases in Singapore typically prohibit a tenant from assigning or sub-letting without the prior written consent of the landlord, which may be

given subject to terms and conditions. Conditions imposed for consent may range from a fee or levy payable to increased rents or a requirement for the sharing of profits from the sub-let rents.

6.19 Right to Terminate a Lease

Whilst a tenant would typically have minimal or no right to terminate the lease, the landlord would be able to terminate the lease and exercise the right of re-entry if any of the following occurs:

- non-payment of rent or other sums payable under the lease;
- breach of any term or condition of the lease;
- compulsory land acquisition by the authorities;
- major damage and destruction of the building in which the leased premises are comprised;
- insolvency of the tenant; or
- a prolonged force majeure event.

6.20 Registration Requirements

A lease of land for a period exceeding seven years shall be void under Singapore law unless it is made by deed in the English language. There is no formal requirement for the registration of leases, but a lease of registered land for a term exceeding seven years may be registered under the land registration system. A registration fee is payable by the party submitting the lease for registration.

6.21 Forced Eviction

A typical lease will provide for the landlord to determine the lease and exercise the right of re-entry in respect of the premises if any event of default on the part of the tenant occurs.

The Conveyancing and Law of Property Act 1886 (CLPA) governs the exercise of a landlord's right of forfeiture, including prescribing for notice requirements. Where the requirements are complied with, the landlord may then exercise its right of re-entry. Re-entry is usually effected by the issuance of a writ of possession (a process by which the landlord seeks from the court the right to serve an order requiring the tenant to leave the premises), but the landlord is entitled to effect peaceable re-entry and take possession of the property if the lease provides for it.

Upon the purported exercise by the landlord of a right to forfeit the lease, the tenant may apply to court for relief from forfeiture, pursuant to the CLPA. Specifically with regard to a situation where rent has not been paid, after the court has ordered the tenant to return possession to the landlord, the tenant has to pay the rent in arrears; if the tenant does so, the tenant may continue to hold on to the lease.

The total duration required before the landlord regains possession will depend largely on whether the statutory requirements have been complied with by the landlord, the complexity of the claim, whether the tenant seeks relief from the forfeiture and whether the tenant has paid outstanding rent prior to the landlord's possession.

6.22 Termination by a Third Party

As mentioned in **2.9 Condemnation, Expropriation or Compulsory Purchase**, land may be compulsorily acquired. The length of the compulsory acquisition process will depend on the urgency with which the real estate is needed by the State or relevant agencies, and whether there are objections from the persons concerned.

6.23 Remedies/Damages for Breach

Where a tenant is in breach of the lease and such lease is terminated, while there is gener-

ally no restriction against the type of damages that a landlord may seek, a landlord would generally be under a duty to mitigate and minimise its losses in a claim for damages founded on the tenant's breach of the lease, and a landlord cannot recover more than the damages that the landlord would suffer or be entitled to as a result of such default and termination. Any legal action against the tenant must be brought in a court with the appropriate jurisdiction.

A landlord may also have recourse to other remedies prescribed under Singapore law. For example, pursuant to Section 28(4) of the Civil Law Act 1909, a landlord may charge the tenant double the amount of rent if the tenant holds over after the determination of the lease, until possession of the leased premises is given up by the tenant. In a situation where the rent is in arrears, the Distress Act 1934 affords the landlord the remedy of applying to the court for the issuance of a writ of distress, entitling the seizure and subsequent sale of movable property found at the leased premises, for the realisation and recovery of the rent due to the landlord.

A landlord also typically holds security deposit(s) furnished by the tenant, either in cash or guarantee (from a bank or insurance company), as security for the payment of rent, which may be enforced against in the event of non-payment of rent by the tenant.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The two most common contractual models for pricing construction works are the "lump sum" contract and the "measurement" contract.

The lump sum contract is the most common form of construction contract and is used where the type and quantities of works are clearly defined. In this form of contract, the contractor is paid a lump-sum price for the works described in the contract. Subject to the conditions, the lump-sum price may be subject to change, due to the addition or omission of works, extensions of time resulting in increased costs and expenses, and/or agreed fluctuations in prices of materials, for example.

The measurement contract is used where the type and quantities of works are not clearly defined at the time a tender is called. In such a case, the contractor usually submits a schedule of rates (SOR) setting out the cost of each type of materials, parts and labour required for the works. Upon completion of the works, parties would carry out measurements, usually with the assistance of a quantity surveyor, to determine the types and quantities of materials, parts and labour incorporated into and expended for the works, and apply the rates stated in the SOR to determine the amount of payment due to the contractor.

7.2 Assigning Responsibility for the Design and Construction of a Project

Under the traditional contracting model, the employer (who is the owner of the project) will engage a third-party consultant (an architect in a building project, or an engineer in an engineering project) as the lead consultant responsible for the preparation and completion of the design. That lead consultant typically also oversees the development of the project, together with other consultants engaged by the employer, and acts as the contract administrator or superintending officer for the main construction contract. The lead consultant would also undertake the role of an independent certifier to certify payment,

assess claims by the contractor and certify the works done and, ultimately, the completion of the project, fairly and independently, notwithstanding having been appointed by the employer.

In such a model, the responsibility for design lies with the consultants; the contractor will only be responsible for the building works.

The employer will have direct contractual recourse to its directly appointed consultants for any deficiency in design, and against the main contractor for any delay or defects in the building works that are not design-related. The main contractor is responsible for the building works and is typically liable for any delay or any other default under the terms of the main construction contract arising out of its works, even if such delay is caused by a subcontractor. There are specific instances where an employer may wish to have direct rights against a specialist subcontractor (eg, in relation to water-proofing works) or a supplier (eg, in relation to the supply of certain fixtures). This would require the specialist subcontractor or supplier to extend a warranty in relation to those specialist works or material to the employer.

Alternatively, it is increasingly common for employers to enter into a "design and build" contract, where responsibility for design and construction lies solely with the main contractor. In this model, the employer provides a desired outcome and broad specifications for the project. As the single point of responsibility, the main contractor undertakes the obligations and risk of the design (through its employment of the relevant architects, engineers and consultants) and the construction of the project. In this model, the employer typically does not have direct contractual recourse against the architect and engineers who are appointed by the main contractor, but would have recourse to the main contractor.

7.3 Management of Construction Risk

Contractors and specialist subcontractors are typically required to furnish undertakings and/or indemnities relating to specific works. Employers of large projects would commonly require a security deposit, in the form of a cash deposit or a performance bond. This provides the employer with some security in the event of non-performance by the contractor. Performance bonds typically secure about 5% to 10% of the value of the contract, and are usually valid up to the expiry of the defects liability period.

It is also common for performance bonds to be drafted as "on-demand" bonds, which would require the issuer of the performance bond to make payment to the beneficiary on demand, without enquiring into the beneficiary's reasons for the demand. A restraint on payment under such bonds will only be allowed on limited grounds (eg, fraud or unconscionability), although unconscionability can be excluded as a ground for such restraint under the contract or in the performance bond.

In some cases, employers may also require a parent company guarantee from the contractor.

Payment mechanisms in the building contract are usually designed to provide payment for works that have already been done, rather than in advance. A contract administrator is often tasked with certifying that the works have been done, whilst reserving the right to require any rectification of defects, or to dispute any such works that fall short of the employer's requirements. Furthermore, the employer usually reserves rights to have access to and inspect the works, or to request the opening up of the

works for inspection. The employer usually also incorporates a contractual right to require the main contractor to rectify defects in the works that might surface during a period of a year or 18 months from the date of completion (usually referred to as a maintenance period or defects liability period).

Typically, the employer would also have various contractual rights to terminate a construction contract in certain pre-agreed events (the bankruptcy of the contractor, failure to start works, failure to comply with material obligations under the contract, etc). The exercise of such rights is usually subject to strict compliance with the contractual provisions (eg, notice requirements and cure period).

Contractors are usually obliged to provide certification and warranties for certain types of works (eg, fire-rating certificates for doors, and water-proofing warranty to guarantee the water-tightness of the roof and wet areas).

Insurance is also particularly crucial in building contracts for managing risks. The employer often requires contractors to procure contractors' all-risks insurance, public liability insurance and other insurances as may be prudent, having regard to the work. Employers usually require consultants to obtain professional indemnity insurance. Workers' compensation insurance is required to be taken out by all parties (including the employer and the contractor) by law under the Work Injury Compensation Act 2019 to compensate employees for any personal injury by accident.

7.4 Management of Schedule-Related Risk

Most building contracts will contain provisions allowing for extensions of time and providing for the payment of liquidated damages by the contractor in the event of delay in the completion of the project. Allowance for valid grounds for extensions of time is crucial to prevent time from being set at large, where, for example, a delay is caused by the employer.

A liquidated damages clause gives the employer a remedy of receiving an agreed sum, usually accrued on a daily basis, based on a genuine pre-estimate of the loss in the event that there is a delay in the completion of the project. Contractors may negotiate a limitation of delay-related liability with the employer, or the exclusion of certain liabilities (eg, indirect and consequential losses).

If it appears that there is going to be a delay in the works, the employer's first course of action would usually be a request for the contractor to expedite its works. Depending on the form of contract used, the employer may also request that the contract administrator issues an instruction or direction to the contractor setting out the delay and requiring that the works be expedited. The contractor will not be allowed to claim any additional losses or expenses arising from a delay if the delay is not excusable under any ground for an extension of time. A claim for acceleration costs might be viable if it can be shown that the employer had expressly or constructively issued an instruction or direction for accelerative measures to be undertaken.

Where it is stated that time is of the essence in completing the contract, the employer may rely on this as a ground for terminating the contract.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

See **7.3 Management of Construction Risk**.

7.6 Liens or Encumbrances in the Event of Non-payment

The contractor has no right under general law to impose a lien or otherwise encumber an immovable property in the event of non-payment.

However, a contractor has the statutory right under the Building and Construction Industry Security of Payment Act 2004 to a lien over unfixed goods supplied by the contractor that have not been paid for, if the contractor has obtained an adjudication determination in its favour under the Act and the amount determined thereunder has not been paid.

7.7 Requirements Before Use or Inhabitation

Under Singapore law, a development must comply with the statutory requirements stipulated under the BC Act and Building Control Regulations 2003, including the obtaining of all necessary clearances from the relevant government agencies (eg, the URA, Land Transport Authority, National Parks Board, Singapore Civil Defence Force, Public Utilities Board and National Environment Agency), before a Certificate of Statutory Completion (CSC) is issued to certify that the development is fit for occupation.

Alternatively, if the development has certain outstanding issues but has nonetheless fulfilled the requirements or clearances suitable for occupation, a Temporary Occupation Permit (TOP) may first be issued, allowing the development to be inhabited.

The application for the TOP or CSC is to be made by the QP to the Building and Construction Authority at a suitable stage upon completion of the works.

8. Tax

8.1 VAT and Sales Tax

Singapore currently imposes GST at the prevailing rate of 9% on all imports of goods and taxable supplies of goods and services made by a taxable person in the course or furtherance of carrying on a business.

A purchaser of non-residential real estate will be liable for payment of the GST unless the purchase is part of the transfer of a business as a going concern and the prescribed conditions for exemption are satisfied. However, supplies of residential property are exempt from GST.

8.2 Mitigation of Tax Liability

Subject to the fulfilment of conditions, the remission of stamp duty is available at law in a number of circumstances (eg, reconstruction of certain companies and transfers between certain associated companies). Under Section 33A of the Stamp Duties Act 1929, there is a general anti-avoidance rule that grants broad powers to the Commissioner of Stamp Duties to challenge any arrangement that reduces or avoids liability for stamp duty.

8.3 Municipal Taxes

Apart from GST and stamp duty, businesses owning immovable property are also subject to property tax at the rate of up to 10% on the annual value of the property.

8.4 Income Tax Withholding for Foreign Investors

Rental income is subject to income tax, which is payable by the landlord. The prevailing corporate tax rate is 17%. Where real estate is sold by a seller who is a property trader, gains are also subject to income tax. Where the seller is a property trader who is not resident in Singapore and

whose operations are carried on outside Singapore, such gains are subject to withholding tax at 15% of the consideration, but the seller may file a tax return to claim a deduction for allowable expenses. Where a seller is not a property trader, the gains are not subject to tax as there is no capital gains tax in Singapore.

8.5 Tax Benefits

Expenses incurred solely for producing the rental income and during the period of tenancy may be claimed as tax deductions. Depreciation of furnishings (eg, furniture, fixtures and electrical appliances) is not claimable.

Trends and Developments

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WongPartnership LLP is an award-winning law firm and one of the largest in the country, with offices in China and Myanmar. It has affiliate offices in Abu Dhabi, Dubai, Indonesia, Malaysia and the Philippines, through member firms of the WPG regional law network, offering the expertise of more than 400 professionals to meet clients' needs. WongPartnership has one of the largest teams of real estate lawyers in the country, working on a diverse range of deals throughout the region, across different real estate investment products. The firm's corporate real estate practice offers knowledge on acquisitions, divestments and financing arrangements, joint ventures, purposed build-to-suit projects, commercial leasing and extensive development projects. The firm advises major developers, landlords and tenants, investors, lenders and borrowers. Clients include high net worth individuals and family offices, foreign and local property funds, public listed and private real estate companies and funds, financiers, government-linked companies and statutory bodies.

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Real Estate in Singapore: an Introduction

The introduction of higher rates of stamp duties payable by buyers for residential properties in the second quarter of 2023 curbed the jump in residential property prices in the first quarter of 2023. The rates of buyer's stamp duties were raised, with rates for residential properties rising up to 6% and rates for non-residential properties rising up to 5% of purchase consideration or market value.

The rates of additional buyer's stamp duties payable by buyers of residential properties on top of the existing buyer's stamp duties were also increased. For Singapore citizens buying their second residential property, the rate of additional buyer's stamp duty was raised from 17% to 20% of the purchase price or market value; for those purchasing their third and subsequent property, the rate increased from 25% to 30%. Entities and trusts buying residential property are now required to pay additional buyer's stamp duty at a rate of 65%, up from the previous rate of 35%. The greatest increase is for foreigners buying residential property, for whom additional buyer's stamp duty increased from 30% to 60%.

These increases in stamp duty rates were instituted to cool the continued rise and to discourage speculation in the residential market. Following the increase in buyer's stamp duty and additional buyer's stamp duty, the percentage of foreigners buying residential property has decreased. New private residential sales also dipped to a 15-year low.

Integrated mixed-use developments and projects located near amenities continued to garner interest. Public housing also saw a new framework, which classified public flats by location (eg, near city or town centres or transport nodes). New policies that will provide for more subsidies in public housing but with stricter sale conditions were introduced. Landed residential property prices, particularly in good class bungalow areas, continued to show a strong increase, given the scarcity of landed housing in Singapore.

Despite concerns about rising interest rates and uncertainty in macroeconomics, the commercial real estate sector was relatively buoyant in 2023, supported by several large-scale transactions, including the following:

- the SGD652.2 million acquisition of a 50% stake in the NEX suburban mall by Frasers Centrepoint Trust and Frasers Property Limited;
- the SGD538 million en-bloc acquisition of a commercial building known as Shenton House in the central business district, by Shenton 101 Pte Ltd; and
- the SGD525 million sale of Parkroyal Kitchener Hotel by Pan Pacific Hotels Group (a member of UOL Group Limited).

The prices and rent of industrial properties continued to rise in 2023, even though there was a decline in demand in certain segments. There was reduced growth in hi-tech and conventional industrial spaces, given a slowdown in tech demand and manufacturing exports. However, well-located industrial properties, particularly for logistics use and warehousing, showed sustained demand by third-party investors, given limits in new supply. This was highlighted in the SGD313.5 million acquisition of five logistics properties by Hillhouse Capital, representing Hillhouse Capital's first major industrial purchase in Singapore.

Smart Nation

Singapore's efforts towards the development of a Smart Nation (an initiative to use technologies, networks and big data to provide tech-enabled solutions) continued apace with the announcement by the Singapore Land Authority of its appointment of a vendor for the development of the Digital Conveyancing Portal (DCP). The DCP is scheduled to be launched over different phases starting from the second quarter of 2024, and is expected to be fully developed and completed by 2026. The purpose of the DCP is to facilitate and streamline the conveyancing process and to reduce paperwork and physical documents. New digital practices will be put in place for the sale and purchase of property transactions to benefit stakeholders and users.

Code of Conduct for Leasing of Retail Premises

The Code of Conduct for Leasing of Retail Premises (Code of Conduct) was first released in 2021 and sets out guidelines for what constitutes fair practice in relation to tenancy agreements of qualifying retail premises. It includes a checklist template to accompany retail tenancy agreements.

The Code of Conduct has now been given force of law through the Lease Agreements for Retail Premises Act 2023 (LARPA), which was passed by Parliament on 3 August 2023 and came into effect on 1 February 2024. Under the LARPA, all landlords and tenants of retail premises must abide by leasing principles set out in the Code of Conduct. These include the prohibition on landlords from the pre-termination of tenancies unless on certain specific grounds, and from imposing a gross turnover rent component where specified rent has been exceeded.

In addition to a requirement for all landlords and tenants of qualifying retail premises to comply with the Code of Conduct, the LARPA also sets out a framework for dispute resolution to enable parties to file complaints about non-compliance. The Code of Conduct applies only to qualifying retail leases with a tenure of at least one year but does not apply to residential, office and industrial premises.

Green Plan

2023 saw further developments and initiatives to the 2030 Green Plan first released by the Singapore government in February 2010, including the following.

- The launch of the first government land sales tender for the farming of mushrooms and fruited vegetables, intended to increase Singapore's food resilience and to provide greater choices of local produce.
- Master planning for the Lim Chu Kang area – this proposal is led by the Singapore Food Agency with the aim of optimising limited land and transforming the area into a hi-tech agri-food zone.
- By introducing the mandatory energy improvement regime, the Building and Construction Authority proposes to help certain existing buildings with poor energy performance to improve by requiring that these buildings undergo energy audits and implement measures to improve energy use intensity. This will enhance efforts to decarbonise the built ecosystem and serve to complement the existing requirements for new buildings to obtain and maintain green marks certification.
- A coastline-specific proposal to construct "Long Island", a new island out of reclaimed land, off the east coast of Singapore was unveiled. The proposed 800 hectares, decades-long project will host a reservoir and other residential and recreational spaces for coastal defence. As the city-east coast stretch of coastline includes the central business district as well as other important areas such as Changi Airport, the initiative to protect the east coast shoreline is to take precedence over other locales.

Conclusion

Whilst the residential property market was somewhat dampened by the introduction of new cooling measures in the first quarter of 2023, interest in well-located residential and commercial properties remained strong. The industrial real estate market continued to see keen interest from investors.

Notwithstanding uncertainty in the world economic outlook, the Singapore real estate market remained resilient, with a number of sectors showing improvement in performance from the previous year. This is expected to grow in 2024. The continuance of efforts by major developers to integrate environmental, social and governance principles in business practices provides promise for sustainable future real estate.

SLOVENIA



Law and Practice

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Odvetniki Šelih & partnerji, o.p., d.o.o. is a full-service business law firm that continues the tradition of a partnership established in 1961. Through the lawyers' unwavering focus on clients' business objectives, their professional know-how, firm-wide dedication, responsiveness and hard work, the firm offers top-tier legal advice in Slovenia. Their real estate and construction practice is one of the strongest in the firm; it combines knowledge, local experience, and a practical grasp of the individual requirements of each project. The practice assists national and international property companies, project developers, investors, banks and other property financiers, real estate funds, shopping centre operators and entities involved in the engineering and construction business in relation to the purchase, development, construction, operation and financing of properties.

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1. General

1.1 Main Sources of Law

Besides the Constitution of the Republic of Slovenia, which lays down basic principles of private ownership, the main law governing real estate is the Law of Property Code, which prescribes the main rules regarding property rights. The Law of Property Code is supplemented by the Land Register Act and the Real Estate Cadastre Act, which govern real estate records.

In addition to general sources of real estate law, certain specific laws govern particular types of real estate. Such laws include:

- the Housing Act;
- the Protection of Buyers of Apartments and Single Occupancy Buildings Act;
- the Agricultural Land Act;
- the Act on Forests;
- the Water Act;
- the Nature Conservation Act; and
- the Cultural Heritage Protection Act.

In a broader sense, rules relevant to real estate are also prescribed in the Spatial Management Act and the Building Act, which govern spatial planning and construction, as well as in general sources of civil law, such as the Obligations Code.

1.2 Main Market Trends and Deals

In the past year, the real estate market in Slovenia has been impacted by rising inflation and increases in interest rates. These factors have resulted in price increases in real estate transactions, which is a trend that began a few years ago, and a reduction in the number of real estate transactions, which is a more recent trend. Nevertheless, the most pronounced trend in all segments of the real estate market is ESG (environmental, social and governance).

Among the most significant real estate deals in Slovenia in the past year are the sale of Austria Trend Hotel Ljubljana, which was purchased by a Serbian company Agromarket, and sale of land representing the unfinished construction of a shopping centre next to Stožice stadium and hall in Ljubljana to Bosnian company MG Mind. There were also several deals on the sale of commercial buildings, in particular acquisition of the Situla commercial building in Ljubljana by Trigal RE Fund and sale of the Tabor II shopping centre in Maribor to Boscarol d.o.o. In addition, Corwin has several ongoing notable projects in Ljubljana, such as construction of the busi-

ness complex Vilharia, which is underway and is going to be the first LEED platinum certified building in Slovenia.

Due to rising inflation and increases in interest rates, the price of real property has increased and as a result there has been a decrease in real estate transactions and leases of business premises. In 2023, purchase transactions for all industrial space declined by around 40%, with significantly smaller declines in office space (13%) and retail and service space (7%). The number of business premises leases also decreased by 15–20% at national level in 2023.

Although modern technologies in financial services, such as blockchain, decentralised finance and similar, are present in the Slovenian real estate industry, their impact cannot yet be considered as disruptive, nor is it expected to become disruptive to these services in the next year. Conversely, proptech has had a significant impact on the real estate industry, most significantly through online marketplaces for short-term housing leases (eg, Airbnb, Booking). The emergence of such online marketplaces resulted in increased interest from investors in the purchase of real estate in order to lease it short term, which resulted in increased housing property prices. Due to the increased tourist count each year and, consequently, the increase in demand for accommodation, it is expected that online marketplaces will continue to impact the real estate industry in the year ahead.

There were some adaptations of formerly commercial office space to residential property. However, this is not a big trend in Slovenia, as the process of changing the use of commercial space to residential use is quite complicated and there is still a high demand for office space.

Financing resources for real estate projects are still mainly the different types of financial loans from banks or equity. Corwin, currently one of the biggest real estate developers in Slovenia, has attempted an issue of a five-year real estate bond for one of their projects; however, there was not much demand for it.

Since foreclosures and workouts/restructuring were not a major trend during rising inflation and the increase in interest rates, it can be expected they will be even less so, if the expected stabilisation of the market occurs.

1.3 Proposals for Reform

In Slovenia, reform in the taxation of real estate has been a long time coming. The ruling political parties have announced, in the coalition agreement, the introduction of a wealth tax, which would encompass reform in the taxation of real estate. Reform in the taxation of real estate is a measure that has long been proposed by international organisations such as the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD).

The Slovenian Ministry of Finance launched a Tax Task Force and a Strategic Tax Council in February 2024 to analyse the challenges of the current tax system and share proposals for possible solutions. It is likely that real estate, in which the owner lives, will not be taxed, but each additionally owned real estate might be. The rate of taxation is not yet known, but it has been suggested that it could range from 0.1% to up to 1% of the value of the real estate per year. The reform in the taxation of real estate is intended to limit investment and speculative purchases and force owners of empty real estate to put it on the market.

It must be noted, however, that the reform in the taxation of real estate has proven to be, time and again, a difficult political compromise to achieve. Therefore, it is possible that the reform will not be adopted immediately: currently, the reform is planned to be implemented in 2025. A similar reform was enacted in 2013, but was repealed by the Slovenian Constitutional Court.

After severe floods in Slovenia in August 2023, an Act on intervention measures to deal with the consequences of floods and landslides was adopted in 2023 (the "Intervention Act"), which, among others, amended certain provisions of the Spatial Management Act, Building Act, Agricultural Land Act, Act on Forests, Water Act, etc.

The amended Spatial Management Act allows for detailed municipal spatial plans to address natural and other disasters, modifying land-use designations and spatial conditions. Under the amended Building Act, reconstruction to mitigate flood and landslide effects can alter a building within minor permissible deviations, provided project documentation and water consent are provided with construction commencement by 31 July 2024. With the Intervention Act, the Republic of Slovenia also gained the right to purchase agricultural land, a forest or a farm to remedy flood and landslide consequences, overriding pre-emption rights and other procedural steps and provisions in existing legislation.

2. Sale and Purchase

2.1 Categories of Property Rights

In accordance with the Law of Property Code, the following categories of property rights can be acquired:

- ownership right;
- lien;
- easement (encompassing both easements in rem and personal easements);
- encumbrance; and
- building right.

A non-accessory land charge can no longer be established, as it was widely abused by the debtors and was omitted from the Law of Property Code. Land changes established before 5 November 2013 have remained in effect.

The principle of numerus clausus applies to categories of property rights. No different property rights may be created at the will of the parties. The principle of numerus clausus is somewhat alleviated in the case of easements in rem, the subject matter of which is not precisely prescribed.

2.2 Laws Applicable to Transfer of Title

The transfer of title of real estate is primarily governed by the Law of Property Code, the Obligations Code and the Land Register Act.

In addition to the above-mentioned laws, which are generally applicable to the transfer of title of real estate, regardless of the type, additional specific laws apply to the transfer of title of particular types of real estate, which prescribe restrictions in the transfer of title of these types of real estate. Such laws are, inter alia:

- the Agricultural Land Act and the Act on Forests, which regulate pre-emption rights of specific beneficiaries, who have priority when purchasing agricultural or forest land, as well as a specific procedure for the sale of agricultural and forest land;
- the Water Act, which prohibits the sale of state-owned water land;

- the Nature Conservation Act and the Cultural Heritage Protection Act, which prescribe special protection regimes and restrictions on transfer of title of real estate designated as natural and cultural monuments; and
- the Spatial Management Act in connection with implementing regulations of the municipality or the state, which provide for pre-emption rights of the municipalities or the state over land plots which are of special importance.

2.3 Effecting Lawful and Proper Transfer of Title

For the proper transfer of title to real estate a binding sale and purchase agreement, a land register permission and an entry in the land register is required. The land register records transfers of title. Entry in the land register is a constitutive element in the transfer of title.

The Land Register Act prescribes the principle of reliance on the land register data. In accordance with it, anyone who acts honestly in legal transactions and relies on the information entered in the land register should not suffer adverse consequences as a result. The land register is kept electronically and is publicly accessible. Considering the foregoing, title insurance is not common in daily transactions. In large transactions, however, foreign buyers who want to mitigate all risks during the pre-registration period or cover transaction-specific matters might seek title insurance.

The limitations in governmental office functionality and in-person availability for document signing or notarisation that existed during the coronavirus pandemic have resulted in certain new processes or procedures for the documentation and completion of real estate transactions. Most notably, the latest amendment to the Notariat Act envisages a comprehensive digitisation of notarial services. The amendment enables remote access to notaries and remote drafting of notarial deeds, video-electronic identification through a direct secure video link with the notary and simplifies data retrieval by electronic link to official records, registers and public books. The described provision of digital notarial services will be possible when technical requirements are ensured.

2.4 Real Estate Due Diligence

The aim of real estate due diligence is to thoroughly inspect the real estate to reduce and mitigate uncertainties. Besides legal due diligence, acquisition of real estate frequently also requires performance of technical or environmental due diligence.

The manner and scope by which buyers carry out real estate due diligence depends heavily on the objectives of the transaction. On one hand, the acquisition of an income-producing property like a shopping centre requires the buyer to examine existing lease agreements and each tenant's rental payment history. On the other hand, the acquisition of greenfield intended for real estate development requires the buyer to examine the zoning. Regardless, due diligence always involves a review of public records (land register, land cadastre, etc).

A due diligence activity specific to the acquisition of real estate in Slovenia is the examination of potential ongoing restitution proceedings, which is a legacy of the former collective ownership system.

2.5 Typical Representations and Warranties

The scope of representations and warranties in commercial real estate transactions depends on

the characteristics of each individual transaction. Nevertheless, representations and warranties may include confirmation that:

- the parties have authority to enter into the agreement;
- there are no title defects;
- there are no rights of third persons;
- there are no unpaid taxes related to the real estate;
- there are no pending litigation, expropriation and restitution proceedings related to the real estate; and
- there is no environmental contamination.

As a result of the coronavirus pandemic, no significant additional representation and warranties have developed that would persist in post-pandemic transactions.

Certain seller's warranties, however, are also provided under statute, in particular in the Obligations Code and in the Protection of Buyers of Apartments and Single Occupancy Buildings Act that applies to the purchase of new constructions for which the buyer is a consumer and the seller is an investor or intermediate buyer. The seller may be held liable for the following:

- visible defects or defects in the property that could not have been detected when the property was taken over ("hidden defects"), if the hidden defects become apparent within two years of taking over the property;
- if a third party has any right in the property sold that excludes, reduces or restricts the buyer's right (legal defect); and/or
- serious defects in the construction of the property, if such defects become apparent within ten years from the date of delivery and acceptance of the property.

Under the Protection of Buyers of Apartments and Single Occupancy Buildings Act, an additional liability of the seller is established, namely for defects in the common parts of the building where the owners of the flats have co-ownership.

In the event of the seller's misrepresentation constituting a breach of agreement, the buyer is entitled to demand that the breach of agreement is remedied, that the purchase price is proportionally reduced or that the agreement is rescinded. At the same time, the buyer may claim reimbursement of damages. By way of contractual regulation, the parties often set a cap on the maximum amount of compensation for certain breaches (25–50% of the deal value) and agree on de minimis, granting damages only if the claim exceeds a certain amount. As security for these remedies, payment of a certain proportion of the purchase price is sometimes held back or is held in escrow. Although representation and warranty insurance is available, it is not commonly used.

The general statutory expiry period for representations and warranties is six months as of handover. Considering that this period is relatively short, it is occasionally contractually prolonged.

2.6 Important Areas of Law for Investors

In addition to property law, construction law, spatial planning law and environmental law, the main sources of which were specified in **1.1 Main Sources of Law**, investors also ought to consider finance and tax law. Investors seeking to purchase or develop an office building should also monitor whether new legislation on business leases shall be adopted.

2.7 Soil Pollution or Environmental Contamination

Under the polluter pays principle, prescribed by the Environmental Protection Act, the person who is responsible for soil pollution or contamination is responsible for undertaking the measures necessary for the rehabilitation of the environment. Therefore, the buyer who did not cause the pollution or contamination is generally not liable for incidents that occurred while the relevant assets were held by the previous owner.

Nonetheless, if environmental damage occurs and, after its occurrence but before its remediation, the polluter disposes of the real estate on which it carried out certain types of environmentally burdensome activities, the agreement by which it disposes of the real estate must include a provision to the effect that the person acquiring such real estate will also assume the remediation; otherwise, the contract is null and void.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The permitted use of real estate is determined by the state and local authorities under the spatial planning regulations. Permitted use of a specific land plot can be most reliably ascertained by obtaining location information from the competent local authority. Permitted use can also be ascertained through online public spatial data information systems. Conclusion of specific development agreements with relevant public authorities is possible to a limited extent (see **4.6 Agreements With Local or Governmental Authorities**).

2.9 Condemnation, Expropriation or Compulsory Purchase

In accordance with the Spatial Management Act, owners may be expropriated on the condition that expropriation is essential to attain the public benefit, and that the public benefit pursued is in proportion with the interference with private property. Owners need to be either awarded damages or compensated in kind with a real estate of same type and quality.

Before the expropriation procedure commences, the expropriation beneficiary must make an offer to the owner to purchase the real estate. If the sale and purchase cannot be agreed, the expropriation beneficiary may submit a request for expropriation, with which the expropriation procedure is commenced. The expropriation procedure is conducted by the administrative unit, which decides on the expropriation and the compensation.

Besides the above-mentioned generally applicable provisions of the Spatial Management Act on expropriation, the provisions of specific legislation concerning expropriation, such as the Investment Promotion Act and the Water Act, may be applicable in particular cases.

2.10 Taxes Applicable to a Transaction

Asset deal transactions are taxed either by the real estate transaction tax (RETT) or VAT. If the transaction is not subject to VAT, RETT amounting to 2% of the value of the real estate is to be paid by the seller. Payment of RETT may contractually be shifted to the buyer. Differently, in the case of sale of real estate owned by a taxable person identified for VAT purposes, VAT amounting to either 22% or 9.5% is applied instead of RETT in cases enumerated by the law or by choice of the parties (see **8.1 VAT and Sales Tax**).

Both asset deal transactions and share deal transactions may be subject to corporate income tax (CIT) if the seller is a legal entity, or income tax on capital gains if the seller is a natural per-

son. As regards CIT, any profit (or loss) from the deal counts towards the total profit of the legal entity. Corporate income is taxed at 19% of the legal entity's profit. As regards income tax on capital gains, natural persons are taxed based on capital gains and the capital holding period. The tax rate, which first amounts to 25% of the difference between the value of the capital at the time of disposal and the value of the capital at the time of acquisition, decreases over the years of ownership, ie, it amounts to 20% after five years of ownership and 15% after ten years of ownership. After 15 years of ownership, the transaction is exempt from tax on capital gains.

The above-mentioned taxes are also triggered by partial ownership transfer.

2.11 Legal Restrictions on Foreign Investors

Foreign investors are classified into the following groups as regards the possibility of acquiring real estate in Slovenia.

- Foreign investors that can acquire real estate without legal restrictions: legal entities and citizens of the EU, OECD and EFTA. Some additional cases are foreseen for natural persons, eg, Slovene status, inheritance.
- Foreign investors that can acquire real estate on the basis of a legal transaction, inheritance or decision of a public authority, under the condition of reciprocity: legal entities and citizens of candidate countries for EU membership.
- Foreign investors that cannot acquire real estate or can only acquire it based on inheritance under the condition of reciprocity: legal entities and citizens from all other countries that do not fall into any of the groups listed above.

The restrictions described above are somewhat alleviated, as it is possible for foreign investors to obtain real estate through legal entities established in countries with no legal restrictions applicable to them.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are in many cases financed by both debt and equity, whereby the ratio between the two depends on the characteristics of each individual acquisition. Nevertheless, in order to acquire debt financing from lenders, investors are usually required to ensure sufficient equity. Large real estate portfolios or companies holding real estate are often financed by syndicated loans of different lenders, which may be not only Slovenian lending institutions, but also foreign.

3.2 Typical Security Created by Commercial Investors

The most typical security created by commercial real estate investors borrowing funds to acquire or develop real estate is a mortgage. A special type of mortgage, which is also very common, is a maximum mortgage, where all existing and future claims arising from specific business relationships are secured by the same mortgage on real estate up to a specific amount. In addition to mortgages, security is sometimes also given in the form of pledges on movable property, securities, company's business shares, receivables and bank deposits, guarantees, etc.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Generally, there are no restrictions on granting security over real estate to foreign lenders, nor

are there restrictions on repayments being made to foreign lenders under a security document or a loan agreement. However, EU restrictive measures against Russia have caused standstills in the possibility of making repayments to Russian banks and financial institutions.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Under the Law of Property Code, loan agreements, the claim of which is secured by security over real estate (ie, mortgage), need to be either notarised or, in case of directly enforceable mortgages, concluded in the form of a notarial deed. In this respect, notarial fees are payable according to official notary tariffs. Furthermore, mortgages need to be registered in the land register, whereby a registration fee is payable. Enforcement of security over real estate is done by way of court proceedings or, in certain cases, with a notary's assistance, in which court or notary fees are payable. In addition to the aforementioned fees, no taxes or stamp duties are payable on the granting and enforcement of security over real estate.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The applicability of legal requirements that must be complied with before an entity can give valid security over its real estate assets, such as "financial assistance" rules and "corporate benefit" rules, depends on the entity granting security.

As regards public limited companies (d.d.), financial assistance (ie, legal transactions by which a public limited company procures an advance payment or loan or another legal transaction with a similar effect for the benefit of a future shareholder) is in general prohibited under the Companies Act. Transactions entered into in breach of these rules are null and void. It is also prohibited that a public limited company returns (or pays interest on) a contribution to a shareholder.

As regards limited liability companies (d.o.o.), such companies may generally provide financial assistance in relation to the acquisition of their share(s) or shares in any holding company of that company, provided that capital maintenance rules and solvency rules are considered.

In respect of capital maintenance limitations, under the Companies Act, a limited liability company is prohibited from making payments to its shareholders or making a legal transaction with a similar legal effect (eg, guarantee with its assets for the loan of the shareholder or any other group company except its own subsidiaries) to the extent that this would prevent the preservation of its minimal lawfully allowed share capital, actually registered share capital and tied-up reserves.

In relation to provision of upstream security, certain risks may arise within the borrower's group in relation to potential personal liability of management of the group companies. Namely, the Companies Act provides for relatively strict rules regarding the obligations of the management of group companies in case of so-called harmful instructions.

3.6 Formalities When a Borrower Is in Default

In the event of borrower default, the lender may achieve enforcement of its security over real estate against the defaulting borrower through court proceedings. Since loan agreements are usually concluded in the form of directly enforceable notarial deeds, the borrower in such case does not need to first initiate litigation proceedings, but rather can directly initiate enforcement

proceedings. The law prescribes no additional steps that must be taken to give priority to the lender's security interest over real estate over the interest of other creditors. In certain limited cases, real estate can also be sold in an out-of-court sale with a notary's assistance.

If only enforcement proceedings are necessary, official statistics show that the average time needed to successfully enforce and realise on property security is 2.7 months. Differently, if litigation proceedings also need to be initiated, the average time needed to successfully enforce and realise on property security significantly increases and is likely to exceed 12 months.

There are no ongoing restrictions on a lender's ability to foreclose or realise on collateral in real estate lending that would be implemented by governmental entities in response to the pandemic.

In the current market, lenders have been rather lenient with debtors and tend to forbear before foreclosing.

3.7 Subordinating Existing Debt to Newly Created Debt

In principle, earlier rights defeat later rights. Nevertheless, existing secured debt can be subordinated both by agreement and under the law. By way of agreement, creditors can allow subordination of their existing secured debts to later debts of other creditors. A note of subordination in favour of another mortgagee can be registered in the land register.

Moreover, under the Companies Act, a shareholder of a limited liability company who made a loan to the company at a time when the shareholder knew or should have known that the company was facing financial and/or economic difficulties may not enforce a claim for the repayment of the loan against the limited liability company in bankruptcy or compulsory settlement proceedings. A bankruptcy court will consider whether the shareholder, acting as a good manager, should have provided its own capital to the company instead of giving a loan. Under such circumstances, the loan is considered to be part of the company's bankruptcy estate. Repayments of such loans made during the year prior to a company's bankruptcy must also be returned to the bankruptcy estate. Similar rules apply to shareholder loans to public limited companies, where the shareholder holds more than 25% of the voting rights.

3.8 Lenders' Liability Under Environmental Laws

Under the Environmental Protection Act, lenders cannot be held liable for pollution of real estate by merely holding or enforcing security over such real estate. Theoretically, however, a lender could be held liable for any pollution of real estate caused by it.

3.9 Effects of a Borrower Becoming Insolvent

Under the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act, security interests created by a borrower in favour of a lender may be set aside or annulled, if they were established in the look-back period and if, at that time, the debtor was insolvent and further objective and subjective conditions were satisfied. The objective condition is satisfied if the debtor's actions resulted either in the decrease in the net value of its assets, resulting in reduced payments to creditors other than the (benefited) person, or if the other (benefited) person acquired more favourable payment conditions for its claim against the debtor. The subjective condition is met if, at the time of the debtor's

actions, the other (benefited) person knew (or should have known) of the debtor's insolvency.

Security interests created by a borrower in favour of a lender, which may be set aside or annulled, are only those made in a look-back period starting from 12 months prior to the day of filing of the motion for bankruptcy and ending on the day on which the bankruptcy proceedings are initiated. The look-back period is extended to 36 months if the other (benefited) person received assets of the company without being obliged to provide consideration, or if it was only obliged to provide consideration of a small value.

3.10 Taxes on Loans

The costs in connection with mortgage loans that need to be paid by lenders or borrowers are, according to the Land Registry Act, Notary Act and the Law of Property Code:

- court fee for registration in the Land Register; and
- notary's fees (which are payable according to the official notary tariffs) for notarial services.

Registration in the Land Register requires a Land Registry Permission, which must be either notarised or issued in the form of a notarial deed. In the land registration procedure, the notary often serves as the proxy of the applicant for registration of the mortgage.

No specific stamp duties apply, and the costs and fees are generally rather low compared to neighbouring jurisdictions.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

In Slovenia, spatial planning and zoning is governed by the Spatial Management Act, which envisages a system and hierarchy of spatial planning acts. Spatial planning acts either take the form of spatial strategy acts or spatial implementation acts, and are adopted at a state, regional and municipality level.

Accordingly, the state is responsible for the adoption of a spatial planning strategy for Slovenia and a thematic and regional actions programme, constituting strategy acts, as well as national spatial plans, and regulations on the most appropriate variant and national spatial development plans, which serve as implementation acts. Likewise, the state and local municipalities adopt regional spatial strategies, which are strategy acts. Lastly, municipalities adopt municipal spatial strategies as strategy acts, as well as municipal spatial plans and municipal detailed spatial plans as implementation acts.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

On a general level, the design, appearance and method of construction of new buildings or refurbishment of existing buildings is regulated by the Building Act and the Spatial Management Act. On an individual level, the design, appearance and method of construction is controlled in the process of issuing of the building permit. In this process, the competent administrative unit or the Ministry of Natural Resources and Spatial Planning in case of large-scale construction projects considers, inter alia, whether:

- the intended construction is in accordance with the implementing zoning regulations;
- the constructed or reconstructed building will meet the essential requirements; and
- the intended construction will not prejudice the rights of third parties and the public interest.

If the above conditions are fulfilled, the responsible authority will allow such construction.

4.3 Regulatory Authorities

Regulatory competences in spatial management are hierarchically divided between the state and municipalities. As regards the regulation of the development and designation of use of individual parcels of real estate, the competences generally lie with municipalities. Municipalities are, however, bound by hierarchically higher spatial planning acts.

4.4 Obtaining Entitlements to Develop a New Project

In order to obtain entitlements to develop a new project or to complete a major refurbishment, an investor has to obtain a building permit. The building permit is issued by the territorially competent administrative unit or – in certain cases – by the Ministry of Natural Resources and Spatial Planning. In the administrative procedure for the issuance of a building permit, third parties have the right to participate and may potentially object to or comment on the intended construction. Such third parties are, inter alia, the owner of the land plot subject to construction or the holder of another property right over such land plot, the owner of the neighbouring land, as well as other persons, if they demonstrate that their rights and legal interests are likely to be affected by the proposed construction.

4.5 Right of Appeal Against an Authority's Decision

A decision issued by an administrative unit in the issuance of a building permit may be appealed against. The right to appeal is granted to the investor as well as third parties, which have the right to participate in the said procedure (see **4.4 Obtaining Entitlements to Develop a New Project**). The right to appeal the decision issued by the Ministry of Natural Resources and Spatial Planning is only limited to an administrative dispute procedure.

4.6 Agreements With Local or Governmental Authorities

A public utility charge is payable in respect of any planned development. The amount of the charge depends on the scope of available public utility infrastructure, whereas, generally, connection to the available public utility infrastructure is mandatory.

Instead of paying part of the public utility charge, an investor can – to a limited extent – agree with a local municipality that the investor will, instead of the municipality, construct the public utility infrastructure for the land on which the investor intends to build. After the infrastructure is constructed, it is transferred to the ownership of the municipality free of charge. Such agreements are common practice.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and designated use are enforced by the inspection services, which supervise the implementation of the regulations in the field of spatial planning and construction. Inspection services serve to prevent the illegal construction of buildings and their use without the required permits.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Generally, all entities, including foreign entities, that have legal capacity can hold real estate assets, although restrictions described in **2.11 Legal Restrictions on Foreign Investors** need to be observed. In any case, the predominant type of entity used to acquire real estate is the limited liability company (d.o.o.), followed by the public limited company (d.d.).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Company

A limited liability company is a legal person whose shareholders may be one or more (up to 50) domestic or foreign legal and natural persons. The shareholders are not responsible for the company's liabilities. A limited liability company is formed by a memorandum of association, which may be in the form of a notarial deed or on a special physical or electronic form. The procedure for establishing a limited liability company depends on whether it is a one-person limited liability company or a multi-person limited liability company and whether the share capital is paid in cash or in kind.

Public Limited Company

A public limited company is a company whose share capital (capital stock) is divided into shares. The shareholders of a public liability company are not personally liable; rather, liability is held by the company itself. A public limited company may be set up by one or more domestic or foreign natural or legal persons that adopt statutes (memorandum of association), which must be drawn up in the form of a notarial act. The company is established when the founders take over all the shares. The founders may pay up the shares in cash or by means of contributions in kind. The main advantage of public limited companies is that they are able to be listed on stock exchanges.

Tax

There are no material differences in tax benefits or cost for the two types of entities set up to invest in real estate. For details on the taxes, see **2.10 Taxes Applicable to a Transaction**.

5.3 REITs

REITs are not present in Slovenia.

5.4 Minimum Capital Requirement

A limited liability company is required to have capital that amounts to at least EUR7,500, whereas a public limited company is required to have minimum share capital in the amount of EUR25,000.

5.5 Applicable Governance Requirements

No specific governance requirements apply to investment in real estate as such, save that each company must be registered for any activity it pursues. The general requirement to act with the diligence of a prudent businessperson must be complied with.

5.6 Annual Entity Maintenance and Accounting Compliance

Annual entity maintenance and accounting compliance costs depend heavily on the type of entity as well as the real estate investments themselves, and therefore cannot be estimated at a general level.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The most common type of agreement that allows a person, company or other organisation to occupy real estate for a limited period of time without buying it outright is a lease agreement. A similar effect may be achieved by personal easements (ie, usufruct, use and apartment easement), as well as the building right, which is a right to own a built structure above or beneath the real estate of another person, and in effect comes close to ownership.

6.2 Types of Commercial Leases

Slovenian law differentiates between different types of leases depending on the subject of the lease. The Obligations Code prescribes general rules applicable to all lease agreements. In addition to and/or instead of the general rules, mandatory provisions are prescribed by the Housing Act for leases of residential buildings and the Agricultural Land Act for leases of state- or municipality-owned agricultural land. In the past, leases of business buildings and business premises were also regulated by the Business Buildings and Business Premises Act; however, this Act was repealed and continues to apply to only lease agreements concluded before 19 June 2021.

6.3 Regulation of Rents or Lease Terms

In principle, rents and lease terms are freely negotiable. However, the Housing Act applicable to leases of residential buildings designates rent as usurious if it exceeds the average market rent in the municipality for the same or a similar category of housing by more than 50%. Furthermore, in accordance with the Agricultural Land Act, lease terms of state- or municipality-owned agricultural land cannot be less than ten years (or 15 or 25 years for specific types of agricultural land). Regulation of rents and lease terms was enacted as a result of the coronavirus pandemic; however, its validity has since expired.

6.4 Typical Terms of a Lease

Length

The length of lease term for business premises is typically agreed as a fixed period of between one and ten years (for offices) or between five and 20 (for facility, warehouses and retail). Extension options are also often agreed. In the past, fixed-term leases were far more common in comparison to indefinite lease terms, because the latter had to be terminated through court proceedings in accordance with the Business Buildings and Business Premises Act. Although this Act was repealed and (new) indefinite period lease agreements for business premises are no longer required to be terminated through court proceedings, fixed-term lease agreements are still more common.

Maintenance and Repair of Real Estate

In accordance with the Obligations Code, the landlord must maintain the condition of the subject of the lease during the entire lease term and, if necessary, repair it. The landlord is obliged to reimburse the tenant for maintenance costs incurred by the tenant. However, the costs of minor repairs caused by the normal use of the subject of the lease and the costs of its use are borne by the tenant. Although the parties are free to set different terms of lease on maintenance and repair, in most cases the parties follow the statutory regulation. Nevertheless, in triple net leases, which are common in commercial (specifically sale and leaseback) transactions, the burden of maintenance and repair is shifted to the tenant.

Frequency of Rent Payments

Rent is mainly paid on a monthly basis. Different frequencies of rent payments are uncommon.

Coronavirus Pandemic Issues

Newer post-pandemic commercial lease agreements commonly contain specific clauses relating to the pandemic. Lease agreements that contain force majeure clauses either explicitly include the COVID-19 pandemic as a force majeure event or expressly exclude it, with the latter being more common.

6.5 Rent Variation

In the case of fixed-term leases for a shorter period of time, the rent payable will normally remain the same for the entire duration of the lease term, with the rent being increased, if so agreed between the parties, alongside the prolongation of the lease term. Conversely, fixed-term leases concluded for longer periods of time commonly include rent variation systems, such as rent indexation, graduated rent or rent linked to turnover. It is expected that in the new inflation-influenced reality, even the short- to mid-term leases will contain indexation clauses.

6.6 Determination of New Rent

On one hand, if the rent is to be changed or increased, the determination of new rent is usually regulated by the lease agreement itself. In the case of rent indexation, the rent will be adjusted according to the changes in the chosen index. For graduated rent, the rent will be raised gradually by a specified amount after a certain period of time. For rent linked to turnover, the rent will be adjusted according to the tenant's turnover. On the other hand, if the determination of the new rent is not regulated, the new rent is usually negotiated in view of the average market rent applicable to the type of real estate.

6.7 Payment of VAT

Generally, VAT is not payable on rent. However, in accordance with the Value Added Tax Act, the parties to the lease agreement may under certain terms opt into the VAT system, thereby enabling the deduction of input VAT.

6.8 Costs Payable by a Tenant at the Start of a Lease

Although not mandatory under the law, the parties to the lease agreement commonly agree that the tenant will pay a security deposit to the landlord, which is usually determined in the amount of a few monthly rents. For commercial leases, security deposits are sometimes replaced with the procurement of a bank guarantee by the tenant to the landlord as security for fulfilment of the tenant's obligations under the lease agreement. In certain cases, the landlord and the tenant will agree to split the fit-out costs (sometimes against a rent-free period, and sometimes not).

6.9 Payment of Maintenance and Repair

In accordance with the Obligations Code, the costs of maintenance and repair (also) of common areas are the burden of the landlord. However, commercial lease agreements commonly shift the costs of maintenance of common areas used by several tenants, such as parking lots and gardens, to the tenants, and divide the costs proportionally between them.

6.10 Payment of Utilities and Telecommunications

The utilities and telecommunications costs arising solely from the business operations of the tenant are typically borne by the tenant, even if invoiced to the landlord. The utilities and telecommunications costs related to the common services and infrastructure are typically allocated proportionally to each tenant.

6.11 Insurance Issues

The person responsible for paying the costs of insuring real estate that is the subject of a lease can differ depending on the subject of the lease. For instance, for leases of residential buildings, it is most common that insurance is procured and paid for by the landlord. Similarly, for leases of commercial buildings, the landlord usually procures insurance for the subject of the lease, covering fire, storm, hail, water damage, etc. However, the costs are commonly shifted to the tenants as part of the operating costs. Also, the landlord's insurance policies do not usually cover all risks, eg, tenant's property or interruption of business, which are in turn insured by the tenants themselves. Nevertheless, in triple net leases, which are common in commercial sale and leaseback transactions, all costs of insuring the real estate that is the subject of a lease are borne by the tenant.

Since most business insurance policies did not expressly cover the coronavirus pandemic, which resulted in the interruption of business, it has proven to be difficult for tenants to recover rent payments and other costs.

6.12 Restrictions on the Use of Real Estate

Generally, the parties to a lease agreement are free to agree on restrictions on the use of the subject of the lease. There are no specific regulations and/or laws regarding restrictions on how a tenant uses the real estate, whereas provisions of law operate with the term "ordinary use" in different contexts. For this reason, restrictions are commonly regulated contractually. Statutory provisions governing the prevention of restriction of competition must be complied with.

6.13 Tenant's Ability to Alter and Improve Real Estate

The Obligations Code prescribes that, if the tenant made any alterations to the subject of the lease, it is obliged to return the subject of the lease to the landlord after the lapse of the lease term in the same condition as it was before. The tenant may remove the improvements it has made to the subject of the lease, provided that it is possible to remove them without damage to the subject of the lease. Nevertheless, the landlord may retain the improvements if it compensates the tenant for their value. In lease agreements, this matter is typically regulated in detail.

6.14 Specific Regulations

As described in **6.2 Types of Commercial Leases**, specific provisions prescribed by the Housing Act apply for leases of residential buildings and specific provisions prescribed by the Agricultural Land Act apply for leases of state- or municipality-owned agricultural land. Previously, leases of business buildings and business premises were also regulated by the Business Buildings and Business Premises Act. The intervening coronavirus legislation also made distinctions between asset classes and, for instance, regulated measures applicable solely to leases of business buildings and business premises.

6.15 Effect of the Tenant's Insolvency

Upon commencement of bankruptcy proceedings, the insolvent debtor acquires the right to terminate lease agreements concluded before the commencement of the insolvency proceedings by giving one month's notice, notwithstanding the general rules laid down by law or contractually on the right to terminate the lease agreement. The exercise of the right of termination is without prejudice to the right of the other party to the lease agreement to claim from the insolvent debtor compensation for damage suf-

fered as a result of the exercise of the right of termination.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is common for the parties to the lease agreement to agree that the tenant will pay the landlord a security deposit, which serves as security to protect against failure of the tenant to meet its obligations. For commercial leases, security deposits are sometimes replaced with the procurement of a bank guarantee by the tenant to the landlord. Other forms of security are also possible, subject to agreement between the parties.

6.17 Right to Occupy After Termination or Expiry of a Lease

The tenant does not have a right to continue occupying the relevant real estate after the expiry or termination of a lease, per se. If the tenant continues to use the real estate after the expiry of the lease term and the landlord does not object to such use, a new lease is deemed to have been concluded for an indefinite period. Accordingly, upon expiry of the lease agreement, the landlord needs at least to object to the continuous use of the real estate, should such use occur.

Moreover, if the landlord wants the real estate to be vacated against the will of the tenant, it must generally obtain a judgment ordering the tenant to vacate the real estate and enforce the judgment in enforcement proceedings. The need to obtain such judgment may be avoided if the lease agreement is concluded in the form of a directly enforceable notarial deed, in which case the landlord may turn directly to enforcement proceedings.

6.18 Right to Assign a Leasehold Interest

Unless otherwise agreed, the tenant may generally sublease the subject of the lease or otherwise grant its use to another person; however, only if such transfer of leasehold interest does not cause damage to the landlord. In practice, lease agreements commonly prohibit subleases or demand the landlord's consent for the sublease.

6.19 Right to Terminate a Lease

Lease agreements concluded for an indefinite period of time can be terminated by way of notice, which either party may give to another, observing the notice period. However, since most lease agreements are concluded for a fixed term, the ordinary termination rights are excluded. A lease agreement concluded for a fixed term is terminated upon expiry of the lease term.

The Obligations Code also grants both the landlord and the tenant extraordinary termination/withdrawal rights. The landlord may, under the law, terminate the lease agreement:

- if the tenant, even after being reminded by the landlord, uses the subject of the lease in breach of the agreement or its purpose, or neglects to maintain it, and there exists a risk of significant damage to the landlord;
- if the tenant fails to pay the rent within 15 days of the landlord's request to do so; and/or
- if the tenant subleases the subject of the lease without the landlord's permission when required to do so.

Conversely, the tenant may withdraw from the lease agreement:

- if the necessary repairs of the subject of the lease impede its use to a significant extent and for a prolonged period of time;
- if the subject of the lease has a defect that cannot be remedied at the time of handover; and/or
- if the subject of the lease is partially destroyed or damaged.

In addition, the tenant may terminate the lease agreement if the disposal of the subject of the lease results in the transfer of the lease to the new owner of the real estate. A range of additional termination options is usually contractually granted to both parties of the lease agreement.

6.20 Registration Requirements

A lease is not required to comply with registration requirements or particular execution formalities. Nevertheless, lease agreements may (but do not need to) be entered in the land register, which bears the effect of publicity. For the entry in the land register to be possible, the owner of the real estate needs to grant the tenant a land register permit that requires notarisation of the landlord's signature, for which notarial fees are payable, and a registration fee needs to be paid.

6.21 Forced Eviction

The tenant may be forced to leave the leased premises in the event of default even prior to the date originally agreed if the landlord terminates the lease agreement.

If the tenant fails to comply with its obligation to vacate the leased premises, the landlord must generally obtain a judgment ordering the tenant to vacate the real estate and enforce the judgment in enforcement proceedings. The need to obtain such judgment may be avoided if the lease agreement is concluded in the form of a directly enforceable notarial deed, in which case the landlord may directly initiate the eviction in enforcement proceedings.

If only enforcement proceedings are necessary, official data states that the average time needed to successfully achieve enforcement is 2.7 months. However, if litigation proceedings are also necessary, the average time needed for successful enforcement significantly increases and may even exceed 12 months. No eviction moratoriums or related restrictions were enacted as a result of the coronavirus pandemic.

6.22 Termination by a Third Party

As described in **2.9 Condemnation, Expropriation or Compulsory Purchase**, owners of real estate may be expropriated under certain conditions. The decision ordering expropriation may also order that lease agreements connected with the real estate being expropriated are to be terminated. In such case, the tenant needs to be either awarded damages or compensated in kind depending on the subject of the lease.

6.23 Remedies/Damages for Breach

In the event of a tenant breach and termination of the lease, the landlord has a claim for delivery and vacating of the property (which means that the tenant must, in principle, return the property in the same condition as it was received) and a right to compensation for damages under the general damage liability regime; no specific rules for rent apply and it has not been widely adopted that the landlord would be entitled to receive the full amount of remaining rent. The Obligations Code adheres to the principle of full compensation, though it is limited by the principle of foreseeability of damage while, simultaneously, the landlord has a duty to mitigate damages. In case of rental agreements, the latter will require the landlord to make efforts to secure a new tenant promptly.

Landlords typically hold security deposits posted by tenants, usually in cash form, or the tenants provide other types of security, such as a bank guarantee or promissory note.

7. Construction

7.1 Common Structures Used to Price Construction Projects

In construction agreements, the most common price clauses are either (i) unit prices, where the price of works is determined by the unit of measurement of the agreed works applied to the actually implemented quantities of work, or (ii) fixed (lump-sum) prices, where the price is set as a total price for the entire scope of works. Construction agreements also commonly include a "turnkey" clause, in accordance with which the contractor independently undertakes to jointly execute all the works necessary for the construction and use of the entire building. At the same time, the agreed price also includes the value of any unforeseen and excess works but excludes the price impact of any missing works. Fixed-price clauses are also common as they allow for a shift of the price-change risk (up to 10% increase in price of elements) to the contractor.

7.2 Assigning Responsibility for the Design and Construction of a Project

Responsibility for the design and construction of a project is split between the contractor and the project designer. The contractor and the project designer may be responsible for defects in the structure, which occur due to the building not being constructed in accordance with the design or the professional code of conduct, as well as the defects in the solidity of the structure, which is stricter, as the liability for defects in the solidity of the structure extends over a period of ten years after handover and acceptance.

If there is a defect in the project design, the project designer is liable. If the defect is due to the special nature of the site, the designer is liable, as it must take the relevant site conditions into account. However, the contractor may also be liable if it should have detected the defect due to the special nature of the site if it acted diligently. In the case of a defect in the material, the designer is liable if it has included inappropriate materials in the building design. The contractor may also be liable for a defect in the material if the correct material was planned but the contractor used the wrong material. For defects in the manner of execution, liability lies with the contractor.

7.3 Management of Construction Risk

Construction risk is managed, to a certain extent, through the appointment of a construction supervisor. The construction supervisor is responsible for the supervision of construction works so as to ensure that the statutory requirements are complied with, that preventative action is taken and that defects are prevented in a timely manner.

The contractor is also obliged to take out insurance against liability for damage in connection with its activity. The liability insurance must cover liability for damage caused to the investor or to a third party in connection with the performance of the contractor's activities and must cover damage caused by negligence, fault or default of the contractor and its employees, up to an annual sum insured of at least EUR50,000. The investors commonly request that their contractors conclude insurance policies with higher insurance sums.

In addition to the foregoing, construction agreements commonly require that the contractor delivers bank guarantees, either for good performance, return of the advance payment or remediation of defects during the warranty period.

7.4 Management of Schedule-Related Risk

Construction contracts commonly foresee contractual penalties for delays in the execution of works. The contractual penalties are typically foreseen not only in case of delays in the completion time, but also penalise delays to (certain) interim milestones.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for investors to seek additional forms of security to guarantee the contractor's performance on a project. The most common forms of security are (different) bank guarantees, bills of exchange, enforcement notes, parent company guarantees, retained amounts, etc.

7.6 Liens or Encumbrances in the Event of Non-payment

Although possible, it is very uncommon for contractors and/or designers to encumber real estate in the event of non-payment by the investor. Such encumbrance would be possible only upon explicit agreement between the contractor/designer and the investor as the owner of real estate and would need to be perfected in the land register. In such case, removal from the land register would be possible based on a deletion permit issued by the contractor/designer.

7.7 Requirements Before Use or Inhabitation

Where a building permit had to be obtained before the commencement of the construction project, it is also necessary to obtain a use permit upon its completion. A use permit is a decision issued by the administrative unit authorising the use of the building. In certain more complicated constructions, a successful technical inspection is also one of the conditions for obtaining the use permit. In instances of certain specific commercial uses, additional permits may also be required.

8. Tax

8.1 VAT and Sales Tax

VAT is payable in certain (but not all) sale and purchases of real estate. The sale and purchase of real estate is taxed with VAT only if the seller is a taxable person identified for VAT purposes. Moreover, VAT may be applied depending on the type of real estate being transferred and whether the parties opt into VAT treatment of the transaction.

As to types of real estate being transferred, the supply of land is exempt from VAT; however, the supply of (empty) building land is subject to VAT. Furthermore, the supply of buildings or parts of buildings and land on which the buildings are located is also exempt from VAT, unless the supply is made before the buildings or parts of the buildings are occupied or used for the first time, or if the supply is made before two years have elapsed from the beginning of the first use or first occupancy. Nevertheless, if the buyer is also a taxable person identified for VAT purposes with the right to deduct input VAT, the parties may opt into VAT treatment of the transaction, even though the supply would otherwise be exempt from VAT.

VAT must be paid by the buyer. However, the buyer may deduct the amount from input VAT and demand reimbursement from the state,

making the transaction tax neutral. Conversely, if the parties opt into VAT treatment of the transaction, the reverse charge system applies.

The general VAT rate is 22%. A lower VAT rate of 9.5% is applied to supplies of apartments, housing and other buildings intended for permanent residence, and parts of buildings, if they are part of social policy.

If VAT is not payable on the sale and purchase of real estate, real estate transactions are subject to real estate transaction tax (see **2.10 Taxes Applicable to a Transaction**).

8.2 Mitigation of Tax Liability

There are no methods which could be used to mitigate tax liability on acquisitions of large real estate portfolios.

8.3 Municipal Taxes

There is no annual tax specific to the holding of business premises. However, payment of an (annual) compensation for the use of building land is required. This compensation is generally payable in respect of the following areas:

- towns and settlements of urban character;
- areas designated for residential and other complex construction;
- areas for which a spatial implementation plan has been adopted; and
- other areas equipped with water and electricity utility networks.

The exact areas for which the compensation should be paid, the criteria for determining the amount of compensation and the applicable exemption are determined at the municipality level. The person liable for payment of this compensation is generally the direct user of the land or building or part of the building.

8.4 Income Tax Withholding for Foreign Investors

Foreign investors are subject to special rules on income taxation in Slovenia. Income tax may be withheld, but this is not automatic and depends on various factors such as tax treaties between countries, the type of income and the status of the investor.

Natural persons are obliged to pay tax on rental income, which is payable by the landlord. The rate is 25% from the income from renting out real estate, reduced by standard costs of 10% or actual costs. If a natural person rents out real estate as a business activity, these incomes can be considered as income from the activity, which go into the tax base for the annual assessment of income tax.

Natural persons also pay tax on capital gains in connection with the disposal of real estate. The law provides for several exemptions, the most important being disposal after 15 years of ownership. Even otherwise, the tax rate, which first amounts to 25% of the difference between the value of the capital at the time of disposal and the value of the capital at the time of acquisition, decreases over the years of ownership, ie, it amounts to 20% after five years of ownership and 15% after ten years of ownership.

Meanwhile, legal entities pay corporate income tax (CIT), which amounts to 19% of their profits.

A 15% CIT withholding is provided for rent income if paid to a non-resident stemming from real estate located in Slovenia, unless the lease is provided by the business unit of the non-resident in Slovenia, in which case it is paid to this business unit.

8.5 Tax Benefits

There are no tax benefits from owning real estate, per se. Still, depreciation of real estate is taken into account in the assessment of tax (see **8.4 Income Tax Withholding for Foreign Investors** for decrease of the rate of the tax on capital gains as well as consideration of costs in the tax base for tax on rental income).

SOUTH KOREA



Law and Practice

Contributed by:
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Bae, Kim & Lee LLC (BKL) was founded in 1980 and is a full-service law firm covering all major practice areas, including corporate law, mergers and acquisitions transactions, dispute resolution (arbitration and litigation), white-collar criminal defence, competition law, tax law, capital markets law, finance, intellectual property, employment law, real estate, technology, media and telecom (TMT), maritime, and insurance matters. With more than 650 professionals located across its offices in Seoul, Beijing, Hong Kong, Shanghai, Hanoi, Ho Chi Minh City, Yangon and Dubai, it offers its clients a wide range of expertise through a vast network of offices. The firm is composed of a diverse mix of Korean and foreign attorneys, tax advisers, industry analysts, former government officials, and other specialists. A number of its professionals are multilingual and have worked at well-known law firms in other countries, enabling them to assist international clients as well as Korean clients abroad successfully with cross-border transactions.

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1. General

1.1 Main Sources of Law

The main sources of real estate law are as follows:

- the Civil Code;
- the Real Estate Registration Act (RERA);
- the National Land Planning and Utilisation Act (NLPUA);
- the Report of Real Estate Transaction Act (RRETA);
- the Building Act;
- the Housing Lease Protection Act (HLPA); and
- the Commercial Building Lease Protection Act (CBLPA).

1.2 Main Market Trends and Deals

Over the past 12 months, investments in the Korean real estate market slowed down due to high inflation rates, causing increased uncertainty in the financial market. The Bank of Korea's benchmark interest rate, which was continuously raised to 3.5% in January 2023, is expected to remain unchanged until the first half of 2024.

Commercial real estate transactions remained at around 65% of the previous year's level, with an overall decrease in the office and logistics markets and a decrease of around almost 60% in the retail and hotel markets.

Considering the timing of the U.S. Federal Reserve's interest rate cut, many financial institutions are expecting its cut in the second half of 2024. Thus, the commercial real estate investment market in the second half of 2024 could be more active than last year.

The highest transaction among the top 10 commercial real estate deals in 2023 by value was the purchase of a water treatment plant from SK Hynix by SK REIT. The SK hynix water treatment plant is located in Icheon-si, Gyeonggi-do, with a land area of 46,144 m² and a gross floor area of 146,714 m². SK REIT acquired the property through its subsidiary REIT in Sepetember 2023. The transaction amounted to about KRW1.12 trillion.

Blackstone, a global private equity fund (PEF) management company, completed the sale of Ark Place, a large office building in Gangnam, Seoul, at the end of March 2024. It has exited the property after more than eight years since its purchase in 2016. The sale price was approximately KRW800 billion, making it the largest largest office building transaction in a year. Ark Place has a land area of 4171.7 m², a gross floor area of 62,725.31m², six basement floors and 24 upper floors. With a GFA of 53.17% and a floor area ratio of 980.53%, it is considered a landmark in the Gangnam Yeoksam Station area.

A recent trend has seen the introduction of new business models that leverage blockchain and other disruptive technologies, such as digital asset-backed securities (DABS) offered with real estate as the underlying asset. The Korean government has been supportive of new technologies and has exempted the application of current regulations to business models designated as an innovative financial service under a "regulatory sandbox" regime.

Since 2019, several real estate investment platforms have been admitted to the regulatory sandbox, enabling them to offer trust interests backed by commercial buildings. This allows investors to trade on the platform while recording the transactions on a blockchain, without being subject to securities regulations. The regulatory sandbox provides a transitional exemption

for new business models for a period of up to four years.

These recent advancements suggests an increasing influence of disruptive technologies on real estate markets. Digital assets and blockchain are expected to become one of the key instruments for securitising real estate and raising funds. The evolution and regulation of these new technologies and products will continue to be significant topics within Korean real estate capital markets in the future.

Over the past 12 months, large-scale public financing for real estate investment has faced challenges due to persistently high interest rates, and there have been burdensome situations in refinancing matured PF loans. The difficulty in obtaining funding through loans has sometimes led to situations where additional capital injections from sponsors or their affiliates are required to prevent defaults. Concurrently, a growing demand for credit funds specialising in distressed assets has also been observed.

A slowdown in the real estate market and high interest rates have adversely affected the profitability outlook for real estate project financing. This has increased liquidity risks for construction companies and related sectors, leading to deteriorating financial soundness and debt restructuring workouts. In Korea, financial institutions tend to prefer private workouts over court-led rehabilitation or bankruptcy proceedings, except in unavoidable circumstances.

1.3 Proposals for Reform

An amendment to the Special Act on Non-Governmental Rental Housing has been proposed and is likely to be passed in 2024, changing the policy that prohibits registration of purchased rental flats rather than constructed rental flats and allowing registration of flats of 85 m^2 or less.

An amendment to the law to reduce the acquisition tax from 12% to 6% for corporations that operate purchased rental housing has been proposed and is likely to be passed within the year.

In addition, the government has decided to amend the law to allow public funds, such as ETFs, to invest in publicly traded REITs that have invested more than 40% of their total assets in funds, and this is expected to be implemented by the end of the year.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights that may be acquired include:

- ownership rights;
- superficies (*jeesang-kwon*);
- easements (*jeeyeok-kwon*);
- *jeonse-kwon* (a deposit-based lease right recorded in the registry); or
- mortgages.

2.2 Laws Applicable to Transfer of Title

The RERA applies to the transfer of title of all real estate.

2.3 Effecting Lawful and Proper Transfer of Title

To be lawful and proper, transfers of real estate must be registered in the real property registry. Title insurance is not common in Korea. The COVID-19 pandemic has not particularly disrupted or added to these procedures.

2.4 Real Estate Due Diligence

Buyers carry out legal due diligence based on information provided by sellers and on public information such as that acquired through the real estate registry, the real estate ledger and the certificate of land use plan issued by the municipal government. Legal due diligence typically covers the transaction structure, title, encumbrances, zoning, government permits and approvals, and taxes.

2.5 Typical Representations and Warranties

Representations and warranties provided in a commercial real estate transaction typically include:

- authorisation, enforceability;
- title;
- no encumbrances;
- government approval;
- no violation;
- registration;
- no litigation or dispute;
- taxes;
- environment;
- no expropriation and encroachment; and
- no hazardous materials.

No specific warranties are statutorily required to be provided by a seller in the sale of real estate. However, the Civil Code provides that in the event that a property has defects and unless a buyer was aware of, or could have been made aware of, these defects at the time of the sale, such buyer may cancel the contract if the objective of the contract cannot be achieved as a result of such defects. Otherwise, a buyer may only claim damages for the defects. A buyer's remedies are termination of the contract, indemnification and/or claim for damages. In many cases, security deposits are kept for a certain period of time as security for damages claims. The survival period for the seller's representations and warranties varies by case, with a maximum limit of ten years under the Civil Code and five years under tax law. In particular, for investment vehicles that must be liquidated after the sale, the period is often not set at all or is set at a short period of six months. The scope of the seller's liability for a breach of its representations and warranties is also diverse, making it difficult to speak universally, and in many cases different limits are set on liability depending on the specific representations and warranties. There have been cases where representation and warranty insurance was used.

COVID-19 related representations and warranties are not usually included in real estate transaction documents.

2.6 Important Areas of Law for Investors

As several government approvals may be required for real estate transactions, parties should ascertain which approvals are required for their deals and incorporate sufficient time into the deal timeline to obtain any such approvals.

2.7 Soil Pollution or Environmental Contamination

Even if a buyer did not cause the pollution or contamination of a property, such buyer is responsible for the pollution or contamination unless such buyer was not aware of, or could not have been made aware of, the state of pollution or contamination of the property.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer may ascertain the permitted uses of a parcel of real estate by obtaining a certificate of land use plan issued by the relevant municipal government. It is possible to enter into specific

development agreements with the relevant public authorities. A typical example would be the development of non-governmental rental housing in accordance with the Special Act on Non-Governmental Rental Housing.

2.9 Condemnation, Expropriation or Compulsory Purchase

The government's taking of land (including by an industrial site development project enterprise) is permitted for public interest projects as stipulated in the Act on Expropriation of Land, etc, for Public Works and Compensation (AELPWC). To expropriate property, the government must make a public announcement of the properties to be expropriated, notify the property owners and implement a compensation plan. The government must assess the compensation amount and negotiate with the property owners.

If an owner agrees to transfer their property at the price offered by the government based on the government's assessment, an agreement for the property transfer may be executed at such a price. However, if an owner does not accept the government's proposal, the government may file, or must file at the request of the owner, a motion to determine the appropriate purchase price for the relevant property with the Central Land Expropriation Committee, which will examine the value of the property, assign a certified appraiser to assess the property, and consider briefs from the government and the property owner.

In approximately three to four months, the Committee renders a decision on the purchase price for the property subject to the expropriation. The government must then pay the purchase price as determined by the Committee. Ownership of the expropriated property is then transferred to the government on the expropriation date indicated in the Committee's decision, even if the owner files an objection or a lawsuit regarding the decision.

2.10 Taxes Applicable to a Transaction

Acquisition and Recordation Tax

When a company or an individual acquires real property in Korea, it must pay an acquisition tax of 4.6% (inclusive of surtax) of the purchase price (ie, actual acquisition cost) reported at the time of the acquisition. However, if the real property is located in a specific region designated as an overpopulated control area, a stepped-up tax rate of 9.4% will apply. The acquisition tax is inclusive of a recordation tax. Acquisition tax is exempt if a property is purchased on condition that it will be donated to the state or a local government.

Stamp Duty

Stamp duty of up to KRW350,000 is payable on the contract for the acquisition of real estate and generally paid by the buyer. The buyer must also purchase national housing bonds at a rate of approximately 5% of the purchase price of the real estate. In practice, these bonds are immediately resold at a 10% to 15% discount on the purchase price of the bonds.

Additional Taxes

Additional taxes apply to share deals and partial ownership transfers, to the extent that the buyer (and its related parties) becomes a majority shareholder of a target company holding real estate. A deemed acquisition tax is imposed when an entity (along with its related parties) becomes a majority shareholder of a target company by acquiring more than 50% of its shares, and the majority shareholder is required to pay deemed acquisition tax of 2.2% (inclusive of surtax) of the book value of the real estate held by the target company in proportion to the majority

shareholder's ownership percentage, as if it has directly acquired such real estate. In addition, the seller of shares in a share deal must pay a securities transaction tax, which is equal to 0.35% of the sale price.

2.11 Legal Restrictions on Foreign Investors

Foreign investors acquiring land are required to file a report with the local government in Korea within 60 days of the execution of the sale and purchase agreement, or to obtain approval in cases where the land is located in:

- a military facilities protection area;
- a cultural relic protection area;
- a natural ecology protection area; or
- a wildlife protection area.

Foreign investors acquiring 50% or more of shares in a land-owning company are required to file a report to that effect. However, the filing of this report may not be required if the foreign investors elect to file a general real estate transaction report with the local government in accordance with RRETA.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are financed through both debt and equity financing. In particular, institutional investors such as investment banks, public pension funds, mutual aid associations, securities companies and insurance companies are a significant source of financing for such acquisitions, as well as foreign investors.

In addition to conventional debt and equity financing by various investment vehicles (as described in **5. Investment Vehicles**), there are some financing options more customised for acquisitions involving large real estate assets. For example, real estate securitisation using ABS (asset-backed securities) or ABCP (asset-backed commercial paper) is common in Korea. Sale-and-leaseback transactions have also been a commonly used alternative financing method in Korea.

3.2 Typical Security Created by Commercial Investors

Investors borrowing funds to acquire or develop real estate typically use a mortgage on the real estate as security, created by a mortgage agreement between the parties. Another type of security typically used is a security trust under which the real estate investor entrusts the real estate to a trustee and the lender becomes a beneficiary.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Any foreign lender who intends to acquire a security interest over real estate located in Korea is required to file in advance a report with a foreign exchange bank in Korea under the Foreign Exchange Transaction Regulations. Furthermore, if the land in question is located within a district subject to prior approval by the MOLIT under the NLPUA, and if the foreign lender intends to acquire a security interest that would grant them the right to use the land for the purpose of owning buildings and structures on such land, additional approval must be obtained from the local government with jurisdiction over the land.

A foreign lender is generally not subject to any restrictions on transferring the proceeds of a loan repayment to its offshore account as long as the government authorisation required under

the Foreign Exchange Transaction Regulations was duly obtained in respect of the security agreement and the loan agreement at the time of signing or closing the financing transaction.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Security over real estate (ie, mortgages) must be registered with the competent court registry office. In the case of mortgages, registration tax (0.2% of the maximum secured debt amount) and local education tax (20% of the registration tax), as well as certain other fees and duties such as charges for the purchase of national housing bonds and stamp duty, must be paid prior to filing the application for registration of the mortgage.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under Korean law, if an entity (the security provider) grants security over its assets to secure the debt of another person/entity (the debtor) without adequate consideration from the debtor, this may constitute criminal and civil breach of fiduciary duty by the directors of the security provider. In other words, if the security provider's directors fail to procure adequate consideration when they approve the provision of collateral, the directors will be deemed to have caused economic harm to the security provider in breach of their fiduciary duty. In order to be deemed "adequate" in this context, the consideration must be equivalent to the risk exposure of the security provider (ie, forfeiture of its assets should the debtor default on the loans).

In addition, if the debtor is a specially related person/entity of the security provider (ie, its major shareholder), the provision of security by the security provider may be subject to certain additional restrictions or requirements under Korean law, including the following:

- approval by a resolution of its board of directors with the affirmative votes of two-thirds or more of the directors, in accordance with the Korean Commercial Code (KCC);
- if the security provider is a listed company in Korea, the provision of security to a specially related person/entity must fall under a specifically permitted exception under the KCC; and
- it may not constitute "unfair trading" under the Monopoly Regulation and Fair Trade Act of Korea (MRFTA), ie, there will be no negative effect on the market by unfairly enhancing the competitiveness of the debtor in the relevant industry by granting security to such debtor without receiving reasonable compensation.

Furthermore, there is a requirement to file a public notice of acquisition of security interest if the security provider and the debtor belong to the category of "companies subject to restriction on mutual contribution" under the MRFTA, and the value of the security to be granted exceeds a certain threshold.

3.6 Formalities When a Borrower Is in Default

The enforcement of security over real estate against a defaulting borrower may be made in accordance with the terms of the security document, and there is no other legal formality that must be complied with or legal impediment to enforcing the security if the requisite foreign exchange report was made in respect of the security document and the loan agreement. However, if a rehabilitation proceeding under Korean insolvency law is commenced in respect of a security provider, enforcement of security will generally be prohibited, and the lender will be required to report its claim and security and

will have to be repaid in accordance with the terms of the rehabilitation plan approved by the court.

Korea is a race jurisdiction, and therefore, priority of any competing lender's security interest over the real estate is determined in the order of registration of security. If the foreign lender is a secured lender, no additional step needs to be taken to secure priority over any lower-ranked security holder or unsecured lender.

It usually takes approximately six to twelve months to enforce and realise real property security, although the actual time may vary for each case.

The government has not introduced any restrictions on the enforcement of collateral in real estate lending due to the COVID-19 situation, but it has required lenders to take steps to extend the maturity of loans made to small to medium-sized enterprises and small business owners. In case of a borrower default, lenders often pursue a loan restructuring or forbearance arrangement rather than taking immediate acceleration and foreclosure action. However, lenders are not particularly reluctant to exercise their foreclosure rights if there is little indication of the borrower's financial status improving enough to pay out the loans within a reasonable timeframe.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt may become subordinated to newly created debt only if all existing lenders agree to subordinate their debt. In such cases, the existing security must also be subordinated to the new loan, and the security must be newly registered in the order of priority. Registration of security is required to have a perfected right to the security (as in the case of mortgages).

According to the Debtor Rehabilitation and Bankruptcy Act (DRBA), if a new loan is advanced to a debtor subject to rehabilitation proceedings that have already commenced, such new loan is granted a preferential right of repayment in priority to pre-rehabilitation claims and secured rehabilitation claims.

3.8 Lenders' Liability Under Environmental Laws

A lender may not be held liable for environmental liabilities caused by encumbered real estate unless it acquires the property through a foreclosure sale (or by otherwise enforcing its security). In such cases, the lender's environmental liabilities will be as described in **2.7 Soil Pollution or Environmental Contamination**. Thus, a lender holding security over real estate will not be liable under environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

Under the Civil Code, security interests knowingly created by a borrower against the proprietary interest of existing lenders may be made void by the courts upon the request of such existing lenders, if:

- the borrower is insolvent or becomes insolvent as a result of the creation of such security interests; and
- the borrower's assets decrease as a result of the same.

Additionally, granting security interests in favour of only some of the existing lenders without receiving any new financing (or new lending arrangements) may constitute fraudulent transfer.

Under the DRBA, a security interest created by a borrower in rehabilitation or bankruptcy may

be voided by the rehabilitation receiver or the bankruptcy administrator if created by a "preferential" act by the borrower that favours certain lenders over others.

3.10 Taxes on Loans

When entering into a loan agreement in Korea, a fixed stamp duty is levied based on the loan amount. For loans exceeding KRW1 billion, the applicable stamp duty is KRW350,000. This applies regardless of whether the loan is secured, mezzanine or any other type.

If a mortgage is created for a secured loan, a registration tax equivalent to 0.24% of the value of the property is levied when registering the mortgage. There is no separate stamp duty for the mortgage.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The principal laws applicable to strategic planning and zoning are NLPUA (regulating zoning and land use) and the Building Act (regulating construction and building use). For certain types of development such as the redevelopment of urban areas, other specific laws may apply, such as the Act on Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents (AMIUADCR) and the Special Act on Promotion of Urban Renovation.

In addition, at a national level, the MOLIT regulates the development and use of land by setting out a basic land-use plan. At a local level, municipal governments regulate the development and use of land by promulgating local ordinances.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The principal laws applicable to design, appearance and method of construction are NLPUA and the Building Act. In particular, the Building Act regulates the standards and usage of land, structure, and facilities of buildings, as well as safety, functionality, environment, and aesthetics of buildings, and its application is overseen by municipal governments.

4.3 Regulatory Authorities

As explained in **4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning**, at a national level, the MOLIT regulates the development and use of land by setting out a basic land use plan. At a local level, municipal governments regulate the development and use of land by promulgating local ordinances.

The NLPUA provides a basic framework for planning regarding the use, development and preservation of national land and the implementation of such plans. Under this framework, the MOLIT devises the national land plan, in accordance with which the regional plan, urban master plan and city management plan are devised by governors, mayors and other heads of local governments.

The city management plan contains a detailed zoning plan covering certain areas of the city. In addition, the city management plan and related local regulations restrict granting development permits or building permits in certain areas where development activities and/or building works could seriously pollute or damage the surrounding environment, scenery, historic buildings, cultural heritage, etc.

4.4 Obtaining Entitlements to Develop a New Project

To develop a new project or a reconstruction/redevelopment project, certain permits, approvals and licences must be obtained in accordance with the relevant laws (ie, the Urban Development Act, the Housing Act, the Building Act, the Act on the Ownership and Management of Aggregate Buildings, the AMIUADCR, etc).

The specific processes for obtaining such entitlements vary depending on the relevant law. Generally, an application for entitlements will be submitted to the relevant government authority, in accordance with the requirements and processes set forth in the relevant laws, and the relevant government authority will then grant such entitlements if the application complies with the relevant city management plan and the restrictions under the Building Act and other regulations.

Third-Party Objections

In general, a third party does not have the right to object to such developments, unless such third party's rights have been infringed by such development. Under Supreme Court precedent, rights are infringed only if there is a "legally protected interest", which means individual, direct and specific interest protected by the law underlying the applicable government decision and other relevant laws.

In addition, a third party who has suffered losses or injury (ie, noise, infringement of the right to light, ground subsidence, etc) due to the construction work for such development may seek suspension of such construction work or claim damages for losses suffered.

4.5 Right of Appeal Against an Authority's Decision

An applicant for permits, approvals or licences may appeal the authority's decision regarding the application (ie, a decision rejecting an application or a decision not fully granting permission) by bringing an administrative suit.

Furthermore, a third party whose legal rights are infringed by the decision may also appeal the decision.

However, an appeal seeking the cancellation of a decision by an administrative agency must be brought within 90 days of the appellant becoming aware of the decision or within one year of the decision, whichever is earlier.

4.6 Agreements With Local or Governmental Authorities

A government authority must consult other government authorities or agencies that will be affected by the permits/approvals being sought, before such permits/approvals are issued. That said, whether it is possible or necessary to enter into separate agreements with government entities or utility suppliers and what kinds of agreements are typical may vary depending on the specific law applicable to each development project. For an example of an agreement that may be entered into, please refer to **2.8 Permitted Uses of Real Estate under Zoning or Planning Law**.

4.7 Enforcement of Restrictions on Development and Designated Use

If a developer who has obtained permits/approvals does not carry out the development in accordance with such permits/approvals, or does not adhere to the prescribed conditions, the relevant government authority may cancel such permits/approvals.

In addition, if a developer engages in any conduct in connection with a development project without obtaining the permits/approvals required under the relevant laws or does not satisfy a prescribed condition under the relevant laws, such developer may be subject to criminal sanctions (ie, imprisonment, penalty payment) or administrative sanctions (ie, fine payment, business suspension).

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

There are two general forms of companies:

- a stock corporation (*chusik hoesa*); and
- a limited liability company (*yuhan hoesa*).

Five special forms of investment vehicles, CR-REIT, general REIT, RETF, RECF and PFV, are also available (see **5.2 Main Features of the Constitution of Each Type of Entity**).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Stock Corporation

A stock corporation has the familiar corporate structure of shareholders, a board of directors and one or more executives, and is organised under the articles of incorporation. Shareholders of a stock corporation are liable only up to an amount equal to their capital contribution, and shares may be transferred freely.

Limited Liability Company

A limited liability company is comprised of "members" instead of shareholders. As in the case of a stock corporation, the liability of members is limited to the amount of their capital contribution to the entity. However, a board of directors is not required for a limited liability company, although one may optionally be created by the members. Unlike in some other jurisdictions, in Korea there is no material difference in tax treatment between a stock corporation and a limited liability company, as both are subject to two-tier taxation from the investor's perspective (on corporate income and on dividends).

Corporate Restructuring Real Estate Investment Trust

A corporate restructuring real estate investment trust (CR-REIT) may be classified as a stock corporation; it is required to invest 70% or more of its assets in "CR-REITable" assets, as defined in the relevant regulations, and to manage its assets through an asset management company with net assets of KRW7 billion or more and with five or more professionals.

Real Estate Investment Trust

A general real estate investment trust (general REIT) may be classified as a stock corporation, and it is required to invest 70% or more of its assets in real estate and manage its assets through an asset management company with net assets of KRW7 billion or more and with five or more professionals.

Real Estate Trust Fund

A real estate trust fund (RETF) may be classified as a trust; it is required to manage its assets through an asset management company with net assets of KRW1 billion or more and with three or more professionals.

Real Estate Corporate Fund

A real estate corporate fund (RECF) may be classified as a stock corporation; it is required to manage its assets through an asset management company with net assets of KRW1 billion or more and with three or more professionals.

Project Financing Vehicle

A project financing vehicle (PFV) may be classified as a stock corporation, and it is required to manage its assets through an asset management company that is a shareholder of the PFV, or a company set up by a shareholder of the PFV.

Tax Benefits and Costs

Stock corporations and limited liability companies are required to pay a corporate registration tax of 0.48% of the par value of shares issued upon establishment and, thereafter, upon each capital increase. If a company is established in an overpopulated control area or a company increases its capital within five years of its establishment, a stepped-up capital registration tax rate of 1.44% (ie, triple the normal rate) applies. However, CR-REITs, general REITs, RECFs and PFVs are not subject to such tripling of capital registration tax nor the stepped-up acquisition tax normally applied to real property located in overpopulated control areas.

Land owned by a public REIT or a public fund for their business use is not separately taxed for property tax purposes and is not subject to comprehensive real estate tax. However, this exception does not apply to PFVs.

As to corporate income tax benefits applicable to each type of entity, please refer to **5.5 Applicable Governance Requirements**.

5.3 REITs

REITs are real estate investment vehicles that are actively used in Korea. Both private and public offerings are available, and general REITs in particular are required to offer at least 30% of their shares to the public, as described in **5.5 Applicable Governance Requirements**. Furthermore, there are 19 REITs listed on the stock market. Foreign investment is also permitted (please refer to **5.5 Applicable Governance Requirements** regarding requirements for qualification).

5.4 Minimum Capital Requirement

The minimum capital requirement for each type of entity is as follows:

- stock corporation – not applicable (KRW100 million for foreign invested companies);
- limited liability company – not applicable (KRW100 million for foreign invested companies);
- CR-REIT – KRW5 billion;
- general REIT – KRW5 billion;
- RETF – not applicable;
- RECF – KRW100 million; and
- PFV – KRW5 billion.

5.5 Applicable Governance Requirements

The ownership limitation for each type of entity is as follows:

- stock corporation – not applicable;
- limited liability company – not applicable;
- CR-REIT – not applicable;
- general REIT – up to 50% by any one shareholder (with certain exceptions);
- RETF – must be owned by more than two investors (with certain exceptions);
- RECF – must be owned by more than two investors (with certain exceptions); and
- PFV – at least 5% of the shares must be owned by financial institution(s).

There are no public offering related requirements that apply to the various types of entity except for:

- general REIT – at least 30% of the shares must be put up for public offering (with certain exceptions).

Restrictions on external financing for each type of entity are as follows:

- stock corporation – not applicable;
- limited liability company – not applicable;
- CR-REIT – permitted within double (or 10 times, under certain exceptions) the amount of its net assets;
- general REIT – permitted within double (or 10 times, under certain exceptions) the amount of its net assets;
- RETF – permitted within double the amount of its net assets (with certain exceptions);
- RECF – permitted within double the amount of its net assets (with certain exceptions); and
- PFV – not applicable.

Qualifications for assets invested in by each type of entity are as follows:

- stock corporation – not applicable;
- limited liability company – not applicable;
- CR-REIT – seller of the assets is a company subject to corporate restructuring;
- general REIT – at least 70% of the assets are invested in real estate;
- RETF – more than 50% of the assets are invested in real estate (with certain exceptions);
- RECF – more than 50% of the assets are invested in real estate (with certain exceptions); and
- PFV – investment is made in facility and SOC development, natural resource development, or other specific development projects which require large amounts of time and money.

Requirements for real estate development projects invested in by each type of entity are as follows:

- stock corporation – not applicable;
- limited liability company – not applicable;
- CR-REIT – the investment ratio is required to be set by shareholders' resolution and the business plan is required to be confirmed by a licensed real estate investment consulting service company;
- general REIT – the investment ratio is required to be set by shareholders' resolution and the business plan is required to be confirmed by a licensed real estate investment consulting service company;
- RETF – the business plan is required to be confirmed by an appraisal company;
- RECF – the business plan is required to be confirmed by an appraisal company; and
- PFV – it is required to invest all of its assets in real estate development projects.

The applicability of corporate income tax to each type of entity is as follows:

- stock corporation – taxable;
- limited liability company – taxable;
- CR-REIT – dividend declared deduction;
- general REIT – dividend declared deduction;
- RETF – not taxable;
- RECF – dividend declared deduction; and
- PFV – dividend declared deduction (applicable through the fiscal year ending on or before 31 December 2025).

The governing law of each type of entity is as follows:

- stock corporation – KCC;
- limited liability company – KCC;
- CR-REIT – Real Estate Investment Trust Act (REITA) and KCC;
- general REIT – REITA and KCC;
- RETF – Financial Investment Services and Capital Markets Act (FISCMA) and KCC;
- RECF – FISCMA and KCC; and

- PFV – Special Tax Treatment Control Act and KCC.

The implications of the Corporate Transparency Act may extend to US contributors investing offshore, including those investing directly or indirectly in Korean real estate. Their compliance obligations regarding disclosure, reporting and enhanced due diligence for anti-money laundering purposes may potentially affect their strategic decisions regarding the ownership structure, investment timeline, and deal structuring. Given that US contributors may be required to disclose the beneficial ownership of the Korean target they are investing in under the CTA, it would be important for Korean sponsors to recognise that such information concerning their identity and ownership could potentially be reported to US authorities. Korean counterparts may also need to provide their co-operation so that US contributors can provide the information required to fulfil their disclosure obligations under the Corporate Transparency Act.

5.6 Annual Entity Maintenance and Accounting Compliance

The main items in annual maintenance costs for special investment vehicles are the fees paid to the asset management companies, custodians and business trustees. As an example, for REITs, annual fees paid to asset management companies are typically within 0.2% to 0.4% of the total property purchase price, while annual fees paid to custodians and business trustees typically add up to 0.04% of the total property purchase price. Fees paid by other special investment vehicles do not vary significantly. The annual accounting compliance cost for special investment vehicles is typically around KRW10 million or lower, although this may vary slightly depending on the asset size and the accounting period.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Arrangements for the occupancy and use of real estate include a lease on real estate, an easement on land, and a superficies on land.

6.2 Types of Commercial Leases

There are two main types of commercial leases:

- a gross lease typically used for offices – a tenant is not responsible for the payment of any amounts other than rent; and
- a net lease typically used for retail stores – a tenant pays, in whole or in part, the cost of possession and maintenance with respect to the real estate, in addition to rent.

6.3 Regulation of Rents or Lease Terms Under the Civil Code

Rents and lease terms are basically freely negotiable. However, under the Civil Code, certain terms may not be contractually agreed upon to the extent that they are unfavourable to a tenant. For example, in the event that the agreed rent becomes inadequate due to an increase in taxes, public charges or other claims, the landlord is entitled by law to request an increase in future rent. However, the tenant's right to request a reduction in rent in case of a change in economic circumstances may not be waived or excluded by contractual agreement. As another example, in the event that a tenant installs a fixture in or on the leased building for its benefit with the landlord's consent, the tenant is entitled by law to request the landlord to purchase the fixture upon termination of the lease and such right of the tenant may not be waived or excluded by contractual agreement.

Under the CBLPA

Furthermore, for commercial building leases regulated under the CBLPA, the lease term may not be less than one year (unless the tenant, on its own, elects for a period of less than one year), and the tenant is entitled to request renewal of the lease for a cumulative term of up to ten years. In addition, for such leases, with respect to the right to request an increase or reduction of rent based on changes in economic circumstances, rent may not be increased within one year from the execution date of the lease or of a prior rent increase, or by the maximum limit for a rent increase as prescribed by law.

In September 2020, the CBLPA was amended, following the spread of the COVID-19 pandemic, to explicitly stipulate the outbreak of "Level 1 Infectious Disease" as an event qualifying as a change in economic circumstances based on which the tenant may request a rent reduction, although COVID-19 has since then been declared a Level 2 Infectious Disease and this provision is not currently applicable. In January 2022, where commercial tenants are going to close their business due to the impact of COVID-19, the CBLPA was amended to allow the tenant to terminate the lease contract immediately on account of a significant change in the economic situation caused by any collective restrictions or prohibitions imposed by the government for more than three months.

6.4 Typical Terms of a Lease

A lease for business premises typically includes the following terms:

- lease term may be one or two years, and may usually be extended to up to ten years by the tenant, as set out in the CBLPA;
- the tenant is usually responsible for the maintenance and repair of leased retail stores, whereas the landlord is usually responsible for the maintenance and repair of leased office buildings; and
- rent is paid monthly.

The COVID-19 pandemic did not cause any apparent change in the typical terms

6.5 Rent Variation

The amount of rent depends on the terms agreed between the parties but will usually increase for retail shop leases in accordance with an increase in the consumer price index (CPI). The CBLPA provides that if the rent or security deposit becomes insufficient due to taxes, import duties or any other increase or decrease in the burden on the leasehold building, or fluctuations in economic conditions, each party to a lease may claim an increase or decrease in the future rent or security deposit. However, the landlord may not increase the rent or security deposit by more than 5% at a time, and a rent increase is not allowed within one year of commencing the lease contract, or within one year of an agreed increase in the rent or security deposit.

6.6 Determination of New Rent

New rent will be determined by an agreement between the parties after negotiations but, as stated in **6.5 Rent Variation**, an increase in rent for certain leases will be regulated under the CBLPA, as applicable.

6.7 Payment of VAT

VAT is payable on rent, unless the leased property is:

- a rice paddy;
- a garden;
- an orchard;
- a ranch site;
- forest land;

- a salt pan; or
- housing (and attached/accompanying) land.

6.8 Costs Payable by a Tenant at the Start of a Lease

Costs payable at the start of a lease include a security deposit and a maintenance fee, the amounts of which are negotiated with the landlord.

6.9 Payment of Maintenance and Repair

Under the Civil Code, the landlord is basically responsible for maintaining and repairing areas used by tenants, but the costs for maintenance and repair incurred by the landlord may be charged to tenants in accordance with the lease contract. In such cases, the tenants must pay for the maintenance and repair in proportion to the size of their leased property.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunications charges are paid by tenants, in proportion to the size of their leased property.

6.11 Insurance Issues

A landlord purchases a package insurance policy and, in many cases, pays the premium for insurance, which includes coverage for:

- property all risk;
- machinery risk;
- landlord's business interruption;
- gas accident liability; and
- general liability.

In some double-net or triple-net leases for retail stores, the tenant pays the cost of insuring the real estate.

There are very few insurance policies that cover reduced profits from the suspension of operations, and there is no insurance policy that compensates for any damage caused by COVID-19.

6.12 Restrictions on the Use of Real Estate

There are no regulations or laws generally restricting a tenant's use of real estate, but restrictions may be imposed by the landlord, relevant clauses may be incorporated into a lease agreement, and regulations relating to specific areas may impose specific restrictions on a tenant's use of real estate. For example, the Outdoor Advertisement Control Act (OACA) stipulates that any person who intends to display advertisements or change authorised advertisements must obtain permission from, or report to, the local government depending on the type of advertisements, thereby directly restricting a tenant's use of real estate in connection with advertisements.

6.13 Tenant's Ability to Alter and Improve Real Estate

Under the Civil Code, a tenant is basically permitted to implement improvement measures that objectively increase the value of the leased real estate. However, the tenant is not allowed to alter or improve the real estate against the landlord's objection.

6.14 Specific Regulations

Special laws (as opposed to the general provisions of the Civil Code) do exist, such as:

- the HLPA, which applies to residential leases; and
- the CBLPA, which applies to commercial leases.

Parties cannot contract around clauses contained in these special laws to the detriment of

tenants (ie, lease agreements cannot contain provisions that are less favourable to tenants than as set forth in the relevant special law).

As described in **6.3 Regulation of Rents or Lease Terms**, legislative amendments were made to the CBLPA in 2020 to mitigate the impact of the COVID-19 pandemic.

6.15 Effect of the Tenant's Insolvency

A lease term that stipulates the tenant's insolvency as a cause of termination is invalid because it is inconsistent with the DRBA, which provides that the insolvent company has the right to elect either to terminate or keep the contract effective.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

In most cases, a security deposit in cash is provided as security to a landlord to protect against a failure by the tenant to meet its obligations under a lease. A letter of guarantee issued by a financial institution may replace the security deposit in cash in rare cases.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant has the right to continue to occupy the leased real estate until the security deposit is returned by the landlord, even after the expiration of the lease. Therefore, the landlord needs to be prepared to return the security deposit to the tenant on the date originally agreed.

6.18 Right to Assign a Leasehold Interest

Tenants and sub-tenants may assign their leasehold interest with the consent of the landlord; however, it is extremely rare in practice for such consent to be granted by the lessors.

6.19 Right to Terminate a Lease

A common reason for a landlord to terminate a lease is a tenant's failure to make timely rent payments, or the tenant's alteration of the real estate without approval from the landlord. On the other hand, a common reason for a tenant to terminate a lease is the landlord's transfer of the real estate to a third party. In such cases, the landlord may negotiate with the tenant to insert a clause in the lease agreement permitting the landlord to freely transfer the real estate as long as the transferee (ie, the third party) agrees to accept all the terms and conditions of the lease agreement.

6.20 Registration Requirements

There are no registration requirements or particular execution formalities for leases. However, in order for the tenants to protect their leasehold interest from third parties, tenants are advised to record their leasehold interest in the registry (in practice, and in many cases, leases are recorded in the real estate registry). In addition, the tenant must pay a recording tax of 0.24% (inclusive of surtax) of the monthly rent payable to the landlord and a recording fee of KRW15,000 for the real property.

6.21 Forced Eviction

A tenant may be forced to leave if they are late paying rent, but the CBLPA stipulates that the tenant cannot be forced to leave until the delayed rent payments amount to, or exceed, triple the periodic rent payments (eg, three months' rent in the case of monthly payments).

If the tenant refuses to surrender the real estate voluntarily, the landlord may file an eviction lawsuit against the tenant. It usually takes about six to ten months for a district court to render a judgment, which may then be appealed to a higher court. In order for the landlord to avoid

such a long adjudication procedure, at the time the lease contract is made, they may opt for a pre-trial settlement procedure. With respect to the enforcement of the court judgment or the pre-trial settlement protocol, the eviction is executed by a court-appointed enforcement officer, and it usually takes two to three weeks from the landlord's filing of a petition for the commencement to the completion of the eviction process.

6.22 Termination by a Third Party

A lease may be terminated in accordance with the relevant law, including the AELPWC, and the tenant's leasehold interest may be extinguished upon expropriation of the leased premises (whether land or building) by the government. Specifically, a lease is automatically terminated at the time the expropriation process is commenced, in which case the landlord must return the lease deposit to the tenant. The landlord is not obliged to pay separate damages for termination due to expropriation. However, under the relevant law, the expropriating entity must pay the following as compensation to the tenant of an expropriated building:

- if a residential lease – two months' cost of living for relocation, relocation settlement cost (between KRW6 million and KRW12 million) and the cost of moving; or
- if a commercial lease – loss of profits for the interruption of business for up to four months (calculated by aggregating profits from operations, decrease in profits from operations, depreciation, maintenance costs, labour costs, etc).

6.23 Remedies/Damages for Breach

If a lease is terminated due to reasons attributable to the tenant, the landlord, in principle, is entitled to claim liquidated damages under the lease (eg, an amount equivalent to the remaining rent). However, if the lease agreement is silent as to liquidated damages, the landlord may only claim damages equivalent to the rent covering the period between the date of termination and the date on which the landlord was able to secure a new tenant. The majority of case law has rarely allowed this period to be longer than six months. Please refer to **6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations** regarding security deposits.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Since there are no statutory or other legal procedures for paying contractors, the payment structures for construction projects are typically set out in contractual agreements. The most common payment method for construction contracts is the fixed fee method, while the cost of the work method (or cost plus fee) is rarely used. However, in public construction contracts, unlike private construction contracts, escalation clauses are generally allowed.

In fixed-fee contracts, contractors bear the risks relating to, among others:

- delays due to local civil petitions against the construction;
- cost increases (including labour and material costs);
- procurement of construction equipment; and
- personal injury caused by on-site accidents.

7.2 Assigning Responsibility for the Design and Construction of a Project

For small to medium-sized projects, build-only contracts are common in both public and private construction projects. In such contracts, the

owner is responsible for appointing an architect to carry out the design, and the contractor is responsible for the construction only.

For large-scale public construction projects, design-build contracts have become more frequently used of late. In such contracts, the contractor is responsible for the design (in whole or in part) as well as the construction of the project.

7.3 Management of Construction Risk

Commonly used contractual devices for managing construction risks are as follows.

Retention/Retainage/Holdback Provisions

Although these provisions are enforceable in principle, a contract that has been prepared by one party for execution with multiple counterparties will be treated as a standardised contract, and any retention provision in a standardised contract that is unjustifiably unfavourable to the other party may be unenforceable.

Indemnity Provisions, including Liquidated Damages and Penalty Provisions

Although these provisions are enforceable in principle, a court may reduce the amount of liquidated damages at its discretion if it finds the amount to be excessive (ie, in circumstances involving concurrent delay), and a penalty provision may be unenforceable if the amount is found to be excessive.

Contract Provisions Regarding Damages for Delay

Delay damages are generally calculated by multiplying the contract price by the rate of delay, and the amount is payable unless the delay was due to force majeure, or it was the owner/employer's fault. Although delay damages are enforceable in principle, they are treated as liquidated damages by Korean courts, and if a court finds the amount of delay damages to be excessive, it may exercise its discretion to reduce the amount. Please see **7.4 Management of Schedule-Related Risk**.

Consequential Damages Provisions

Consequential damages are only recognised if they are expected or reasonably foreseeable by the party liable for such damages. Therefore, in order for consequential damages to be recoverable, they should be expressly contemplated in the contract to the extent possible. A contractual agreement to exclude consequential damages or compensation for loss of profit is enforceable in principle.

7.4 Management of Schedule-Related Risk

Schedule-related risk on construction projects may be managed by including provisions regarding damages for delay in the construction contract. Parties are allowed to agree that an owner is entitled to monetary compensation for delays in achieving certain milestones and completion dates. However, if a court finds the amount of delay damages to be excessive, it may exercise its discretion to reduce the amount. The typical percentage for delay damages is 0.1% of the contract price per day of delay.

Furthermore, parties may include a provision allowing the owner to terminate the contract if there is a material delay in the construction.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Owners often seek additional forms of security to guarantee the performance of contractors under construction contracts, such as:

- bid bonds, whereby a bidder is obliged to pay the deposit money when participating in a bid

and, if the bid is successful, to execute the construction contract (a general requirement for public procurement);
- performance guarantees/bonds, which secure the performance of a contractor's obligation under the contract;
- warranties, which oblige a contractor to remedy defects that occur after completion of construction; and
- advance payment guarantees, which secure the contractor's obligation to return the advance payment under the construction contract.

7.6 Liens or Encumbrances in the Event of Non-payment

In the event of non-payment, a contractor may exercise lien rights and refuse to hand over the project until the contract price is paid, provided that an incomplete building that is not deemed an independent building is classified as an improvement on the land, and thus may not be subject to a lien. Therefore, the subject property must be objectively considered to be an independent building in order for a lien to be exercised. According to relevant court precedents, an incomplete building will be considered an independent building if it has more than a minimum number of pillars, a roof and main walls.

Civil and Commercial Liens

There are two types of liens available, and a contractor may selectively assert a lien under the Civil Code (a civil lien) or under the KCC (a commercial lien).

Civil liens

For a civil lien, a contractor must be in possession (including indirect possession) of the subject property, and the claims for the contract price must be correlated to the property in possession (meaning that the property in possession must be the property in relation to which the claim for the contract price has arisen). The subject property is not required to be owned by the debtor.

Commercial liens

For a commercial lien, this correlation is not required, but the subject property must be owned by the debtor (ie, the project owner), and the contractor must be in possession of the subject property as a result of the relevant commercial transaction.

In addition, a contractor may demand that the owner establish a mortgage on the subject real property to secure the contract price.

Similarly, a designer may assert a commercial lien or demand that the owner establish a mortgage on the subject real property, but the civil lien would not be available as the designer's claim for the contract price would not be correlated to the property in possession. To assert a commercial lien, the designer must be in possession of the subject property as a result of a commercial transaction.

Lien Waivers

The right to a lien and the right to a mortgage may both be waived by agreement of the parties. Since the parties may execute lien waivers at any time by mutual agreement, a comprehensive lien waiver is often executed in advance for convenience. If a comprehensive lien waiver is executed, a monthly/periodic lien waiver is not required.

While there is no statutorily prescribed form for a lien waiver, the waiver will typically contain the location and other details of the subject property, and an expression of intent to waive a lien.

7.7 Requirements Before Use or Inhabitation

Under the relevant laws, a use permit must be obtained before a completed project may be inhabited or used for its intended purpose. A use permit (or temporary use permit) may be obtained from the competent authority after the completion of construction.

8. Tax

8.1 VAT and Sales Tax

For the transfer of a building, a VAT is levied at the rate of 10% of the transfer price, and the transferor must collect the amount of VAT from the transferee. However, no VAT is imposed on a transfer of land, which is exempt from taxation. In the case of a comprehensive transfer of a business, including all rights and obligations therein, no VAT is imposed even if the transferred assets include a building.

8.2 Mitigation of Tax Liability

If an investment vehicle such as a REIT or a PFV distributes 90% or more of its distributable income as dividends, the disbursed dividend amount may be deducted from the income calculated for the relevant business year. For PFVs, this tax benefit is applicable through the fiscal year ending on or before 31 December 2025. An REF is a pass-through entity and thus not a taxable entity and is also exempt from the tripling of the acquisition tax or the corporate registration tax in an overpopulated control area such as the Seoul Metropolitan City.

8.3 Municipal Taxes

If a corporate entity occupies premises where it continuously conducts business, with its employees working there and its facilities installed at the location, the business owner registered in the tax ledger must pay the property tax portion of the resident tax, in the amount of KRW250 per square metre of gross floor area of the business premises. If the business owner is not the owner of the building where the business premises are located, then the owner of the building may become secondarily liable for unpaid tax. However, any business premises with an area under 330 square metres is tax exempt.

In addition, the corporate entity must pay a per capita resident tax at the rate of 0.5% of the aggregate monthly salaries paid to employees, to the municipal government of the location of the business premises. The per capita resident tax may be increased or decreased by up to 50% in accordance with the rules set by the municipal government.

8.4 Income Tax Withholding for Foreign Investors

Regarding a foreign corporate entity's income generated from Korean domestic sources, depending on the category of income, either the person/entity providing the income must withhold and pay income tax to the government, or the foreign corporate entity itself must report and pay the income tax. Rental income from real estate constitutes income generated from domestic sources, and a foreign corporate entity itself must report and pay the income tax. The applicable tax rate is 9.9% to 26.4% of the income, depending on the amount of taxable income. On the other hand, a foreign corporate entity's income from the transfer of real estate constitutes income from domestic sources, and the person/entity providing the income must withhold as income tax the lower of either 11% of the amount paid to the foreign corporate entity for the transfer, or 22% of the capital gain from the transfer, and report and pay the same to the government.

The foreign corporate entity receiving income from the transfer of real estate must also complete an income tax filing, but the amount withheld as income tax by the transferee is creditable. The applicable tax rate is the same as it is for real estate rental income (9.9% to 26.4%). There are no special exemptions for real estate transfer taxes, and tax treaties joined by Korea generally prescribe that real estate rental income and real estate transfer income are taxable in Korea, the location of the income source.

8.5 Tax Benefits

A domestic corporate entity owning real estate (as opposed to leasing real estate) may recognise depreciation of the building as an economic loss of such corporate entity, within the limits prescribed in the Corporate Tax Act. There appear to be no other tax benefits that can be gained from owning real estate.

SPAIN



Law and Practice

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Cases & Lacambra

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CASES & LACAMBRA

1. General

1.1 Main Sources of Law

The main sources of real estate law in Spain include:

- the Spanish Civil Code or equivalent regional legislation (*legislación foral*);
- Act 49/1960, of 21 July, on Horizontal Division (special condominium regime applicable to buildings);
- Act 29/1994, of 24 November, on Urban Leases;
- Decree of 8 February 1946, on the Mortgage Act;
- Decree of 14 February 1947, on Mortgage Regulation;
- Royal Legislative Decree 7/2015, of 30 October, on the Land Act;
- Act 38/1999, of 5 November, on Building Development (LOE); and
- Act 12/2023, of 24 May, on the Right to Housing.

The autonomous regions have competencies in territorial and urban planning, as well as housing. Zoning, however, falls under the jurisdiction of the municipalities.

1.2 Main Market Trends and Deals

For the real estate market, after a 2022 marked by strong growth in residential property prices, 2023 has seen a slowdown in activity, with a decline in the number of transactions and an increase in prices overall. In addition, the real estate market has grown strongly on the back of development in the hospitality and logistics sectors, as a complement to residential assets.

Some of the most relevant transactions executed during 2023 were:

- the sale and purchase of a 17-hotel portfolio owned by Equity Inmuebles, SL to the Abu Dhabi Investment Authority – EUR600 million;
- the sale and purchase of a 70-building portfolio owned by WP Carey to the Junta de Andalucia – EUR328 million; and
- the sale and purchase of the hotels and club branded as "Pacha" in Ibiza owned by Trilantic Capital Partners to Five Holdings – EUR320 million.

The economic repercussions of the conflict in Ukraine, such as increased interest rates, inflation, rising construction and energy costs, etc, have prompted significant regulatory activity in Spain's real estate market throughout 2023, particularly regarding residential rental properties. Of particular note in this regard are:

- the restriction on annual rent adjustments for residential rental contracts, which remained in effect throughout 2023 as per the provisions of Royal Decree-Law 6/2022, dated 29 March; and
- Act 12/2023, which passed on 24 May, concerning the right to housing, and which introduces several interventionist measures in the rental market aimed at curbing residential rent in Spain.

Several additional trends have been observed in the Spanish real estate market:

- *Property repurposing* – in response to changing market demands, underutilised commercial office spaces has been repurposed into residential properties, mixed-use developments or co-living spaces, reflecting evolving lifestyle preferences and work dynamics.
- *Financial diversification* – the real estate market has expanded beyond traditional bank financing to explore a range of alternative

funding sources including debt funds and crowdfunding platforms.
- *Sustainability and ESG focus* – developers and investors are increasingly integrating energy-efficient features, green building certifications and sustainable design practices into their projects to meet evolving market demand and regulatory requirements.
- *Digital transformation* – the adoption of digital tools and platforms in the real estate sector has accelerated, especially in areas such as virtual property viewings, online transactions, and property management.

1.3 Proposals for Reform

Among all the measures and concepts outlined in Act 12/2023, dated 24 May, regarding the right to housing, perhaps the most significant is the provision allowing autonomous regions to declare areas with a stressed housing market. The above-mentioned declaration involves the implementation of rent limitation in said areas.

However, as of the issuance of this document, only the region of Catalonia has declared a stressed residential market area. There are rumours in the press suggesting that Navarre, Asturias, and the Basque Country may also be considering such measures.

2. Sale and Purchase

2.1 Categories of Property Rights

The main property right in Spain is absolute property or full ownership, the civil law equivalent of the common law concept of "freehold". Absolute property grants the entire right to enjoy, use, encumber and dispose of an asset without limitations other than those set forth in the applicable regulations, such as planning and zoning limitations, the rights of neighbouring owners, and other general considerations such as aviation easements.

Spanish legislation also stipulates other property rights such as:

- co-ownership (*condominio*), which refers to the ownership of a thing or right belonging pro indiviso to several owners; and
- bare ownership (*nuda propiedad*), which is the right of a person (called the "bare owner") to own a property with the limitation of not being able to enjoy or benefit from it, and where the "usufruct" is the right of enjoyment, use, and benefit of a person (called the "usufructuary") over a property owned by a bare owner.

2.2 Laws Applicable to Transfer of Title

The Spanish Civil Code contains the general applicable regulations for the transfer of private properties. Concerning public properties, Section 1.1 of Act 33/2003, dated 3 November, on Public Administration Holdings, applies.

Additionally, depending on the intended use of the property, the type of transmission, and its location, additional administrative regulations and authorisations may apply. These may include sector-specific legislation and regulations applicable to foreign investors.

2.3 Effecting Lawful and Proper Transfer of Title

In Spain, to acquire ownership of real estate, it is necessary to have a valid acquisition title ("title") and the physical delivery or legal transfer of the property ("mode"). In other words, having a document that demonstrates the intention to acquire the property (the title) is not sufficient; it is also necessary to carry out a material or legal act that effectuates the transfer of ownership (the mode).

The title can be a sale and purchase agreement, a donation, or an inheritance, among other legal documents that establish the right of acquisition over property.

Regarding registration in the Land Registry, it is not compulsory (except for certain rights such as mortgages or surface rights), but it is common practice and highly recommended to register the granting of a public deed. Such registration grants public protection to any good-faith third-party purchaser who acquires their title from a registered owner.

The system is so effective and secure that recourse to title insurance is often not required and only necessary in certain circumstances. Evidence of the effectiveness of the system is the fact that it has remained unchanged since the COVID-19 pandemic.

2.4 Real Estate Due Diligence

The prospective investor often conducts a due diligence review to check legal, technical, environmental and other matters affecting the targeted real estate. Such review usually includes issues such as:

- title of ownership of the asset;
- charges and encumbrances;
- cadastre information;
- leases and occupancy status;
- co-ownership rules;
- urban planning status and licences;
- payment of property taxes; and
- third-party rights (including those of public administrations).

2.5 Typical Representations and Warranties

The Spanish Civil Code automatically provides legal warranties against any dispossession regime ("eviction") and a warranty against hidden defects in the sold asset.

An alternative or complementary regime of representations and warranties ("R&W") may be agreed upon by the parties. Some examples of the most common seller's R&W include:

- the seller's capacity to execute the transaction;
- the asset is free of charges, encumbrances, tenants, and occupants, up to date with tax payments, expenses, and free from any litigation or administrative procedures;
- compliance with current regulations; and
- confirmation that there are no third-party rights such as preferential acquisition or right of first refusal.

Sellers often seek to limit their liability arising from the R&W regime, which is initially unlimited, by methods such as:

- establishing a threshold for compensation;
- limitation periods (12–24 months, except for tax and urban planning representations); and/or
- liability caps.

Buyers' remedies against the seller for misrepresentation include contract resolution, return of any reciprocal benefits, compensation for damages to the buyer, or mandatory execution of the agreement.

Furthermore, it should be noted that some of the most common R&W are also mandatory content in sales contracts, such as those related to environmental status, the existence of rights of first refusal and the existence of urban charges.

2.6 Important Areas of Law for Investors

The most important areas of law for an investor to consider when purchasing real estate are:

- real estate contractual law – civil law, property rights, charges and encumbrances that may affect the asset;
- urban planning and administrative – public law:
  (a) the regulations pertaining to planning and zoning which may affect the asset; and
  (b) the granted licences;
- corporate law – structuring the investment; and
- taxation – the direct and indirect tax structure implications of real estate transactions.

2.7 Soil Pollution or Environmental Contamination

R&W regarding environmental matters are not common practice, but some regulations request them under certain parameters or on certain occasions. In Spain, starting from 10 April 2022, it is mandatory to include an explicit statement in the deed formalising the acquisition regarding whether any activity that may have contaminated the soil has been carried out on the property. This statement will be subject to a marginal note in the Land Registry, for the purpose of providing corresponding registry publicity.

Regarding liability, the "polluter pays" principle applies in Spain. This means that the person who caused the pollution is liable and shall assume the expenses involved in compensation and will bear the costs of remediation.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

General municipal urban development plans (PGOU) contain the uses permitted for a plot, sector, and zones.

Urban agreements with the relevant public authorities are common in Spain to facilitate a project, eg, the execution of public interest or local sectorial plans. In addition, it is possible to subscribe to an urban agreement (*convenio urbanístico*) between the town hall and a developer, see **4.6 Agreements with Local or Governmental Authorities**.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation is permitted under Spanish Law if the expropriation is justified by public interest and under the payment of compensation or "fair price" to the title holders affected.

The procedure first requires the prior declaration of "public utility" of the project and requires the occupation of the property or the acquisition of the affected economic rights.

In order to carry out the expropriation, the expropriator must submit a file, which must be duly published.

2.10 Taxes Applicable to a Transaction

Taxation on real estate transactions depends on the envisaged deal scheme (ie, asset or share deal), the type of real estate asset to be transferred (rustic or urban land), and constructions, as well as the condition of the parties intervening in the transaction, eg, an entrepreneur acting as such or a consumer.

Asset Deal

VAT and property transfer tax

The condition of the seller determines whether an asset deal shall be subject to VAT or property transfer tax.

If the seller does not qualify as an entrepreneur or as a professional for VAT purposes, the real

estate transfer will be subject to property transfer tax ("transfer tax") borne by the purchaser. Applicable tax rates vary depending on the autonomous region where the asset is located (tax rates range from 6% to 11% on the "value of reference").

If the seller qualifies as an entrepreneur or professional for VAT purposes, the real estate transfer will be subject to VAT, which shall be charged by the seller and borne by the purchaser. The applicable VAT rate shall generally be 21% (10% in the case of transfers of dwellings).

However, the transfer of real estate subject to VAT could benefit from a VAT exemption if certain requirements are met. Nevertheless, should the transfer be exempt from VAT, it shall be subject to transfer tax.

Tax on the increase of the value of the urban land

Where an asset deal concerning urban land is carried out, it is generally subject to tax on the increased value of the urban land (TIVUL).

However, the transfer would not be subject to tax on the increased value of the urban land if the seller does not derive profit from the transfer of the relevant real estate.

Stamp duty (actos jurídicos documentados)

A transfer of a real estate asset that is subject to VAT shall also be subject to stamp duty, which shall be borne by the purchaser. The applicable tax rate would depend on the autonomous region within Spain where the real estate asset is located and range from 0.75% to 1.5% on the value consigned in the notarial deed by means of which the real estate asset is being transferred. Also, in the case of a waiver of the VAT exemption, an increased tax rate for stamp duty (up to 2.5%) shall apply.

Share Deal

Should the transfer of real estate be carried out by means of a share deal, the transaction would not be subject to VAT, transfer tax or TIVUL.

However, Section 314 of the Spanish Securities Market Act set forth an anti-abuse rule to prevent circumvention of the taxation that would correspond to a regular direct transfer of real estate should the latter be directly transferred. In this context, this specific anti-abuse rule shall apply in those cases where:

- the acquirer obtains the control over an entity in which at least 50% of its assets are comprised of real estate assets located in Spain not used for business or professional activities;
- the acquirer obtains control over an entity in which some assets are shares in other entities whose asset is, in turn, comprised of at least 50% of real estate assets located in Spain not used for business or professional activities; or
- the shares transferred have been previously received in consideration for in-kind contributions materialised by means of a contribution of real estate assets within a three-year clawback period.

2.11 Legal Restrictions on Foreign Investors

In Spain, the system for foreign investment and exchange controls has been totally liberalised, in line with EU legislation.

In this regard, only foreign direct investments to be made in critical sectors or in places considered as defence zones of national interest, or carried out by specific categories of investors,

shall be subject to prior authorisation by the competent public authority.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are generally financed by loans (bilateral or syndicated) granted by local Spanish banks.

The structure of the financing and security package granted (see **3.2 Typical Security Created by Commercial Investors**) depends mainly on the specific characteristics of the transaction and the borrower profile.

When the commercial real estate asset that is being financed requires construction work (either for its development or refurbishment), lenders usually structure the financing in two different tranches: one in the form of a loan facility for the partial financing of the purchase price and the other, in the form of a credit facility, to fund the construction works.

Banks in Spain also offer financing for the acquisition of commercial real estate assets in the form of real estate leases. Under the leasing, the use of the real estate asset is transferred by the lessor to the lessee in exchange for the payment of instalments that can be constant, increasing or decreasing. Renovation costs can also be financed.

When the leasing ends, the lessee has the option to acquire the property. This form of financing also offers certain tax advantages.

Structures may be adjusted but not differ materially when the transaction being financed is the acquisition of large portfolios of commercial real estate assets.

3.2 Typical Security Created by Commercial Investors

The most common security package to secure repayment of the financing granted for the acquisition and/or development of commercial real estate would typically comprise:

- a mortgage on the real estate asset;
- a pledge over the shares of the company holding the real estate asset (the "borrower");
- a pledge on the borrower's bank accounts;
- a pledge granted on the credit rights arising from any income producing agreement entered by the borrower and related to the specific real estate asset (such as insurance policies, construction agreements and/or lease agreements).

Each type of security has, under Spanish law, its own formalities to be effective against third parties, and therefore, it is advisable to confirm on a case-by-case basis that the security is validly created and perfected.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate assets to foreign lenders, provided that the mortgagor is not considered a consumer.

Nevertheless, it is necessary to highlight that the lender must confirm the potential enforceability of the mortgage granted in a default scenario and ensure that the charge is properly granted and registered at the relevant land registry.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

A security:

- is granted in a public deed;
- has valuable content; and
- may be registered in a public registry, the formalisation of that security shall trigger stamp duty.

The tax rate would vary depending on the region where the public deed is executed but will range from 0.5% to 3%.

No stamp duty shall be levied should the security not be granted on a public deed (ie, only in the granting of mortgages may stamp duty not be avoided).

3.5 Legal Requirements Before an Entity Can Give Valid Security

Spanish corporate law prohibits Spanish companies from providing financial assistance in the form of financing, advancing funds, granting security or guarantees, or assisting in any manner that contributes to the purchase of their own shares or of their parent company (public limited liability companies) or any of the group companies (private limited liability companies).

Infringement of this legal prohibition would render any such financial assistance null and void.

With respect to the corporate benefit rules, under Spanish corporate law, the directors of a company must exercise their powers in the interests of the company and its shareholders, acting diligently in the management of the company and faithfully and with loyalty to the company.

Accordingly, when the borrower is a Spanish company, it is necessary to confirm that the relevant corporate resolutions have been adopted to incur in the financing and to grant the relevant security.

3.6 Formalities When a Borrower Is in Default

Before starting a judicial or extra-judicial foreclosure proceeding, the lender must formally notify the concurrence of an event of default and the termination of the loan to the borrower. The notification must state:

- that a breach of the terms of the loan has occurred, detail the specific breach and that, consequently, the loan is terminated early according to the relevant clause of the loan agreement; and
- the total amount due because of the early termination of the loan.

Spanish courts have traditionally been reluctant to uphold loan acceleration and subsequent enforcement of security if the default is not deemed material.

Please note that Spanish law expressly prohibits what is known as *pacto comisorio*, which comprises any agreement by virtue of which the lender would be entitled automatically to acquire the mortgage property in case of default by the borrower.

3.7 Subordinating Existing Debt to Newly Created Debt

The subordination of existing debt to a newly created one is possible under Spanish law by an agreement between the different creditors and the borrower which establishes an order of preference of the debt (ie, senior, mezzanine, junior).

The subordination implies that certain debts are subject to prior repayment of other debts.

Spanish legislation stipulates the order of preference of certain kinds of credits and establishes those which have special privileges (ie, properties secured by a mortgage).

3.8 Lenders' Liability Under Environmental Laws

A lender may not be liable for the borrower's breach of the environmental regulations unless it acquires the property where the environmental infringement has been committed due to the enforcement of the security. In such a scenario, the lender could be deemed liable for the environmental damage.

3.9 Effects of a Borrower Becoming Insolvent

In principle, the validity of security interests created by the borrower shall not be affected by the declaration of insolvency of the borrower.

Nevertheless, Royal Legislative-Decree 1/2020, of 5 May, approving the Restated Insolvency Act provides that the special privilege of secured creditors shall be restricted to the fair value of the property or right over which the security has been created, subject to certain deductions, understood in this case as the value resulting from a valuation report issued by an approved appraisal company registered in the Bank of Spain's Special Register.

If the borrower becomes insolvent, certain effects related to security interests are created. Secured claims on assets or rights that are used in the insolvent debtor's business or required to continue the running of the business may not be initiated or continued until the earlier of:

- the date a settlement agreement becomes effective, which does not prevent the right of separate enforcement over those assets or rights; and
- a year from the date of the declaration of bankruptcy without the liquidation phase being opened.

3.10 Taxes on Loans

The constitution of a mortgage loan involves a series of necessary expenses, among which are:

- fees for the Property Registry, derived from the Inscription in the Registry of the mortgage – these will be determined according to the price of the property and the amount of the mortgage; and
- stamp duty.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Regional governments hold the territorial and urban planning competence, whilst the Spanish central government has the competence to set out the basic and general rules and liaise with the regional planning regulation through its sectorial competences (such as ports, roads, coastline and coasts, water planning and energy networks).

Town halls are competent in drafting and approving the general municipal urban development plans (PGOU) and other planning and development instruments, as well as in granting the building licences and permits.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Act on Building Development (*Ley de Ordenación de la Edificación*), which regulates the building process, sets out the rights and obligations of the intervening parties in the building procedure, including liabilities and cover for purchasers.

Requirements are further developed by the Technical Building Code, which stipulates basic safety and habitability requirements.

Depending on the scope of the works, construction licences may be required, together with technical documentation. The authorities, in general, are regulating to simplify the urban planning process, including the substitution of the occupancy licence for a responsible statement (*declaración responsable*) made by the constructor, declaring the validity and compliance of the executed work with the building licence granted.

4.3 Regulatory Authorities

As previously stated in **4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning**, different authorities are involved when it comes to regulating the development, design and use of a plot, such as the local authorities, regional government and the State.

Competent local authorities are responsible for the drafting and approval of a general urban development plan (*plan general urbanístico*) that determines the land classification (urban land, developable land and no developable land). In urban land, the general urban development plan also determines the uses of each plot of land.

Finally, state and regional regulations must be considered for certain actions, such as areas of special protection and coastal and public domain areas or military territory.

4.4 Obtaining Entitlements to Develop a New Project

As stated in **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction**, a building licence by the town hall must be granted to develop a new project or complete a major refurbishment.

The procedure for a building licence approval is divided, in general terms, into the following stages.

- Phase 1 – Submission of the building licence request with some technical documents, among others, the basic project (*proyecto básico*), the project's history and plans, together with a tax fee.
- Phase 2 – Review: the town hall shall review the documents submitted and draft the applicable technical, legal and sectorial reports regarding the compliance of the project with the applicable regulation.
- Phase 3 – Granting of the licence: the granting may be subject to the fulfilment of certain conditions (ie, technical amendments that the town hall may consider).

In some regions, the functions of the town hall are partially replaced by a private urban planning entity.

4.5 Right of Appeal Against an Authority's Decision

Any citizen can appeal to declare null and void, or claim amendments to, any administrative decision or act related to urban planning law,

if these decisions or acts infringe the law. The decision may be reviewed by a judicial court.

Such a claim does not require proof of a subjective right or legitimate interest.

4.6 Agreements With Local or Governmental Authorities

It is possible to enter into an agreement – named "urban planning agreements" – with local or governmental authorities, agencies, or utility suppliers to facilitate the development of a project. These agreements are subject to the principles of legality, transparency and publicity.

Depending on the scope of the urban activity affected, they may be classified into two main groups:

- planning agreements, the main objective of which is urban planning modification; and
- management agreements, which seek to speed up the management and execution of planning.

Expropriation agreements may be reached during an urban expropriation process with the payment of a "fair price" or compensation.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and designated use are enforced "ex ante" and "ex post".

Ex ante controls are applied by granting licences through a regulated procedure, as stated in **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction** and **4.4 Obtaining Entitlements to Develop a New Project**.

Ex post mechanisms are applied through the exercise of the sanctioning power of the administration and the granting of additional measures aimed at stopping any administrative infraction, including the suspension of construction works and demolition.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Several alternatives are available to hold real estate assets in Spain. The typical vehicles to hold real estate assets are the following.

- A limited liability company (*Sociedad de Responsabilidad Limitada*) or a public limited company or Spanish corporation (*Sociedad Anónima*).
- Regulated investment vehicles, such as:
  - (a) a variable capital investment company (SICAV);
  - (b) the SOCIMIs (further explained in **5.3. REITs**); and
  - (c) the real estate investment company (*Sociedad de Inversión Inmobiliaria*) known as a non-financial collective investment institution, necessarily a public limited company which invests mainly in urban real estate for rental purposes, or the real estate investment fund (*Fondo de Inversión Inmobiliaria* or FII) known as a non-financial collective investment institution, without legal personality, which invests mainly in urban real estate for rental purposes.

The regulated investment vehicles are subject to a special legal regime, with obligations deriving from their regulation. Moreover, regulated collective investment vehicles are more restricted

due to incorporation costs and prior registration requirements to be fulfilled before the National Securities Market Commission (CNMV).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The main features of the constitution of an entity are the following.

Limited Liability Company (SL)

An SL company may be incorporated by a sole or several shareholders.

Capital is divided into shares (*participaciones*) according to the capital contributed by each shareholder, who benefits from the limitation on personal liability from the company's debts. They are not marketable securities. An SL is incorporated by public deed and registered with the Commercial Registry.

Spanish Corporation or Public Limited Company (SA)

An SA may be incorporated by a sole or several shareholders. Capital is divided into shares (*acciones*) according to the capital contributed by each shareholder, who benefits from the limitation on personal liability from the company's debts. The incorporation process is like an SL, with some specifications.

An SA has an open structure that allows the transmission and traffic of shares as negotiable securities.

It is common practice to sign a shareholders' agreement to regulate matters not strictly related to the governance and ownership of the company, such as:

- mechanisms and restrictions to the transfer of shares;
- voting criteria;
- the resolution of deadlocks;
- financing requirements and capital calls;
- business plans and strategies; and
- control of management and shareholders meetings, etc.

5.3 REITs

The Act 11/2009, of 26 October, which regulates Listed Real Estate Investment Companies (SOCIMIs) introduced the figure of the REIT (real estate investment trust) into the Spanish legal system. The purpose of the SOCIMI is to invest, directly or indirectly, in urban real estate assets for rental, including housing, commercial premises, residences, hotels, garages and offices, among others.

Formally, SOCIMIs must adopt the form of a Spanish corporation and must be listed on a regulated market or in a multilateral trading system in Spain or in any other country with which there is an effective exchange of tax information on an uninterrupted basis throughout the tax period. This also subjects SOCIMIs to the supervision, information, and transparency regime of the CNMV.

Therefore, investment by non-residents through SOCIMIs is only subject to the requirements they must comply with to acquire shares of Spanish corporations.

Among the advantages of investment through SOCIMIs, the following should be noted:

- a special corporate income tax regime applies (0% rate if the SOCIMI complies with the requirement of permanence of its assets);
- special tax regime for shareholders; and
- others (including capital increases being exempt from stamp duty).

5.4 Minimum Capital Requirement

The minimum capital required to incorporate an entity in Spain is as follows:

- for an SL – EUR1 fully subscribed and paid up upon incorporation;
- for an SA – EUR60,000, necessarily fully subscribed and at least 25% paid up upon incorporation;
- for a SOCIMI – EUR5 million, necessarily fully subscribed and paid up;
- for a FII – EUR9 million, necessarily fully subscribed and paid up with a minimum number of 100 stakeholders, and if a real estate investment fund is incorporated by compartments, each shall have a minimum share capital of EUR2.4 million, and the aggregate of all compartments shall not be less than EUR9 million; and
- for an SII – EUR9 million: if a real estate investment fund is incorporated by compartments, each of them shall have a minimum share capital of EUR2.4 million, and the aggregate of all compartments shall not be less than EUR9 million.

5.5 Applicable Governance Requirements

The applicable Spanish regulation is the Royal Legislative Decree 1/2010, of March 1st (the "Act on Corporations" – *Ley de Sociedades de Capital*), for which governance requirements are flexible and allow their setting up and organisation mainly on a shareholder's consensus basis.

- Shareholders' meetings – for an SL, different majorities (and quorums if an SA) are established depending on the content of the resolutions.
- These majorities/quorums may be increased in the by-laws.
- The management body, which must be appointed by the shareholders' meeting, may adopt different forms:
  (a) a sole director;
  (b) two or more directors who act jointly;
  (c) several directors acting joint and severally; or
  (d) a board of directors with a minimum of three members.
- Directors must act diligently and with loyalty to the interests of the company.
- Transfer of shares:
  (a) an SL must be recorded in a public document, and is generally not freely transferable (unless acquired by other shareholders, ascendants, descendants, or companies within the same group) – in fact, the law establishes a pre-emptive acquisition right in favour of the other shareholders or the company; and
  (b) for an SA, the transfer depends on how they are represented (share certificates, book entries, etc) and on their nature (registered or bearer shares) – in principle, they may be freely transferred unless the by-laws provide otherwise.
- Every shareholder has several rights, such as the right to information and the right to challenge corporate resolutions.

Governance requirements applicable to collective investment schemes (FIIs or SIIs, and in some cases, for SOCIMIs) are provided for in Law 35/2003, of 4 November, on Collective Investment Schemes applying to open-ended funds and Law 35/2003, of 4 November, on Collective Investment Undertakings.

5.6 Annual Entity Maintenance and Accounting Compliance

The incorporation of a company requires that certain obligations related to accounting and,

sometimes, auditing be carried out. These requirements depend on the type of entity.

An SL and an SA are obliged to keep accounting records of their business activities. In this regard, entities should register their annual accounts before the Commercial Registry.

It is mandatory for some capital companies to audit their annual accounts when they exceed the regulatory limits.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Some rights established in the Spanish regulation allow the use of a property without ownership:

- A lease (*arrendamiento*) – one of the parties, the landlord, undertakes to provide to the other, the tenant, the use of a property for a certain period of time and price. The law distinguishes between urban leases, which may be dwelling or residential leases ("dwelling-use lease") and non-dwelling or commercial leases ("commercial lease"), and rural leases. Furthermore, seasonal lease agreements are expressly excluded as urban leases and governed by regional and local specific legislation.
- Right of usufruct (*usufructo*) – entitles the beneficiary to use and obtain benefit of a property owned by a third party, the bare owner, in exchange for a price and for a limited time.
- Use and habitation (*uso y habitación*) – entitles a person to receive and use a property belonging to a third person.
- Surface right (*derecho de superficie*) – like common law, separates land ownership from the right over the construction. The right entitles its owner to build on third parties' land, taking ownership of what has been built for a certain period (which may not exceed 99 years).

6.2 Types of Commercial Leases

In a commercial lease, a landlord rents a property to a tenant to perform a business or economic activity. The leases are governed by the principle of freedom of contract, with the exception that the rent guarantee shall be at least equal to two months' rent.

In the absence of an agreement, the leases are governed by the Title II of the Urban Lease Act and, subsidiarily, by the Spanish Civil Code.

6.3 Regulation of Rents or Lease Terms

In general, parties may freely agree on the rent and terms of lease agreements. However, the Urban Lease Act establishes a few mandatory provisions.

Urban Lease Act

Residential leases' minimum period

For residential leases entered after March 2019, the landlord must allow the lease to be extended for up to a minimum of five years if the landlord is an individual, or seven years if it is a legal entity. The parties may freely agree on the duration of a commercial lease.

Rental guarantee

It is compulsory to require and provide a cash deposit equivalent to one month's rent for residential leases and two months' rent for commercial leases.

Rent review

The Spanish Urban Lease Act regulates that residential leases can be reviewed every year and apply the corresponding increases or decreases to the rent, according to either the Consumer Price Index (CPI) or the Competitiveness Guarantee Index (CGI), which are published by the National Statistics Institute, upon agreement by the parties.

The CPI is the main index in Spain that reflexes the inflation. The Spanish government decreed that all reviews of rent on residential lease agreements, unless agreed otherwise by the parties, shall be made according to the CGI, which by definition cannot be higher than a 2%.

Additionally, for the year 2024, the limitation to the rent review established by Royal Decree-Law 6/2022, of March 29 is still on force. See **6.5 Rent Variation** for further detail.

New Rent Maximum Under the Housing Act

The Housing Act introduced some amendments and new provisions to the Urban Lease Act by virtue of which limitations are applied to the determination of new rents for dwellings leased in areas that are declared as stressed residential market zones. See **6.6 Determination of New Rent** for further detail.

6.4 Typical Terms of a Lease

The typical terms of a residential lease agreement are as follows.

- The term of the lease may be freely agreed upon by the parties. For residential leases, however, the minimum term shall be of five years or seven years, depending on whether the landlord is an individual or a legal entity.
- The rent is paid as agreed by the parties. In the absence of an agreement, the rent shall be paid monthly, within the first seven days of each month.
- The sublease and assignment of the agreement must be expressly agreed; otherwise, the tenant shall not be entitled to sublease or assign the contract.
- Unless otherwise agreed, the landlord is obliged to perform the necessary repairs so that the tenant may continue carrying out the purpose for which the real estate was leased. Normally, the parties agree that the tenant must repair any damages to the property and perform any necessary actions to keep it in a good state of maintenance and repair.
- In the event of sale, the tenant has a pre-emption right, but it is market practice that the right is expressly waived by the tenant.

6.5 Rent Variation

It is standard practice that the parties agree to review the rent after a certain period.

As stated in **6.3 Regulation of Rents or Lease Terms**, rent variation in residential leases must be expressly agreed by the parties. Variation may only be set to happen annually.

Additionally, the amendment of the Royal Decree-Law 6/2022, of 29 March, approved by the Housing Act, established that rents for housing leases subject to the Urban Lease Act may only be increased by a maximum of 3% during the 2024 fiscal year.

6.6 Determination of New Rent

The Housing Act introduced some amendments and new provisions to the Urban Lease Act by virtue of which limitations are applied to the determination of new rents in those dwellings leased in areas that are declared as stressed residential market zones.

In this sense, the rents to be applicable to new residential lease agreements in dwellings located in stressed residential market zones (dully declared) will be limited as follows.

The new rent may not exceed the previous rent for a residential lease agreement that had been in force in the last five years in the same dwelling. Additionally, the new contract cannot foresee new conditions that entail the charging of fees and expenses to the lessee that were not foreseen in the previous contract. The rent may only be increased by a maximum of 10% when the dwelling:

- has been the object of a rehabilitation intervention in the two years prior;
- has been the object of accredited accessibility improvement actions in the two years prior; or
- when the lease contract is signed for a period of ten or more years, or a right of extension is established that the lessee may voluntarily exercise for a period of ten or more years.

When the lessor is a large housing holder (an individual or legal entity that owns more than ten urban properties for residential use or a built-up area of more than 1,500 square metres for residential use, excluding garages and storage rooms), the new rent may not exceed the maximum limit of the price applicable according to the reference price index system, which will be calculated and published by the Ministry of Housing, based on the conditions and characteristics of the leased property and of the building in which it is located.

Likewise, when the property has not been subject to any housing lease agreement in force in the last five years, the price reference index system will also be applied to set the maximum rent.

6.7 Payment of VAT

The lease of real estate is generally subject to VAT at a 21% rate. The lessor shall charge VAT to the lessee, who shall bear the VAT cost. However, residential leases are generally exempt from VAT.

Commercial leases owned and leased by businesses are subject to VAT at a rate of 21% if specific Spanish tax law requirements are met.

6.8 Costs Payable by a Tenant at the Start of a Lease

Other costs payable by a tenant at the start of a lease are:

- a mandatory rent deposit (*fianza*) borne by the tenant in an amount equivalent to one month's rent for residential lease agreements and two months' rent for non-residential lease agreements;
- it is usual to undertake complementary guarantees to secure payment of rent (under a limit in dwelling lease agreements);
- although not obliged, the tenant may also subscribe to a home insurance to limit their liability in the event of any contingency; and
- a tenant is obliged to declare the transfer tax to the region when formalising the lease contract, although it is exempt in some regions (eg, Madrid) if several requirements are met.

6.9 Payment of Maintenance and Repair

The landlord is legally obliged to carry out the necessary repairs so that the tenant may continue carrying out the activity for which the property was leased. Nevertheless, it is common that the parties agree that the tenant must repair any damage to the leased property resulting from normal wear and tear and perform any actions necessary to keep it in a good state of maintenance and repair.

6.10 Payment of Utilities and Telecommunications

Utilities and telecommunication expenses, including taxes, are usually borne by the tenant.

No legal restrictions apply to the agreement between the parties to state the landlord's ability to recover service charges from tenants. In most cases, the tenant enters into a contract directly with the utility services.

6.11 Insurance Issues

It is common practice that the landlord subscribes to an insurance policy to protect the property itself. It may also freely subscribe to a rent payments recovery insurance policy. These insurance policies may be borne by the tenant if expressly agreed.

6.12 Restrictions on the Use of Real Estate

The tenant is obliged to use the leased property as a "diligent parent", assigning it to the agreed use. This rule applies to residential and commercial leases. Furthermore, the landlord is entitled to terminate the lease agreement in the case of annoying, unhealthy, harmful or unlawful activities on the leased property or if the tenant carries out activities forbidden in the by-laws of the community of owners.

Concerning the commercial lease agreements, it is common practice that parties may agree on the possibility of terminating the contract in the event of the impossibility of obtaining an opening/activity licence.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant is not entitled, without the written consent of the landlord, to carry out works that modify the configuration of the dwelling or its accessories (eg, garage, storage room), and the tenant may not carry out works that decrease the stability or safety of the dwelling

6.14 Specific Regulations

Urban leases are regulated by the Urban Leases Act (as amended by Royal Decree Law 7/2019) and, subsidiarily, the Spanish Civil Code. Urban leases are divided between residential and non-residential leases (see **6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time**).

Rural leases are regulated by the Spanish Rural Leases Act (*Ley de Arrendamientos Rústico* s), which applies to leases such as the lease of a farm, including all machinery and the right to cultivate crops, etc. In default of express regulation, the Spanish Rural Leases Act, the Civil Code and custom and practice, apply.

6.15 Effect of the Tenant's Insolvency

The Urban Lease Act does not expressly provide as a cause for termination of lease agreements the insolvency of the tenant.

The Spanish Insolvency Act states the general principle of the continuation of the lease agreements in the event of the tenant's insolvency. Any outstanding payment obligations under the lease agreement shall be paid to the landlord directly against the insolvency estate. In the same respect, the Insolvency Act establishes the nullity of the clauses of the contract that set the termination solely due to the declaration of insolvency.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The Urban Lease Act states that, prior to taking possession of the leased property, the ten-

ant must deliver to the landlord a rent guarantee equivalent to one month's rent for residential leases and two months' rent for commercial leases. This deposit is held by the landlord (or deposited in a public administration, depending on the region), to be returned to the tenant upon termination of the lease agreement.

The parties may also agree additional guarantees to cover payment defaults by the tenant (ie, bank guarantees, comfort letters, deposits, or specific default insurances). However, additional guarantees in residential leases shall not exceed two months of rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

When the initial term expires, lease agreements are automatically extended by one year if the rent was fixed annually or extended by one month if the rent was fixed monthly, provided that:

- the parties have not agreed on anything in this regard; and
- the tenant stays in the leased property more than 15 days after the termination of the lease agreement without express opposition from the landlord.

This automatic renewal is named "tacit holding over" (*tácita reconducción*), laid down by Section 1566 of the Spanish Civil Code. The "tacit holding over" may be expressly excluded by mutual agreement of the parties.

6.18 Right to Assign a Leasehold Interest

In commercial leases and unless otherwise agreed by the parties, the tenant may:

- assign its position in the lease agreement to any third party without the landlord's consent; and
- sublease the premises.

The landlord may increase the rent by 10% (in the case of partial subleases) or in an amount of 20% (for total subleases or assignments).

In residential leases, and unless otherwise agreed by the parties, any such assignment or sublease shall be expressly authorised by the landlord.

6.19 Right to Terminate a Lease

The landlord is entitled to terminate the lease agreement if the tenant, among other reasons:

- defaults on rent payment or any other amounts assumed by the tenant or which corresponds to the tenant;
- subleases or transfers totally or partially the leased property without prior consent from the landlord; and
- causes harm to the leased property due to wilful misconduct or gross negligence.

The tenant is entitled to terminate the lease agreement if the landlord:

- interferes in the use of the leased property; and
- fails to carry out the necessary repairs to preserve the property in a suitable condition for its normal use

6.20 Registration Requirements

Lease agreements may be registered in the Land Registry; however, it is not mandatory. Unregistered urban leases may not be effective against a third-party purchaser registering their rights if

that purchaser fulfils the requirements laid down in Article 34 of the Spanish Mortgage Law.

In practice, it is not usual to register lease agreements in Spain since, in order to register the lease, the agreement must be notarised as a public deed (ie, implies notary and registry fees and the payment of the stamp duty tax).

6.21 Forced Eviction

The landlord may force the tenant to leave if the lease agreement has been terminated for any reason. The estimated time is usually over six months.

6.22 Termination by a Third Party

In the strict sense, a lease agreement may not be terminated by a government or a municipal authority. However, if a public authority orders the closure of the premises where the specific economic activity is carried out due to non-compliance, eg, with certain measures regarding occupational hazards, then by virtue of this, as well as in accordance with the clauses of the contract, the contract may be terminated.

6.23 Remedies/Damages for Breach

The owner may collect, in addition to the rent outstanding up to the date of termination of the lease, the compensation corresponding to the cost incurred by the landlord in restoring the property to the condition in which it was originally leased.

Likewise, additional penalties may be established for non-compliance with the minimum term of the lease. In this regard it is customary to pledge additional guarantees to ensure the payment of additional rents or indemnities in the event of early termination of the contracts (subject to a limit in the case of residential leases).

On the contrary, in housing contracts, the Urban Lease Law establishes that only the first six months of the agreement will be mandatory for the lessor, so that the establishment of any additional penalty would be contrary to this rule.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common structures used to price construction projects are as follows.

- A fixed price – the price shall be considered as a lump sum, fixed, and closed pursuant to the definition in Article 1,593 of the Spanish Civil Code. In this case, the contractor shall not be entitled to claim a price increase, even if the actual costs and expenses result in a sum higher than budgeted. However, depending on the contract, the lump-sum price may be subject to review in particular circumstances.
- A unit price – a price is agreed by means of a unit or quantity or unit prices per piece or based on a module (ie, per unit of work or unit of measurement).
- A price agreed based on the costs incurred and duly proved by the contractor in the execution of the works, to which a spread is added in favour of the contractor.

7.2 Assigning Responsibility for the Design and Construction of a Project

Act 38/1999, of 5 November 1999, on Building Development (LOE) establishes certain obligations and liabilities which may be involved in a construction project.

In this respect, the “building agents”, as defined in the LOE, are all the individuals or legal enti-

ties involved in the building procedure that are liable to the owners and third-party purchasers of buildings or parts of buildings from the date of reception of the construction works. The liability may be joint and severally requested when it may not be allocated individually and when there is a concurrent fault, without it being possible to specify the involvement of each agent in the damage caused.

The contractor usually assumes the risk of damage or destruction of the construction works until the delivery of the completed works to the developer, including some period of guarantee after delivery of the works.

The LOE establishes specific periods during which a claim may be made against the party involved in the construction, depending on the type of the defect affecting the building:

- for a ten-year period, for damages caused to the building affecting structural elements which compromise the stability of the building;
- for a three-year period, for damages caused to construction elements which result in the failure to fulfil habitability requirements; or
- for a one-year period for damage due to defects in construction affecting elements of the finished building.

The developer and the rest of the building agents may be deemed liable for construction flaws under the regime of Article 1,591 of the Spanish Civil Code.

7.3 Management of Construction Risk

In addition to the guarantees stated in the LOE some typical guarantees that may be agreed upon are as follows:

- withholdings;
- work certifications (partial and final work certificate);
- bank guarantees;
- the developer's right to designate or impose subcontractors for certain parts of the project; and
- restrictions on the use of materials.

On the contractor's side, there are commonly agreed measures, such as advance payments or rights to suspend work if payment is delayed.

7.4 Management of Schedule-Related Risk

There is no standard form to establish any mechanisms to cover the events of breach by the contractor of any of the partial milestones or the final time limit fixed in the works deadlines programme.

The owner is entitled to claim damages in accordance with the Spanish Civil Code, but the assumptions of force majeure shall not be attributable to the contractor. In the case of serious delay, the owner shall be entitled to terminate the contract.

It is standard practice to specifically regulate these points in the contract.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Construction contracts always require the works to be completed by a specified date and in a specified form. Despite the guarantees stated in Act 38/1999, of 5 November 1999, on Building Development, additional guarantees may be agreed to ensure the execution of a construction project (see **7.3 Management of Construction Risk** and **7.4 Management of Schedule-Related Risk**). Comfort letters, bank guarantees, parent

and group guarantees and letters of credit are commonly used.

7.6 Liens or Encumbrances in the Event of Non-payment

Under the Spanish Civil Code, the contractor is entitled to terminate the works agreement or claim its compulsory performance (ie, the pending payment), including the payment of damages (Article 1,124 Spanish Civil Code).

In the case of default of payment, the contractor shall not take direct legal action against the works; however, it may initiate a court case and request a precautionary measure claim to encumbrance the property.

7.7 Requirements Before Use or Inhabitation

The contractor should comply with some legal provisions; depending on the location of the property and its use, the following licences/certificates must be obtained:

- if the property has a residential use, a final works certificate is required as well as, in most cases, a first-occupation licence or self-declaration to verify that the property may be used for residential purposes;
- some regions establish the need for a certificate of occupancy (*cédula de habitabilidad*), or a formal architectural declaration stating the compliance of the property with the requirements to obtain such a certificate to allow its transfer; and
- if the property is intended for professional use, it shall also be necessary to obtain an activity and opening licence, and some other permits may be required, depending on the type of activity considered.

8. Tax

8.1 VAT and Sales Tax

See **2.10 Taxes Applicable to a Transaction** for the tax implications arising from the transfer of real estate.

8.2 Mitigation of Tax Liability

Subject to certain requirements, the transfer of real estate companies with a large real estate portfolio engaged in economic activities cannot be subject to stamp duty.

8.3 Municipal Taxes

Only the owning of real estate is subject to real estate tax (IBI). This local tax is paid annually by the owner to the city council where the asset is located. The final tax liability is calculated from the cadastral value of the asset.

8.4 Income Tax Withholding for Foreign Investors

Income tax for foreign investors depends on whether the asset is owned directly by an individual or through a company.

If the asset is directly owned by a foreign company or individual without a permanent establishment in Spain, income derived from rent is subject to a general non-resident income tax of 24% in Spain. Should the investor be an EU/EEA tax resident, the applicable rate shall be reduced to 19% and certain expenses could be deducted (eg, depreciation of 3%).

In the case of a transfer by a foreign company or individual without a permanent establishment in Spain, the capital gain derived from the transfer will be subject to a 19% tax rate. The purchaser must withhold 3% of the purchase price on account of the non-resident income tax to be paid by the seller.

Under certain circumstances, the transfer of Spanish companies owning real estate in Spain by foreign individuals could be exempt from taxation by application of a Double Taxation Treaty.

Non-resident individuals are subject to non-resident income tax at a 19% or 24% rate for the mere ownership of real estate located in Spain. The relevant tax burden is calculated by determining a notional income linked to the cadastral value of the relevant property.

Finally, the ownership of real estate by a non-resident could be liable to wealth tax under certain circumstances and, in tax years 2023 and 2024, liable to the temporary solidarity tax on major fortunes.

8.5 Tax Benefits

Spanish companies subject to corporate income tax have the right to deduct the depreciation of construction contributing to economic activities. Depreciation expenses are allowed in the corporate income tax taxable base if they are accounted for in accordance with the depreciation rates set forth in the corporate tax law. Certain accelerated amortisation schedules may be of application provided certain specific requirements are met.

Spanish individuals who derive rental income may be entitled to deduct certain expenses from their personal income tax due, such as the relevant real estate asset depreciation. In addition, the rental income of dwellings may benefit from a 60% reduction on the personal income tax due. Certain tax benefits apply to different regulated Spanish real estate vehicles.

Furthermore, the Spanish Corporate Income Tax Law set forth a special tax regime for entities involved in the rental of dwellings located in Spain, provided that, among other requirements, these entities own and operate at least eight different dwellings during a period of three years.

ST KITTS & NEVIS



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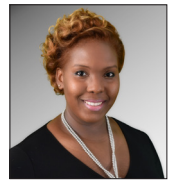
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Joseph Rowe, Attorneys-at-Law is a boutique law firm with offices in Nevis, St Kitts and Grenada with attorneys-at-law also qualified to practice in the island of Anguilla. The firm comprises a 15-person professional team, who pride themselves on having a client-focused law practice providing quality legal services with a view to achieving the best results possible for its clients. Its legal expertise and professional services include citizenship by investment (investment migration), offshore companies and trusts, real estate transactions (including commercial, residential, hotel and investment real estate), maritime/admiralty law and civil and commercial litigation. Recent engagements include providing legal representation for the first geothermal power plant project on the island of Nevis; acting for developers of a commercial complex; representing the developer of resort development projects; successfully securing compensation for a multi-million-dollar beachfront property that was compulsorily acquired by the government in Nevis; and representing multiple purchasers and vendors of luxury real estate within a 5-star resort villa development.

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1. General

1.1 Main Sources of Law

St Christopher and Nevis (St Kitts and Nevis) has two systems of land ownership that operate side by side: the unregistered system (by which one acquires a deed) and the registered system (by which one acquires a Certificate of Title, or COT). The relevant pieces of legislation are:

- the Conveyancing and Law of Property Act (unregistered system); and
- the Title by Registration Act (registered system).

The Stamps Act addresses taxes payable in relation to the transfer of real estate. Non-citizens who wish to invest in real estate would be subject to the Aliens Land Holding Regulation Act and require an aliens land holding licence (ALHL) to hold an interest in real estate. For non-citizen investors, there is also the option of owning land (without requiring an ALHL) through participation in the Citizenship by Investment (CBI) programme, which is governed by the Citizenship by Investment Act.

1.2 Main Market Trends and Deals

In the past 12 months, the authors have noted an increase in the number of lifestyle buyers in the real estate market in St Kitts and Nevis. Persons are choosing to purchase a 2nd home in St Kitts and Nevis and the authors noted more persons moving to the islands to live.

At the same time, the authors have noted a marked decline in the purchase of real estate as a qualifying investment for the citizenship by investment programme. The reason for this may be the new Saint Christopher and Nevis Citizenship by Substantial Investment Regulations, 2023 (SRO No 26 of 2023) gazetted on 27 July 2023, which increased the minimum qualifying real estate investment for citizenship from USD200,000 to USD400,000 for a condominium and for a stand-alone home or private home, the minimum investment was increased from USD400,000 to USD800,000. This has placed St Kitts and Nevis' investment threshold for Citizenship by Investment purchasers significantly above the minimum investment required for CBI in its Caribbean counterparts. However, as recent as 22 March 2024, the heads of state of 4 of the 5 CBI Caribbean countries, namely, St

Kitts and Nevis, Grenada, Antigua and Dominica signed a Memorandum of Understanding committing to co-operate more closely on matters related to the Citizenship by Investment programme, including pricing. This new commitment should benefit the Caribbean CBI jurisdictions significantly, including St Kitts and Nevis, as the prior practice of reducing the minimum investment requirements to be competitive in the CBI market should be a thing of the past.

The authors have not seen the real estate market in St Kitts and Nevis being adversely affected by rising inflation or increases in interest rates. To the contrary, the authors have seen an increase in real estate sales post-COVID-19. The authors have had buyers express that COVID-19 has shown that life is short and they would rather spend time in the Caribbean than in colder climates. Whatever the motivation, the real estate market in St Kitts and Nevis has been doing fairly well post-COVID-19.

Recent Developments

- In 2019, the government of St Kitts and Nevis signed a deal with Medici Land Governance, Overstock.com's blockchain subsidiary, to use blockchain and other technologies to incorporate high-resolution aerial images of the Federation into the Land Registry in developing a cadastral survey system. However, to the authors' knowledge, this project has not been completed.
- In January 2020, the government passed the Virtual Assets Act. However, at present, licensing pursuant to the Act has been suspended.
- On 31 March 2021, the Eastern Caribbean Central Bank (ECCB) launched the ECCB DCash Project in St Kitts and Nevis. DCash was the first digital currency to be used by a monetary union. The DCash Pilot platform operations were closed on 12 January 2024. The ECCB has announced that it will be transitioning to DCash 2.0, "a more advanced and user-friendly version" of its digital currency service. DCash is a blockchain-based, central bank-issued digital currency, which allows persons to complete transactions using a digital version of the Eastern Caribbean dollar.

Use of Disruptive Technologies

It is expected that the emergence of blockchain, decentralised finance (DeFi), proptech and other disruptive technologies would improve the functions of real estate investors, developers and lenders. However, since the concept of disruptive technology is still relatively new, these technologies have yet to emerge as a preferred or even often-used alternative in St Kitts and Nevis.

Cryptocurrency is, however, accepted by the Citizenship by Investment Unit (CIU) as a valid currency for investment. An applicant is simply required to provide documentation in support of the ownership of their cryptocurrency wallet and provide the USD value of the wallet. In the event the applicant is unable to provide a wallet, they may provide the following for consideration by the CIU:

- a letter from a cryptocurrency stock exchange, or other institution that provides digital assets services. The letter should be similar to a bank reference letter (stating the applicant's name and address and the period of time the applicant has been a customer); and
- the applicant's account summary which sets out the cryptocurrency held and the equivalent USD value.

Once the applicant is approved, they would be required to convert the cryptocurrency to USD

then wire the investment funds to the relevant bank account.

1.3 Proposals for Reform

Cadastral Survey Mapping

At present, searches in the Land Registry are conducted by the name of the property owner. Consequently, if the property owner is unknown, the search process can be tedious and even, sometimes, futile. At times, the property owner may be identified by searching known property owners in the area and reviewing the owners on the boundaries (provided a fairly recent survey of the land was done). The proposed cadastral mapping system (see **1.2 Main Market Trends and Deals** under "Use of Disruptive Technologies") will give an identifying number to each lot so that searches may be conducted by lot numbers, removing the requirement to know the identity of the registered property owner to conduct a property search.

There is a project by which a team of specialists used drones to conduct the cadastral mapping of St Kitts. However, it will still take time to formalise the search process since persons may be required to come forward to claim ownership of land in respect of which there is no "paper" owner. There is some prevalence of land ownership without any formal paperwork as property is commonly passed down from generation to generation without the registration of any transfer document.

Digitisation of the Land Registry

The proposed digitisation of the Land Registry aims to create a digital copy of all land titles and deeds in St Kitts and Nevis and the conduct of searches online. A Land Administration Information System (LAIS) is in the development phase. A pilot of the programme was shared with legal practitioners for a brief period. It is expected that the LAIS will be taken to completion and the Land Registry would be fully digitised.

Private Home Sale Option – Citizenship by Investment

By the Saint Christopher and Nevis Citizenship by Substantial Investment Regulations 2023, which came into force on 27 July 2023, citizens of St Kitts and Nevis that are the registered owner by Certificate of Title for the following real estate:

- land on which a single-family private dwelling home is constructed; or
- a condominium unit:
  - (a) previously sold as the subject of CBI application; and
  - (b) for which the statutory time frame for resale has elapsed may apply to the Board of Governors for such real estate to be designated an Approved Private Home and therefore a qualifying investment by which the purchaser may obtain citizenship by investment.

This Private Home Sale option provides an avenue to sell real estate owned by citizens of St Kitts and Nevis through the CBI programme.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights that can be acquired in St Kitts and Nevis include the following.

- "Ownership in fee simple", which is an absolute ownership with full rights to deal with and alienate property.
- Life interest, which entitles the holder to occupy the property for his or her lifetime. This type of interest is most often seen in

cases where a person dies intestate (without a will) and, by law, the surviving spouse is entitled to a life interest in the deceased's property with the remainder to the children in "fee simple" when the surviving spouse passes away.
- Self-vesting deed, which is a self-declaration of one's ownership in property by virtue of long possession. This type of property right can be easily challenged. Consequently, persons with a vesting deed often convert the deed to a COT once they have held the vesting deed for the requisite number of years.
- Ownership by adverse possession after 12 years of open, undisturbed possession.
- Ownership by long possession after undisturbed possession of property for over 30 years.
- Leasehold interests over three years must be registered.
- Licences.
- Easements.

2.2 Laws Applicable to Transfer of Title

As referenced in **1.1 Main Sources of Law**, the laws applicable to the transfer of real property by citizens are as follows:

- the Title by Registration Act; and
- the Conveyancing and Law of Property Act.

The laws applicable to non-citizens are as follows:

- the Alien Land Holding Regulation Act; and
- the Citizenship by Investment Act.

The Stamps Act sets out the stamp duty or taxes payable on transactions (see **2.10 Taxes Applicable to a Transaction**).

2.3 Effecting Lawful and Proper Transfer of Title

The documents required to effect the lawful transfer of property would depend on whether the property is held by COT or deed.

The transfer of property held by deed is effected by registration of a Deed of Indenture.

The transfer of property held by COT is effected by registration of a memorandum of transfer (MOT). In addition to presenting the executed and stamped MOT for registration, the transferor is required to submit his or her original COT, which is cancelled upon the registration of the transfer and a new COT is issued to the new owner.

In each case, the transfer document is to be submitted to the Inland Revenue Department (IRD) for assessment of the taxes due. When the taxes are paid, the IRD stamps the transfer document confirming the payment of the relevant taxes. Once the document is stamped by the IRD, it is presented to the Registry of Titles or the Registry of Deeds (as may be applicable) for the registration of the transfer and issue of a new COT (if applicable).

Title insurance is not required by law and is not common. The instances in which title insurance is taken on property usually involve a large development project, often by an overseas investor or involving an overseas financier.

The Registry of Lands has functioned during the coronavirus pandemic (ie, the COVID-19 pandemic, to be specific in terms of particular coronavirus strain) save for the brief periods when there was a complete lockdown of government offices. During this period, some accommodation has been extended to parties who are una-

ble to get documents notarised to facilitate real estate transactions. In clear cases, notarisation by video conference has been accepted together with an affidavit setting out the circumstances in which in-person notarisation was not possible.

2.4 Real Estate Due Diligence

Purchasers usually engage the services of a local attorney-at-law, who will conduct due diligence on the property. The typical due diligence usually involves the following:

- a physical search at the Land Registry to confirm whether the property is free from encumbrances (eg, mortgage, caveat, restrictive covenants), and, if not, to identify the encumbrances on the property;
- confirming that the seller is the registered proprietor of the property with power to transfer an interest in the property;
- enquiring at the IRD to confirm whether all land taxes in relation to the property are paid up; and
- enquiring at the electricity company and water department to confirm whether all the utilities are paid up.

At times purchasers request a new survey of the property to confirm the boundaries; however, a new survey is not usually ordered as it is not required; it is customary for a surveyor to copy the previous plan of the property for the new owner. A survey and a physical walk-through of the property is always done in cases involving large tracts of land earmarked for development purposes.

2.5 Typical Representations and Warranties

The typical representations and warranties in a purchase and sale agreement in real estate transactions include the following:

- the sellers are the registered proprietors of the property and have a good marketable title to the property in fee simple;
- the property is free of all encumbrances save the customary encumbrance in favour of the government for land tax due and owed from time to time; and
- the property is not subject to any other Purchase and Sale Agreement nor is the property subject to any agreement for a right of first refusal in favour of any third party.

The authors have not seen new representations and warranties driven by the coronavirus pandemic, per se, but the authors have noted an increase in the insistence on force majeure clauses.

There are no seller's warranties provided for under statute. The buyer's remedies against the seller are the remedies available to the buyer under common law.

Typically, if a purchaser breaches a contract for the purchase and sale of real property, the result provided for is forfeiture of the usual 10% deposit paid by the purchaser, ie, the deposit will be paid to the vendor.

Representation and warranty insurance is not normally used in St Kitts and Nevis real estate transactions.

2.6 Important Areas of Law for Investors

Typically, a large investor would negotiate and enter into a development agreement with the government that would set out the taxes and concessions applicable to the investor's development. The Hotels Aid Act sets out the general regime applicable to investors in the hotel industry.

2.7 Soil Pollution or Environmental Contamination

In St Kitts and Nevis, the seller of real estate is to ensure that he or she complies with the laws of the National Conservation Environmental and Protection Act, amongst others, and equally the buyer is responsible for ensuring compliance when the property is transferred. Even if the buyer did not cause the pollution or contamination, as the owner of the land, he or she would be ultimately responsible for same, but he or she may be able to seek an indemnity against the seller if it can be established that the seller was responsible for the contamination.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

According to the Development Control and Planning Act (the "Planning Act"), every person seeking to erect, re-erect, remove or alter the structure of a building is required to make an application to the Department of Physical Planning for permission to do so. A buyer can ascertain the permitted uses of a parcel of real estate under applicable zoning or planning law by contacting the Department of Physical Planning to obtain a copy of the zoning plan, planning scheme and planning regulations relevant to that area.

The relevant plan will contain requirements concerning land use, vehicular access, parking, setbacks from boundaries, site coverage, floor area limitations, height limitations, external appearance (in some cases, including preferred colours) and tree planting. There may also be special planning controls on alterations to buildings of historic interest. Usually, signs and advertising devices are subject to planning controls.

A buyer can also source a copy of the COT or deed in respect of the property that would contain the restrictive covenants attached to the land. The general Building Code applicable to St Kitts and Nevis is set out in the seventh schedule to the Planning Act.

The St Kitts (Planned Community) Act provides for the establishment and registration of planned communities. The purpose of the Act is stated as "to allow and facilitate the creation, development, and operation of one or more planned communities in the St Kitts peninsula resort district and to provide for related matters". The Act has since been extended to other areas in St Kitts that benefit from the special provisions of the Planned Community Act. The objectives of the Act are stated as follows:

- to allow and facilitate the creation, development and operation of one or more planned communities in St Kitts;
- to provide a mechanism for the registration of title to a parcel of land intended for subdivision and development in a planned community and to provide for positive covenants to run with the title to the land;
- to provide for the regulation of the rights and obligations of the owners of property within a planned community;
- to provide for the creation of a community corporation that will be responsible for the development and management of the amenities within and the infrastructure of the planned community; and
- to facilitate the establishment and enforcement of the obligations of a landowner within the planned community.

2.9 Condemnation, Expropriation or Compulsory Purchase

Pursuant to the Constitution of St Christopher and Nevis and the Land Acquisition Act (or the Land Acquisition Ordinance in Nevis), the gov-

ernment has the power to compulsorily acquire land for a public purpose; however, the proprietor of the land is entitled to compensation for such acquisition. The legislation provides for the establishment of an assessment board comprising one nominee of the proprietor, one nominee of the government and a judge as chairperson.

2.10 Taxes Applicable to a Transaction

The seller is generally required by law to pay 10% stamp duty, assessed on the value of the property being transferred, which is usually the purchase price or the value assessed by the IRD, whichever is greater.

There are instances where the seller and the buyer agree to share the stamp duty payable on the transfer, but this is completely dependent on agreement between the parties.

The stamp duty payable may be increased or decreased depending on the location of the property being transferred or the circumstances of the transfer, including familial relationships, the developmental zone, and whether the land is being transferred by the court or the government Housing and Land Development Agency.

If a real estate agent is involved, the seller would usually also pay the real estate commission, which is typically about 5–6% of the sale price. There are also small fees payable by the purchaser if the property is held by a COT:

- an assurance fund fee of 0.2% of value of the property; and
- a registration fee of USD2.70.

The purchaser is also usually responsible for all other closing costs, (eg, legal fees, surveyor's fees).

When shares are being transferred, it is also subject to stamp duty, which is a percentage of the value of the shares, as well as to a nominal registration fee. If the main asset of the company is real property, the transfer of shares would attract taxes at the same rate as the transfer of real property.

2.11 Legal Restrictions on Foreign Investors

In St Kitts and Nevis, a foreign investor is required by law to apply for and obtain an alien land holding licence or citizenship (usually, pursuant to the CBI programme) before that investor can hold an interest in land (see **1.1 Main Sources of Law**). If the investor is a company and the shareholders are granted citizenship, the company would not require an alien land holding licence to purchaser real estate. There are no other legal restrictions on non-citizens investing in real estate.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Commercial real estate is generally financed through lending institutions. There are different financing options for the acquisition of large real estate portfolios or companies holding real estate, such as lease to own arrangements or by participating in the CBI programme, where the purchasers finance the development project. If the large tract of land is owned by the government, there is the option of the government partnering with the developer in various ways to develop the real estate.

3.2 Typical Security Created by Commercial Investors

The typical security created or entered into by a commercial real estate investor who is bor-

rowing funds to acquire or develop real estate is a mortgage over the property. The mortgage can be legal or equitable. If an equitable mortgage is created, a caveat is usually placed on the property to forbid any further dealings with the property. In addition, the company may pledge its shares to the lending institution and use a corporate or personal guarantor as additional security.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Foreign lenders are required to apply for and obtain an alien land holding licence to hold security over real estate in St Kitts and Nevis. The application process is fairly simple and is largely procedural. Other than the requirement to obtain an alien land holding licence, there are no restrictions on granting security over real estate to foreign lenders. Similarly, there are no restrictions on repayments being made to a foreign lender under a security document or loan agreement.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

A stamp duty of 1% of the sum secured is generally payable on the registration of a mortgage. However, the rate is 2% of the sum secured for mortgages taken over land in the South East Peninsula that is designated as a Special Development Area under the Stamps Act.

The main cost of enforcement of the security would be legal fees as a court process is usually involved.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are generally no legal rules or requirements that must be complied with before an entity can give valid security, other than the provision of the usual corporate authorities from the board of directors authorising the proposed transaction.

3.6 Formalities When a Borrower Is in Default

The Title by Registration Act sets out a detailed procedure to be followed by a mortgagee when a borrower is in default.

- Service of a formal notice to pay off, in the prescribed form, on the registered proprietor, requiring payment within 60 days of the date of service.
- If the registered proprietor fails to pay, the lending institution may seize the land by the bailiff appearing on the premises with an order to seize and shall serve the registered proprietor with an act of seizure in the prescribed form. There is provision for substituted service in circumstances where the whereabouts of the registered proprietor are unknown.
- The lender presents a caveat of seizure in the prescribed form to the registrar, which the registrar shall note on the title. The caveat of seizure prohibits any dealings with the land seized until the caveat is removed or withdrawn.
- If no payment or satisfactory arrangements for payment is/are made within 30 days from the date of seizure, the lender applies to the court to settle the articles of sale, estimate an upset price, fix the day of the sale and the mode of publication of the sale. The application is served on the registered proprietor, who may attend the hearing and make representations accordingly.

The lender would usually obtain a valuation to support its application to estimate the upset price. Further, the sale must be satisfactorily advertised and proof of advertisement must be

submitted to the court. If there are no bidders, the auction is postponed. If the auction is not successful, the borrowing entity can apply to the court to reduce the upset price of the property, based on the further appraisal of a valuer.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt; however, this will depend on the lending institution. It is generally done by an agreement, subject to the lending institution's conditions, which typically include that the collateral on the existing debt is valued high enough to secure the newly created debt. Life insurance policies, large enough to accommodate both debts, are also a usual requirement for individuals.

3.8 Lenders' Liability Under Environmental Laws

Generally, a lending institution that merely holds a security over real estate would not be liable for breaches of environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

No registered security interests created by the borrower in favour of a lender are made void if the borrower becomes insolvent.

3.10 Taxes on Loans

There is a 1% stamp duty on the sum secured payable on the registration of a mortgage over real estate in St Kitts and Nevis. The stamp duty is usually for the account of the borrower and the lender would ordinarily include the stamp duty with the payments to be made by the borrower (eg, lender's commission and/or administrative fee, legal fees) as a prerequisite to disbursing the loan.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The legislative and governmental controls that typically apply to strategic planning and zoning in St Kitts and Nevis are set out in the following legislation:

- the Planning Act;
- the Nevis Physical Planning and Development Control Ordinance (the "Planning Ordinance");
- the Nevis Zoning Plan Ordinance; and
- the Condominium Act, which governs the development of condominiums.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The Planning Act and Planning Ordinance broadly govern the design, appearance and method of construction of new buildings or refurbishment of an existing building. In addition to requiring that plans be registered with, and approved by, the Department of Physical Planning (DPP), the DPP also makes regular physical inspection of the construction site to ensure that construction is proceeding according to the approved plans.

Residential and commercial buildings are subject to height restrictions based on the zone in which they are located. Hotels and other buildings on the coast are required to be erected at a minimum specified distance from the high-water mark.

4.3 Regulatory Authorities

The authority that is responsible for regulating the development and designated use of individual parcels of real estate is principally the Department of Physical Planning. If the regula-

tions are not complied with, the DPP may issue a stop order and the offending landowner may be subject to a fine.

4.4 Obtaining Entitlements to Develop a New Project

Applications for approval to develop a major new project or any project under the CBI programme are to be submitted to the St Kitts Investment Promotion Agency (SKIPA) with the relevant architectural and building plans, topographical surveys, environmental impact assessment survey, business plan and other relevant documents.

Depending on the nature of the project, its size and its location, public consultations are held prior to granting approval. In such cases, third parties are allowed to participate and object, if appropriate. In a recent case, Anne H. Bass v Department of Physical Planning, the court confirmed that pursuant to the Nevis Planning Ordinance, members of the public had the right to attend the office of the DPP and inspect the plans and documents submitted in relation to a development in Nevis.

4.5 Right of Appeal Against an Authority's Decision

If an applicant is dissatisfied with the decision of the DPP, the applicant may appeal to the Physical Planning Appeal Tribunal. If the applicant is dissatisfied with the decision of the Tribunal, there is a right of further appeal to the High Court.

4.6 Agreements With Local or Governmental Authorities

Typically, a developer would enter into a development agreement with the government that would usually make provision for co-operation of the various government departments or authorities. The utilities (electricity, water, and such) are government owned (through a company, in the case of electricity) and the government may make representations in relation to those as well. Separate agreements may be negotiated with suppliers of other utility services (eg, internet, cable) but typically with the assistance of the government by agreement.

4.7 Enforcement of Restrictions on Development and Designated Use

While it is not typically a scheduled procedure, employees of the various regulatory departments (where applicable) would usually visit work sites to check the progress of construction or renovation, and whether there are any breaches of the zoning, agricultural, health and environmental laws, amongst others. If there are any breaches, a stop notice may be issued, halting construction. Also, a fine may be imposed on the offending party.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Investors may hold real estate assets through a local company or a limited partnership. A local limited liability company is most frequently used.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The main features of the constitution of each type of entity used to invest in real estate are as follows.

Limited Partnership

Any two or more persons, including a body corporate person, may form a limited partnership but at least one person must be a general partner. In a limited partnership, the general partner

is personally liable for debts and the limited partner has limited liability but cannot participate in the management of a business. The partners of a limited partnership are exempt from all income, capital gains and withholding taxes with respect to the limited partnership if the general partners only transact with persons who are resident outside the Federation. This is the type of ownership structure used for the Park Hyatt project.

Limited Liability Company

A local limited liability company is governed by a board of directors, the members of which may be resident or non-resident. However, there is a requirement that the secretary or assistant secretary of the company be resident in St Kitts and Nevis. The company is also required to have a local address as its registered office. There are several local firms that offer secretarial and registered office services.

The shareholders of the company need not be citizens of or resident in St Kitts and Nevis. However, if the shareholders are non-citizens, they would be required to apply for and obtain an alien land holding licence to own the shares in a local company. The alien land holding licence application procedure to be a shareholder in a company is simple and relatively inexpensive.

5.3 REITs

A real estate investment trust is not a commonly available investment vehicle in St Kitts and Nevis.

5.4 Minimum Capital Requirement

There is no minimum capital requirement.

5.5 Applicable Governance Requirements

See the description in **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual maintenance cost would depend on the type of entity used. The government fee for the maintenance of a local company in St Kitts or Nevis is approximately USD100.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

In the Federation of St Christopher and Nevis, the law recognises the use of leases to allow a person, company or other organisation to occupy and use real estate for a limited period.

All leases are governed by the Conveyancing and Law of Property Act, the Rent Restriction Act and the Recovery of Rent Act.

A “public or commercial building” is defined by the Rent Restriction Act as a building, or part of a building, separately let, or a room separately let, which at the material date was or is used mainly for the public service, or for business, trade or professional purposes, and includes land occupied therewith under the tenancy but does not include a building, part of a building or room when let with agricultural land.

6.2 Types of Commercial Leases

In St Kitts and Nevis, there are two standard forms of commercial leases: the fixed-term lease and the ordinary lease (for a periodic tenancy).

Fixed-Term Lease

A fixed-term lease will automatically terminate at the end of the fixed term stipulated in the lease. There is no requirement to renew the lease or allow a lessee to stay in the premises past the fixed date set out in the lease. This form of lease offers more protection for the lessor, as a lessee may be required to pay for the entire term outlined in the lease if he or she leaves the premises early. The only option a lessee has to opt out of a fixed-term lease prior to the expiry of the term is if there is a break clause in the lease allowing the lessee to do so, if the landlord forfeits the lease, or if the lease prescribes for early termination upon the occurrence of a specific event; for example, an act of God that causes substantial damage to the property.

Ordinary Lease

An ordinary lease allows the lessee to negotiate to extend the lease, as well as to give notice to vacate the premises early without any additional consequences, once the rent up to the time of vacating the premises is paid and all other requirements of the lease were complied with. This form of lease generally offers more protection to the lessee.

6.3 Regulation of Rents or Lease Terms

The Rent Restriction Act made provisions for the governor-general to appoint three fit and proper persons, one of whom shall be a government officer, to be rent commissioners for the state, for the purposes of carrying into effect certain provisions of the Act. The rent commissioners would then prescribe the standard rent to be applied to any category of lease or building. However, to date, there has been no appointment of rent commissioners. Consequently, in practice, the rent of any premises is set by agreement between the parties.

Regulations Governing Length of Leases

The various pieces of legislation governing leases do not specify the length of time that a person can lease the property that they own; however, when a mortgagee of land in possession, as against all prior encumbrances, and as against the mortgagor, leases the mortgaged property, then the lease is governed by Section 37 of the Conveyancing and Law of Property Act, which sets out the number of years a mortgagee can lease the property depending on the type of property being leased.

The Act specifies that an agricultural or occupational lease cannot be rented by a mortgagee for a term exceeding 21 years, a mining lease cannot be rented for a term exceeding 35 years and a building lease cannot be rented for a term exceeding 99 years.

Further, a lease made by a mortgagee must be made to take effect no later than 12 months after the date of the lease.

Regulation of Lease Terms

With respect to the terms of a lease, whereas the statute does not prescribe the form of words to be used when outlining the terms of a lease, the parties to a lease are guided by the statute when setting out its terms.

Other than as set out above, rent and lease terms are freely negotiable.

COVID-19 Regulations Directly Affecting Lease Terms

Although government authorities encouraged landlords to be lenient with tenants in the wake of the coronavirus pandemic, no legislation has been enacted that has directly affected lease terms. However, the National Housing Corporation (NHC) in St Kitts and various banks in the

Federation provided temporary moratoriums in 2020/2021 waiving and/or deferring fees and payments to homeowners who were adversely affected by the pandemic.

Similarly, the Nevis Housing and Land Development Corporation (NHLDC) had a mortgage relief fund to benefit persons who have received financing from the NHLDC to purchase their homes. Further, public auctioning of houses for default in loan payments was temporarily ceased.

6.4 Typical Terms of a Lease

Although the statute does not prescribe the terms to be used in a lease, there are some terms that can usually be found in a commercial lease.

Typically, the length of a lease of business premises is for a fixed term of years with an option to renew. Rent at a fixed sum is usually payable monthly and default of payment can result in the termination of the tenancy.

Ordinarily, the lessor is responsible for the structural maintenance, insurance and property taxes relating to a commercial lease, and the tenant is responsible for any minor wear and tear that arises during their tenancy. Unless otherwise outlined in the lease, the tenant would also be responsible for paying for the utilities during the tenancy.

It is common for a lease to include provisions concerning whether a tenant can assign the lease or sublet the property and outlining the types of permitted alterations or improvements (if any) and whether or not permission from the landlord is required to do so.

In light of the coronavirus pandemic, the inclusion of force majeure, rent abatement and other similar clauses in leases has become more commonplace.

6.5 Rent Variation

The level of rent is determined by agreement between the parties. Express provision may be made in the lease for a predetermined increase in the rent after a stipulated period during the term of the lease.

6.6 Determination of New Rent

See the description in **6.3 Regulation of Rents or Lease Terms**.

6.7 Payment of VAT

The payment of value added tax (VAT) is prescribed by the Value Added Tax Act, which does not prescribe that VAT is payable on rent per se. However, if the income of the landlord from its rental business is more than the threshold of XCD100,000 per year, which is usually the case with leases of commercial properties, and the landlord is registered to collect VAT, the tenant would be required to pay VAT on the rent. If the tenant is registered to collect VAT, the tenant would be entitled to request a refund of the VAT paid on the rent.

6.8 Costs Payable by a Tenant at the Start of a Lease

At the start of a lease, the tenant is not usually required to pay any amount other than rent. However, some leases may require that a tenant pay the first and last month's rent and/or a refundable deposit to be applied to any damage to the property and/or sums outstanding on service accounts and utilities at the end of the tenancy.

6.9 Payment of Maintenance and Repair

When a person is renting a commercial building with a shared rental space – for example, a

shared parking lot or gardens – the maintenance and repair of those spaces would generally be paid by the landlord. However, if the building is on a small lot that is not shared, the tenant would usually be required to maintain and keep in good repair the garden, parking lot and other surroundings associated with the rental property.

6.10 Payment of Utilities and Telecommunications

Usually, each tenant is responsible for the utilities and telecommunications charges associated with its tenancy. It is preferable for each tenant to have a separate meter for electricity and the reading provided each month so that the appropriate payment may be made. If the utilities are not separated – for example, water – they may be charged by the landlord at a flat rate per month as agreed by the landlord and the tenant. Typically, for services such as internet and cable, the tenant would set up its own connection and would be directly responsible for the charges to the relevant companies.

6.11 Insurance Issues

The insurance for the real estate subject to a lease is typically paid for by the landlord. It would usually cover structural damage by flood, hurricanes, tornadoes, tsunamis and other natural disasters but it would not usually cover the contents of the building, as that would typically be for the tenant to insure.

The authors are not aware of any case in which tenants recovered rent payments or other costs under business interruption insurance policies as a result of office closures and clean-up costs incurred during the coronavirus pandemic. As far as the authors are aware, business interruption insurance policies are not commonplace in St Kitts and Nevis.

6.12 Restrictions on the Use of Real Estate

A landlord can include in the lease restrictions on how the tenant uses the real estate. Typically, a lease would indicate that the premises is not to be used for any other purpose than what is set out in the lease.

Further, the premises may be subject to zoning regulations and restrictive covenants attached to the property, with which the tenant would be required to comply (see **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**).

6.13 Tenant's Ability to Alter and Improve Real Estate

The rental agreement would normally outline whether a tenant is permitted to alter or improve the real estate and the extent of such changes.

In order to safeguard against the premises being altered in a way that is not acceptable, the landlord would generally request that the tenant seek permission to make alterations or improvements, and expressly state that the tenant is not allowed to make structural changes, or changes that may change the character of the premises. How alterations and improvements are treated is a matter for negotiation between the parties.

6.14 Specific Regulations

There are no specific regulations or laws that apply to leases of particular categories of real estate. However, there may be legislation that governs the area in which the real estate is located – for example, the St Kitts (Planned Community) Act – or covenants applicable to a particular piece of real estate that may affect how a tenant may use a rental property.

Since the start of the coronavirus pandemic, the government has enacted a series of emergency

powers (COVID-19) regulations (at the time of writing, No 16 is in force) that provide extensive safety measures and protocols for residences, offices, retail and hotels to follow. Subject to the regulations, real estate accessible to the public ought to have measures in place to ensure that hygiene, distancing and other protocols are followed. Additionally, the number of persons allowed to frequent the premises at one time has been restricted.

6.15 Effect of the Tenant's Insolvency

If the tenant is insolvent and owes rent, the landlord would be an unsecured creditor entitled to share in the assets of the tenant with other unsecured creditors pari passu.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

In accordance with the Rent Restriction Act, the landlord is precluded from charging any premium, fine or other additional amount other than rent as a condition to the granting, continuance or renewal of a tenancy. The landlord's only recourse in relation to a breach of a tenant's obligations is to serve notice on the tenant, where the Act so allows, and/or institute legal proceedings against the tenant with respect to any damages arising out of the tenant's failure to meet obligations.

As a practical matter, at the commencement of the tenancy, a landlord can negotiate for and secure first and last month's rent and/or a refundable security deposit.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant does not have a right to continue to occupy the rented premises after the expiry or termination of a fixed-term commercial lease.

Tenants can continue to occupy the premises after the expiry of the date set out in an ordinary lease if they exercise an option to renew the lease, or if they pay for the additional time that they remain in the premises, normally on a month-to-month basis until another agreement is made or the tenant is evicted by the court.

It is open to landlords to exercise any of the following options if they require a tenant to vacate premises:

- serve a notice to quit on the tenant;
- apply to the court for recovery of possession of the premises if the tenant does not leave on the date originally agreed or demanded; and/or
- apply to the court for the recovery of the additional rent (also known as mesne profit) for the period the tenant occupied the premises after the expiry of the lease.

6.18 Right to Assign a Leasehold Interest

A tenant may assign its leasehold interest if the terms of the lease permit.

A clause allowing a tenant to sublet or assign a property would normally include the following:

- a requirement that the tenant give notice to the landlord in writing or request the landlord's permission to sublet or assign the property;
- a condition that the main tenant ensures that all the terms, obligations and covenants outlined in the lease are complied with by the person to whom the lease is assigned or underlet; and
- a term indicating that the act of assigning or subletting does not affect the landlord's right of re-entry or right to forfeit the lease or serve

notice to quit on the tenant for breach of the terms of the lease.

6.19 Right to Terminate a Lease

It is standard for a lease to include a clause providing that a tenant may terminate the lease by giving written notice to the landlord. There is no requirement in law for tenants to outline why they are terminating the lease.

A landlord may give the tenant notice to quit in the following circumstances:

- the tenant is in default of paying rent for over 60 days;
- the tenant has been in breach of the obligations under the lease for over 30 days; or
- any of the conditions set out in the Rent Restriction Act for recovery of possession are satisfied.

6.20 Registration Requirements

A lease of three years or more is required by law to be registered in the Registry of Deeds and noted as an incumbrance on the property. Registration is usually undertaken by the landlord. The taxes and fees payable on registration are minimal.

If the lease is executed in St Kitts and Nevis, it is required to be executed before a witness. If the lease is executed overseas, it is required to be executed before a notary public.

A written lease is valid if it satisfies the common law elements governing a lease, in that it:

- identifies the lessor and lessee;
- identifies the property;
- is for a finite duration;
- outlines that rent is to be paid;
- allows for exclusive possession by the tenant; and
- is signed by both parties.

Additionally, a lease can be made orally; however, this is not normally done as an oral lease is unenforceable and recourse for any breach would only be granted if part performance of the oral lease can be shown, so as to satisfy a court that there was, in fact, an oral agreement to lease the property.

6.21 Forced Eviction

The Rent Restriction Act outlines in detail the circumstances upon which the landlord can forcibly recover possession of the rented premises.

The Act states that the court may make an order evicting the tenant and granting recovery of possession to the landlord in the following circumstances:

(a) Some rent lawfully due from the tenant has not been paid for at least 60 days after it has become due.
(b) Some other obligation of the tenancy (whether expressed or implied) has been broken or not performed and, in the case of non-performance of any such obligation by the tenant, the tenant has been in default for at least 30 days.
(c) The tenant or any person residing or lodging with him or her or being his or her subtenant has been guilty of conduct that is a nuisance or annoyance to adjacent or adjoining occupiers, or has been convicted of using the premises or allowing the premises to be used for an immoral or illegal purpose, or the condition of the premises has, in the opinion of the court, deteriorated or become insanitary owing to acts of waste by, or the neglect or

default of, the tenant or any such person and, where such person is a lodger or subtenant, the court is satisfied that the tenant has not, before the making or giving of the notice to quit, taken such steps as he or she ought reasonably to have taken for the removal of the lodger or subtenant.

(d) The premises, being a dwelling house or a public or commercial building, is reasonably required by the landlord for:
  (i) immediate occupation as a residence for himself or herself or for some person wholly dependent on him or her or for any person bona fide residing with him or her, or for any person in his or her whole-time employment;
  (ii) use by himself or herself for business, trade or professional purposes; or
  (iii) a combination of the purposes in subparagraphs i) and ii) above.

(e) The premises, being building land, is reasonably required by the landlord for:
  (i) the erection of a building to be used for any of the purposes specified in paragraph d) of this section;
  (ii) use by himself or herself for business, trade or professional purposes not involving the erection of a building; or
  (iii) a combination of such purposes.

(f) The premises, being a dwelling house or a public or commercial building, is required for the purpose of being repaired, improved or rebuilt, and an undertaking is given that the landlord will, immediately after the completion of the repairs, improvements or rebuilding, give the tenant an opportunity for renewing his or her tenancy at such rent as the rent commissioners may order.

(g) The premises is required for public purposes.

(h) The dwelling house, or the public or commercial building, or the building erected by the tenant on building land, as the case may be, is required by law to be demolished.

(i) The tenant has sublet, or parted with the possession of, the whole or any part of the premises without obtaining the consent of the landlord or being expressly authorised by or under the tenancy agreement or lease so to do.

(j) The tenant of a dwelling house, or of building land on which the building erected by the tenant is used or is intended to be used mainly as a dwelling, uses the house or building mainly for business, trade or professional purposes without obtaining the consent of the landlord or being authorised by or under the tenancy agreement or lease so to do.

(k) In the case of building land, the building erected thereon has been sold under distress for rent.

(l) The dwelling house has been let to a tenant in the employment of the landlord on condition that the tenancy shall subsist only during the continuance of such employment, or only until the expiry of a period not exceeding one month after the termination of such employment, and the employment has terminated, or such period has expired, as the case may be.

(m) The dwelling house has been let to a tenant in the employment of the landlord in consequence of that employment, and the employment has determined or the landlord has offered the tenant suitable alternative accommodation.

Notwithstanding the aforementioned provisions, a court can make an order forcefully evicting a tenant from the premises if it considers it reasonable to make such an order based on the circumstances of the case.

There have been no amendments to the legislation that alter the position that existed with respect to leases prior to the coronavirus pandemic.

6.22 Termination by a Third Party

A lease can effectually be terminated by the government of St Christopher and Nevis or the Nevis Island Administration if the property leased is compulsorily acquired by the government pursuant to the St Kitts and Nevis Land Acquisition Act or the Nevis Land Acquisition Ordinance.

If the governor general considers that the property should be acquired for a public purpose, he or she may, with the approval of the National Assembly, cause a declaration to that effect to be made by the secretary to the Cabinet. The declaration will then be published in two ordinary issues of the gazette (or newspaper, in the case of Nevis) and copies thereof shall be posted on one of the buildings or exhibited at suitable places in the locality in which the property is situated. Upon the second publication, the land shall vest in the Crown.

If any land shall be comprised in a lease for a term of years unexpired and part only of such land shall be acquired compulsorily, the rent payable in respect of the land comprised in such lease may, on the application of the lessor or the lessee to a judge of the High Court, be apportioned between the land acquired and the residue of the land.

After such apportionment, the lessee shall, as to all future accruing rent, be liable to pay only so much of the rent as shall be so apportioned in respect of the residue of the land, and as against the lessee. The lessor shall have all the same rights and remedies for the recovery of such portion of the rent that was held prior to such apportionment. All the covenants, conditions and agreements of such lease, except as to the amount of rent to be paid, shall remain in force with regard to the residue of the land in the same manner as they would have done if the residue of the land only had been included in the lease.

Where it is shown that the compulsory acquisition of a portion of land comprised in a lease has rendered the residue unsuitable for the purpose for which the land was leased or where in the circumstances the said court considers it just so to do, the court may rescind the lease altogether, and in such case, the lessee shall only be liable to pay the rent due at the date of the occurrence of the circumstances on which the rescission order is based.

Where, as the result of such rescission of lease, the lessor or lessee suffers any loss or injury, he or she shall be entitled to compensation by the government.

6.23 Remedies/Damages for Breach

In the event of a tenant breach and termination of the lease, there are no statutory or other customary limitations on damages that a landlord may collect. The landlord may pursue remedies other than charging the remaining rent and evicting the tenant if the circumstances of the case form the basis for seeking any other remedies. Landlords would typically hold a security deposit that is at least equivalent to one month's rent, which is customarily applied to repair any dam-

age to the property caused by the tenant or any unpaid utility bills left by the tenant.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common methods used to price construction projects are lump sum contracts and unit price contracts.

Lump Sum Contracts

If there is a lump sum contract, the contractor estimates the total cost of constructing the project and the fixed lump sum price is included in the contract. Therefore, the owner of the property will only be responsible for paying that amount in accordance with the terms of the contract.

With this type of contract, the owner effectively assigns all the risk of completing the project to the contractor, who can, in turn, request a higher mark-up. However, once the fixed sum is agreed, if the contractor underestimated the cost of the project, the contractor's profit will be reduced. Likewise, if the contractor overestimated the cost of the project, then his or her profit will be increased.

Unit Price Contracts

If there is a unit price contract, then the risk of overestimating or underestimating the cost of the project is relinquished since the contractor would give an estimate for the work to be done on each unit or phase of the development, and the owner would be responsible for paying the contractor periodically for the work done on each unit or in advance of the work on each unit.

This method is typically used for large projects, as the contractor would have the option of refraining from continuing the remaining unit until the cost of the work done for each unit is paid. Additionally, if, in the development of the various units, an unexpected or unanticipated risk presents itself or if the development of one unit is more challenging than others, then the contractor is able to increase the amount to meet the risk.

7.2 Assigning Responsibility for the Design and Construction of a Project

It is standard procedure that a head architect or contractor supervises a development project and allocates tasks to the various persons working on the project. The head contractor operates as a bridge between the owner and the workers. Normally, that contractor is also responsible for paying the persons working on the project.

It is the norm for the head contractor to set up an integrated system in which the designers and builders of the project work together to safeguard against making avoidable changes and unnecessary re-evaluations in relation to the project. This system allows for the construction workers to ascertain the information needed to produce a more accurate representation of the design since the designers and construction workers would be working simultaneously.

7.3 Management of Construction Risk

The devices most commonly used to manage construction risk on a project are indemnifications and warranties.

Indemnifications

An indemnification clause in a construction contract is included to ensure that the general contractor of the project indemnifies the property owner from any harm caused by its workers.

Warranties
A warranty would be used in a construction contract to specify the course of action to be taken in the event that something goes wrong.

Limitation Act
Any construction contract is subject to the provisions of the Limitation Act, which outlines that a party has six years to sue for a breach of contract, or under a contract, which time can be extended when the breach is acknowledged or a promise is made to fulfil the terms of the contract.

7.4 Management of Schedule-Related Risk
The parties to a construction project would typically include a clause that facilitates the management of schedule-related risks. The contract can outline that the developers compensate the owner if the project is not completed on schedule due to the fault of the persons working on the project. The contract can also set out what is considered as a reasonable delay in the schedule or what would happen if the delay in the schedule was due to any unforeseen circumstances. The specific terms would be based on the negotiations of the parties taking into consideration the nature of the project and issues related to the location of the project, amongst other things.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance
An additional form of security common to construction projects is performance bonds. The owner or investor of a construction project would generally require the general contractor to get the other contractors or project managers to sign performance bonds so that they do not lose the value of the work in the event of an unforeseen circumstance that would adversely affect the project, such as the insolvency of the party before the completion of the project.

7.6 Liens or Encumbrances in the Event of Non-payment
A lien or encumbrance is generally seen in unit price contracts. Those contracts generally stipulate that the developer is paid after or in advance of the construction of a unit. If the payment is not forthcoming, the developer can cease working on the next unit or phase until the contracted payment is made. It is possible for an owner, in an effort to prevent delays in the project, to include a term in the contract that the developer continues working, subject to the payment of interest as a penalty for non-payment.

7.7 Requirements Before Use or Inhabitation
There is no set requirement imposed by the law before a development project can be inhabited or used for its intended purpose. It is only subject to approvals and conditions when permission for the development is being sought. Contracts may require the contractor to issue a certificate of occupancy before the project can be inhabited for insurance or other purposes.

8. Tax

8.1 VAT and Sales Tax
Value added tax is payable on the sale of goods and services. Therefore, VAT is not paid on the sale or purchase of real estate. However, if the attorney-at-law conducting the transaction is registered for VAT, VAT would be payable on his or her legal fees.

8.2 Mitigation of Tax Liability
In order to mitigate the tax liability on acquisitions of large real estate portfolios, the Stamps

Act prescribes a reduced duty or an exemption from paying stamp duty depending on various factors prescribed in the Act. By way of example, transfers made by or on behalf of the Frigate Bay Development Corporation or by or on behalf of the National Housing Corporation are exempt from stamp duty. An investor may apply to the government for concessions in relation to the taxes payable on the development project. Concessions are made with a view to stimulating investment in the local economy.

8.3 Municipal Taxes

In accordance with the Licence on Business and Occupations Act, every person wishing to carry on a business, occupation or trade or practising any profession mentioned in the Schedule of the Act (hereinafter referred to as "business activities") is required to apply for a licence prior to carrying out those business activities. The fee to be paid would depend on the type of business activity being carried out, as prescribed by the Schedule of the Act.

8.4 Income Tax Withholding for Foreign Investors

There is no personal income tax in St Kitts and Nevis. However, the Income Tax Act imposes a 10% withholding tax if a person resident in the Federation pays to any person who is not resident any income as prescribed by the Act, including rental income and income under a lease or contract.

8.5 Tax Benefits

There are no tax benefits from owning real estate per se.

Trends and Developments

Contributed by:
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Joseph Rowe, Attorneys-at-Law is a boutique law firm with offices in Nevis, St Kitts and Grenada with attorneys-at-law also qualified to practice in the island of Anguilla. The firm comprises a 15-person professional team, who pride themselves on having a client-focused law practice providing quality legal services with a view to achieving the best results possible for its clients. Its legal expertise and professional services include citizenship by investment (investment migration), offshore companies and trusts, real estate transactions (including commercial, residential, hotel and investment real estate), maritime/admiralty law and civil and commercial litigation. Recent engagements include providing legal representation for the first geothermal power plant project on the island of Nevis; acting for developers of a commercial complex; representing the developer of resort development projects; successfully securing compensation for a multi-million-dollar beachfront property that was compulsorily acquired by the government in Nevis; and representing multiple purchasers and vendors of luxury real estate within a 5-star resort villa development.

Authors



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Daisy Joseph Andall became a partner at Joseph Rowe in 2021 and has over 13 years' experience as a lawyer in multiple jurisdictions in the Caribbean. She has successfully led and managed negotiations with regional governments on behalf of clients in the areas of land acquisition, development permitting, tax concessions packages and labour matters. Her primary areas of practice include corporate law, real estate development, investment migration (CBI), conveyancing and property law and employment law. Daisy is called to the Bars of St Kitts & Nevis and Grenada and is a former executive member of the Grenada Bar Association.

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Real Estate in St Kitts and Nevis Through the Citizenship by Sustainable Investment Programme

What is new in 2024?

Investors around the world are drawn to the prospect of diverse real estate investment opportunities in developing island-states such as the Federation of St Kitts and Nevis (also called St Christopher and Nevis).

Real estate purchase in St Kitts and Nevis is simple and non-citizens are welcome to own, rent or otherwise invest.

A non-citizen may be required to obtain an Alien Landholding License (ALHL) to hold land. Note that real estate within specific locations in St Kitts are currently exempt from this requirement. Alternatively, by applying for citizenship and purchasing government-approved real estate, whether within a development or a private home, an ALHL is not required.

Unique to only five Caribbean islands including St Kitts and Nevis, an individual's investment in real estate can carry with it added benefits of obtaining a second citizenship in an economically and politically stable tropical paradise in the Caribbean.

Real estate transactions form a significant part of the government's revenue and, as such, the government of St Kitts and Nevis is constantly exploring ways to stimulate the real estate market. Significant resources have been dedicated to the promotion of St Kitts and Nevis around the world as a premier destination for visitors and new or second home seekers alike. The authors have seen the demand for high-end properties remaining stable, with real potential for growth.

Recently, the government of St Kitts and Nevis has taken decisive steps to bolster the real estate market. The St Kitts and Nevis Citizenship by Investment programme has been replaced by the St Kitts and Nevis Citizenship by Sustainable Investment (CSI) programme. Real estate investment remains one of the key features of the CSI programme.

To that end, the government of St Kitts and Nevis has published new CSI Regulations that took effect on 27 July 2023.

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St Kitts and Nevis has fantastic real estate options for the buyer who wants more.

The real estate market in St Kitts and Nevis has shown robust activity in the past year. There has specifically been steady interest in high-end options and prospectively high-end "fixer-uppers". At the moment, a number of distressed properties or hotel properties with under-realised potential remain available for purchase. It is possible that such properties can produce solid returns on investment and some fun-in-the-sun for anyone up to the challenge.

Real estate units

Buyers who purchase approved real estate, whether a condominium unit, villa or private home, have the opportunity to apply for citizenship in St Kitts and Nevis under the CSI programme. Anyone interested in making use of this benefit must comply with the July 2023 CSI Regulations and satisfy the minimum investment requirements thereunder.

Some of the highlights within the current real estate development offerings in St Kitts and Nevis are internationally branded private resort residences. These properties provide the exceptional opportunity of owning and living in the most exclusive gated community, with luxury services and amenities at the owners' disposal. Owners receive the same five-star amenities and services as hotel guests. Real estate investments in these types of developments can qualify the purchaser to become a citizen of St Kitts and Nevis.

In a bold move in July 2023, the government of St Kitts and Nevis increased the minimum investment required under the CSI programme by 100%. The real estate investment option now allows CSI applicants to acquire citizenship by making a minimum investment of USD400,000 (previously USD200,000) in a real property designated by the government as an Approved Development.

The minimum investment of USD400,000 does not include due diligence fees, CBI application processing fees, government approval fees, returns on investment, agent fees or any other commissions and fees, all of which must be paid in addition to the minimum investment amount.

The minimum holding period of seven years remains unchanged.

What has changed is how an owner can resell to a new purchaser also seeking citizenship. In order for the real estate unit to qualify the secondary purchaser for citizenship, the owner must successfully apply for the real estate unit to be sold as an Approved Private Home pursuant to the July 2023 CSI Regulations. More on the Private Home option is explained next.

Private home sales

Under the new CSI Regulations, "Private Home Sale Investment Option" remains a permanent investment option under the CSI programme. However, the requirements for a private home to qualify a buyer and his/her family for St Kitts and Nevis citizenship have changed.

Now, only a private home owned by a citizen of St Kitts and Nevis can qualify for sale to a purchaser seeking citizenship under the CSI programme.

The CSI Regulations clearly provide that where any citizen of St Kitts and Nevis is a registered owner by Certificate of Title of the following real estate:

- land on which a single-family private dwelling home is constructed; or
- a condominium unit:
  (a) previously sold as the subject of CBI application; and
  (b) for which the statutory timeframe for resale has elapsed,

and wishes to sell such real estate to a purchaser seeking to apply for citizenship under the CSI Regulations, the citizen or their real estate agent shall apply to the governing body for such real estate to be designated as an Approved Private Home.

The Private Home Sales Investment Option allows CBI applicants to acquire citizenship by making a minimum investment of USD800,000 (previously USD400,000) in a private dwelling house or USD400,000 (previously USD200,000) for a single-family condominium unit designated as an Approved Private Home. An investment in one private home can only be used to support a CSI application for one family (up to three generations), even if the investment amount exceeds the minimum investment by several multiples.

Under the current CSI Regulations, an Approved Private Home is subject to the following conditions.

- It can only be resold after seven years from issuance of the formal title document to the new owner.
- It can only be resold to another purchaser seeking to apply for citizenship if the Federal Cabinet is satisfied that substantial further investment was injected by way of further construction, renovation or otherwise.
- It cannot be converted into apartments or multi-family condominiums or otherwise subdivided.

The CSI programme offers real estate development financing opportunities

Obtaining financing for tourism hospitality construction or renovation projects in the Caribbean can be expensive and challenging. This is where the CSI programme holds measurable benefits for prospective developers, whether large or small.

Where a developer or prospective developer of land in St Kitts and Nevis (i) owns the land or has entered into a binding purchase and sale agreement; (ii) has approval in principle for development of the land from the local authorities; and (iii) wishes to sell real estate units in that development to purchasers interested in acquiring citizenship, then that developer can apply for an Approved Development under the CSI Regulations.

The St Kitts Investment Promotion Agency (SKIPA) is responsible for reviewing applications by developers and for making recommendations to the governing body under the CSI Regulations for that development to be designated an Approved Development.

For anyone reading this article and considering real estate development opportunities in St Kitts and Nevis, here are some useful tips before you approach SKIPA. Your proposal should contain:

- a description of the project including size, capital investment, concept and layout designs;
- good source and proof of financing;
- a realistic projection for completion of the project or each phase of the project, if applicable;
- a statement on the impact your real estate development project will positively impact the St Kitts and Nevis economy, whether through

introduction of innovations, creation of jobs, skills development, etc;
- a five-year pro forma cash flow statement;
- an Environment Impact Assessment;
- a comprehensive list clearly identifying the licences or concessions required for the real estate development project; and
- due diligence information on all natural persons who are involved in the management or ownership of any corporate entity involved in your project.

Be prepared to have copies of all supporting documents notarised and apostilled, if applicable.

Based on the type of real estate development being undertaken, there may be additional considerations. As a first step, it would be prudent for any potential investor to retain knowledgeable and credible professionals locally. This is relevant whether for a simple purchase of a single family dwelling home or a multi-phase resort development.

The Public Benefit Option

The Public Benefit Option (PBO) is gaining momentum in St Kitts and Nevis. This option was also legislated under the July 2024 CSI Regulations and is an alternative for those seeking to do real estate development outside of the traditional hotel or condominium structures.

Innovative investors wishing to develop a project which brings substantial benefit to the people of St Kitts and Nevis can apply to be designated as an Approved Public Benefactor. These investors can then apply for their projects to be designated as Approved Public Benefit Projects qualified for sale to persons seeking citizenship under the PBO.

PBOs can be linked to real estate developments, but likely require some element of technology and capacity building, in addition to job creation and other aspects of "public benefit".

Under the Public Benefit Option, each individual seeking citizenship under the St Kitts and Nevis CSI programme is required to make a minimum contribution of USD250,000 in a unit of an Approved Public Benefit Project, to be paid to the relevant Approved Public Benefactor.

Ultimately, the St Kitts and Nevis CSI programme is a less expensive means of financing a real estate development project when compared to traditional financing options. Importantly, it offers benefits to potential real estate purchasers, developers and to the state that exceed those generated in traditional real estate transactions.

There remain several intriguing sites, both in St Kitts and in Nevis, that have the potential to be prime opportunities for real estate development. From the charming but neglected boutique hotels of yesteryear to modern eco-friendly large-scale mixed-use properties, potential investors are likely to find a gem. The authors have found that the market has remained a buyer's market into the second quarter of 2024. There are signs that a shift to a competitive seller's market is on the horizon.

For those who are not considering citizenship at this time, purchasing real estate in St Kitts and Nevis can be quite seamless, even for non-nationals. The process for obtaining an Alien Landholding License is straightforward and a licence can be obtained in a reasonable timeframe. Additionally, as mentioned earlier in this article, certain areas in St Kitts have been exempted from the Alien Landholding License requirement. Accordingly, persons desirous of

purchasing real estate in those special zones can become owners of real estate without any requirement to apply or pay for an Alien Landholding License.

In keeping with the very deliberate efforts by the government to support investment in St Kitts and Nevis, the authors are seeing initiatives such as the Inaugural Investment Gateway Summit carded for July 2024. This Summit is focused on showcasing the dynamic investment opportunities that exist in the twin-island Federation of St Kitts and Nevis. The sites mentioned in this article are likely to take centre stage in synergy with the CSI programme.

St Kitts and Nevis is welcoming persons globally to explore and invest. There is a focus on sustainable development and initiatives that support this vision. Whatever the investment being considered, it is paramount to work with trusted independent professionals who can guide clients through the process with certainty and efficiency.

Once an individual has identified a property and has or intends to make an offer, the authors recommend he or she engage a local attorney to prepare or review the Purchase and Sale Agreement. It is prudent, where real estate is being purchased by foreign persons, that the closing of the sale be expressly contingent on approval of the application for an Alien Landholding License or approval of the application for Citizenship by Substantial Investment. Allowances should be made for possible extensions, in the event the relevant application is delayed for reasons beyond the purchaser's control.

SWITZERLAND



Law and Practice

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Walder Wyss Ltd has specialised and established itself in Switzerland's real estate sector over the course of many years. Its experienced and well-known real estate team consists of more than 30 lawyers and tax experts, and is one of the largest and most specialised in Switzerland, enabling it to handle highly complex real estate transactions, planning issues and real estate litigation efficiently and with an integrated perspective. Walder Wyss advises real estate players in all parts of Switzerland through offices in Zurich, Geneva, Basel, Lugano, Bern and Lausanne, which also offer notarial services such as notarisations of sale and purchase agreements. The firm works with clients to develop solutions that generate added value and are executed with interdisciplinary project teams where necessary.

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1. General

1.1 Main Sources of Law

The main sources of real estate law in Switzerland are the Swiss Civil Code and the Swiss Code of Obligations.

1.2 Main Market Trends and Deals

Real estate in Switzerland has come to the end of its current cycle, with prices declining in some market segments for the first time in many years. Accordingly, as there seem to be some doubts in the market as to the correct price level, the transaction volume started to decrease in the first half of 2023, and not all transactions could successfully be closed. However, there were still several interesting transactions in Switzerland and, compared to other European countries, there was no credit crunch so financing is still available on a large scale. Interest rates have already started to decline, which has boosted the transaction market.

Some proptech companies are gaining substantial market shares, and new technologies will certainly impact the market. Alternatives to traditional bank financing seem to have maintained their market shares, but did not grow in 2023.

1.3 Proposals for Reform

There are currently no planned reforms that might affect real estate in Switzerland on a federal level, but it became obvious that ESG will have a significant impact on real estate in the coming years.

2. Sale and Purchase

2.1 Categories of Property Rights

The categories of property rights that can be acquired are:

- freehold;
- leasehold;
- co-ownership; and
- storey-ownership rights.

2.2 Laws Applicable to Transfer of Title

Transfer of title is primarily regulated by the Swiss Civil Code and the Federal Ordinance of Land Registry. The transfer of residential real estate to any foreign person is generally restricted, according to the Federal Law on the Acquisition of Real Estate by Persons Abroad (the Lex Koller). Tax issues also have to be considered, although these differ from canton to canton.

2.3 Effecting Lawful and Proper Transfer of Title

The transfer of real estate is registered at the competent land registry. Any buyer of real estate acting in good faith is protected by the information contained in the land registry, so no title insurance is required in Switzerland. The COVID-19 pandemic did not change anything with respect to such procedures and regulatory requirements.

2.4 Real Estate Due Diligence

As registration is conclusive, legal due diligence involves analysing the land register extract and its supporting documents, which shows all relevant property information. In addition, any existing leases must be examined, since these are transferred to the buyer as the new landlord upon the purchase of the property. Another aspect of due diligence relates to environmental law.

In addition to legal due diligence, prudent buyers also perform tax, technical and financial due diligence. If a foreign person buys property that includes real estate that is not commercial property or provides for relevant land reserves,

it must be verified that there is no infringement of the Lex Koller. This type of purchase can be deemed void, since the Lex Koller restricts foreign persons from buying residential and other non-commercial real estate in Switzerland. Financing transactions should be examined on a case-by-case basis.

2.5 Typical Representations and Warranties

The warranties typically given by a seller within a share deal include corporate warranties relating to the correct organisation and valid existence of the company, accurate correct presentation of the financial statements and title to shares. Other important warranties relate to the accuracy of rent rolls, and the due diligence information being accurate, complete and up to date. Moreover, specific tax representations are usually contained in the purchase agreement. In both asset and share deals, the seller does not usually provide any warranty as to the substance of the building. The seller's other representations are often qualified by the seller's knowledge. Due to COVID-19, a new representation relating to waivers of rent claims in the past was typically included in real estate transactions relating to commercial premises.

In share deals, most of the seller's warranties are often capped at a certain amount – eg, 10% of the asset's price. However, such cap normally does not apply to the seller's title in the shares. In case of any misrepresentation, the seller is liable to compensate the buyer for any damage incurred. In share deals, part of the purchase price is often held in escrow for a limited period of time in order to protect the buyer.

Representation and warranty insurance is very unusual in real estate transactions.

2.6 Important Areas of Law for Investors

Contract law, property law, building law, lease law and environmental law are the most important areas of law for an investor to consider when purchasing real estate.

2.7 Soil Pollution or Environmental Contamination

Basically, the buyer of a real estate asset is responsible for soil pollution or the environmental contamination of a property even if they did not cause the pollution or contamination, since the legal owner of the property is partly liable for contamination of the real estate, even if contamination took place pre-ownership. Moreover, a landlord can be held responsible for pollution caused by its tenant.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Based on the applicable building law, the buyer usually has some certainty regarding the permitted uses of a property. In case of any uncertainty, the issue can be discussed with the competent authority, which can also impose specific rules for a property or area.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental taking of land, condemnation, expropriation and compulsory purchase are possible. The proceedings vary, depending on whether the expropriation is based on federal or cantonal law. However, the landlord has constitutional rights under all relevant proceedings, and is usually fully compensated.

2.10 Taxes Applicable to a Transaction

In most cantons, cantonal and/or municipal real estate transfer taxes apply to the transfer of real estate. Generally, the buyer pays the tax, but the seller is jointly and severally liable for payment.

The rates range between 1% and 3.3%. It is not uncommon for the parties to contractually agree to share the transfer tax.

In some cantons, there is no real estate transfer tax in share deals. Also, corporate restructurings (including of real estate companies) do not generally trigger transfer taxes and similar charges. Further exceptions are regulated in Article 12(3) of the Federal Act on the Harmonisation of Direct Taxation at Cantonal and Communal Levels. Most cantons that impose real estate transfer tax can secure their corresponding tax receivables by a first-ranking legal lien on the real estate. In addition, the transfer of real estate is subject to cantonal and/or municipal land registry and notary fees.

2.11 Legal Restrictions on Foreign Investors

Foreign ownership of residential real estate and, to some extent, land reserves is restricted by the Lex Koller. In the case of an infringement, the transaction can be deemed void, which can even lead to criminal sanctions. Transactions that have a similar effect to ownership should be examined on a case-by-case basis, as the Lex Koller governs not only the mere ownership of residential real estate, but also aspects such as financing, long leases, etc. Exceptions exist for holiday apartments, serviced apartments, inherited real estate, etc. If there is any doubt, rulings from the competent Lex Koller authorities are sought for confirmation and legal certainty.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

While Swiss and foreign institutional investors (eg, pension funds, sovereign wealth funds and insurance companies) invest and hold significant real estate portfolios that are financed without external financing, other investors typically finance through a mix of equity and external funding sources (secured term loans, sometimes revolving loans, development financings). Traditionally, Swiss banks have held the lion's share of the domestic real estate financing market, but new refinancing methods may make it more attractive for foreign banking and non-banking lenders to re-enter the market – eg, following international investors.

3.2 Typical Security Created by Commercial Investors

A typical security package would consist of a security interest in mortgage notes (*Schuldbriefe*), which can take the form of mortgage notes in paper form (*Papierschuldbriefe*) or registered mortgage notes (*Registerschuldbriefe*).

In addition, rent, insurance claims and other receivables are typically pledged or assigned for security purposes. Pledges over the shares of the borrower and security interest in bank accounts are customary.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security to foreign lenders with respect to Swiss commercial real estate financing transactions, nor are there any regulatory restrictions on cross-border lending in general. The financing of residential real estate by foreign lenders will have to be analysed carefully under the applicable Lex Koller legislation restricting the acquisition of residential real estate in Switzerland by foreigners.

However, financing structures typical in the Swiss residential mortgage market (standard security package, standard terms of the loan

agreement, LTV below 80%, etc) should not usually raise concerns. If there is any uncertainty, Lex Koller ruling confirmations are available from the competent cantonal authorities for individual cases; for formal reasons, the Swiss Federal Office of Justice no longer seems to be willing to issue general letter confirmations on covered bond programmes or the like, for example, but has not changed its general view on the permissibility of such structures. It would be desirable – de lege ferenda – for the legislator to exempt such financing transactions from the applicability of the Lex Koller legislation in the first place, to further enhance legal certainty for debt capital market transactions and novel origination structures that will rather involve lenders other than Swiss banks.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Small registration fees apply to the registration of holders of a mortgage note in the creditor register (*Gläubigerregister*) of the competent land registry. However, such registration is only a perfection requirement for the mortgage security in case of a registered mortgage note (*Registerschuldbrief*). For a mortgage note in paper form (*Papierschuldbrief*), such registration rather serves administrative purposes.

There are special withholding taxes on interest payments at both federal and cantonal levels, to the extent foreign lenders are involved. A refund of the Swiss source tax (or reduction at source) will be subject to any applicable double taxation treaty protection. General federal withholding tax on interest payments may also have to be considered, depending on the exact funding structure (banks, non-banks, double taxation treaties, etc). Depending on the location of the property, transfer taxes might apply to the direct and indirect transfer of a Swiss property. Real estate capital gains are taxed either by special real estate capital gain taxes (RCGT) or by ordinary income taxes (this varies from canton to canton). Ordinary notarial and land registry fees will apply. Finally, it is always recommended to keep an eye on Swiss VAT aspects as well (with respect to transfers of Swiss real estate but also with respect to deemed servicing fees, etc).

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under Swiss corporate and tax laws, financial assistance and corporate benefit rules will apply to any upstream or cross-stream security, guarantee or joint liability. The rules are rather detailed and complex but, in a nutshell, the value of any such "impaired" security will be limited to freely distributable reserves (that could be paid out as a dividend) of the Swiss company in question, subject to general Swiss federal withholding tax of 35%, if applicable.

3.6 Formalities When a Borrower Is in Default

The Swiss enforcement process is a court-guided process, the timing of which will very much depend on the behaviour of the borrower in question. However, in larger transactions, private sale mechanisms are often agreed contractually to avoid a lengthy process and a public auction with associated higher costs.

3.7 Subordinating Existing Debt to Newly Created Debt

The subordination of existing debt to newly created debt is generally possible and frequently done, even though there are some residual uncertainties around the enforceability of such arrangements in the insolvency of the borrower. However, the general view of legal scholars is that Swiss insolvency administrators will be

bound by such contractual arrangements as well.

3.8 Lenders' Liability Under Environmental Laws

Generally, lenders who merely financed a property will not become liable under environmental laws but the borrower may become liable, which may have an indirect effect on the financing and potential enforcement scenarios.

3.9 Effects of a Borrower Becoming Insolvent

If a borrower becomes insolvent, security granted by a Swiss borrower will not become void automatically. It should be noted, however, that Swiss law knows the concept of avoidance actions, providing for hardening periods of one to five years. Upstream and cross-stream securities may also be limited in value. Enforcement actions may become the subject of official proceedings run by the court or insolvency administrator.

3.10 Taxes on Loans

For foreign investors, Swiss tax law imposes a source tax on interest payments on loans, which are secured with a mortgage lien/pledge on a Swiss property. The tax is 3% at the federal level. Cantonal and communal tax is also triggered, at rates of between 10% and 30%, depending on the location. This source tax may be reduced or even avoided if treaty protection can be achieved under a double tax treaty. Moreover, if a loan qualifies as a bond under withholding tax aspects, Swiss withholding tax of 35% is triggered on interest payments. Withholding tax can be reduced or even avoided if such is permitted by an applicable tax treaty.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

In Switzerland, regulatory responsibilities are shared among various authorities at the federal, cantonal and municipal levels. Pursuant to Article 75 of the Swiss Constitution, the Confederation shall lay down principles on spatial planning, which are binding on the cantons. Except for some specific regulations at federal level, zoning and building regulations are enacted by the cantons and implemented by the municipal building authorities. Accordingly, there are 26 different cantonal zoning and building regimes. Any construction project and any change to an existing building or construction is subject to a building permit from the competent (typically local) authority.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Design, appearance and construction method requirements vary by zones. Typically, specific dimension and distance regulations apply. Buildings and land under cultural heritage protection or nature conservation areas are subject to particularly strict regulations.

4.3 Regulatory Authorities

Building permits must usually be obtained from the municipal authority where the project is located. The local authority co-ordinates with the cantonal authorities and further bodies involved in the granting of the building permit. Buildings located in non-construction zones require a cantonal building permit.

The following legislation applies:

- the Federal Act on Spatial Planning (*Raumplanungsgesetz* – RPG);
- cantonal planning and construction laws (*Planungs- und Baugesetz*); and
- municipal zoning and construction laws (*Bau- und Zonenordnungen*).

Various other federal and cantonal laws also apply, such as:

- the Environmental Protection Act (*Umweltschutzgesetz*);
- the Noise Control Act (*Lärmschutzverordnung*);
- the Clean Air Act (*Luftreinhalteverordnung*);
- the Water Protection Law (*Gewässerschutzgesetz*);
- the Energy Law (*Energiegesetz*), etc.

4.4 Obtaining Entitlements to Develop a New Project

The building permit application must be filed with the competent authority (typically the municipal authority), which will publish it if all formal requirements are met. The building permit must be granted if the project complies with all applicable regulations.

Third parties that are affected by the project (eg, neighbours) and organisations entitled to appeal may object.

4.5 Right of Appeal Against an Authority's Decision

Applicants and third parties that have objected to the building permit have the right to appeal to the superior administrative authority against the relevant authority's decision. The decision of the superior administrative authority may be appealed to the Administrative Court.

4.6 Agreements With Local or Governmental Authorities

Formal agreements with the authorities are not permitted, with the exception of certain aspects of the project (eg, infrastructural requirements). However, informal, non-binding negotiations with the authorities often take place before the building permit application is filed.

4.7 Enforcement of Restrictions on Development and Designated Use

The competent authority must monitor the realisation of the project, and the completed project is subject to formal acceptance proceedings. Violations of the permit are subject to sanctions, and the removal of illegal structures may be ordered.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Depending on the corporate structure of the buyer, including the ultimate beneficial owner or sponsor, newly established Swiss or foreign special purpose vehicles (SPVs) are used by investors to hold real estate assets. Foreign SPVs are primarily domiciled in countries that have entered into double taxation treaties with Switzerland, to avoid withholding tax and ease an exit by share deals. Foreign SPVs domiciled in offshore jurisdictions are also used. Real estate investment funds also commonly invest in Swiss real estate.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A company with limited liability may be established by natural persons or legal entities. This requires a declaration in front of a public notary that the founder(s) is (are) forming such compa-

ny, laying down the articles of association therein and appointing the governing bodies. The company is entered in the commercial register of the place in which it has its seat and acquires legal personality once it has been registered in the Commercial Registry.

5.3 REITs

Switzerland has real estate investment funds, but not REITs as such.

There are listed and non-listed real estate investment funds in Switzerland. If the units of such Swiss real estate funds are regularly traded, foreign investors can generally acquire fund units, even if the underlying investment is residential real estate. However, the fund management company must consist of people not qualifying as foreigners under the Lex Koller. With respect to a real estate investment fund with underlying commercial real estate, there is no restriction for foreign investors at all.

5.4 Minimum Capital Requirement

The most commonly used investment vehicle is the company limited by shares, which must have a minimum share capital of CHF100,000, of which at least CHF50,000 must be paid in. Its little sister, the partnership limited by shares, must have a minimum share capital of CHF20,000. For investment funds vehicles, the capital requirements are generally higher.

5.5 Applicable Governance Requirements

The governance requirements differ between investment vehicles that require approval from Switzerland's Financial Market Supervisory Authority (FINMA) and investment vehicles that do not require any public approval. For the latter, general corporate governance rules apply. Authorisation for investment vehicles requiring FINMA approval is granted if the following requirements are met, amongst others:

- the persons responsible for management and the business operations have a good reputation, guarantee proper management, and have the requisite specialist qualifications;
- the significant shareholders have a good reputation and do not exert their influence to the detriment of prudent and sound business practice;
- compliance with the duties is assured by internal regulations and an appropriate organisational structure; and
- sufficient financial guarantees are available.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual entity maintenance and accounting compliance cost varies strongly depending on whether it is a regulated or non-regulated investment vehicle, and depending on the real estate assets and structure of the vehicle.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Basically, Swiss (private) law provides for two types of purely contractual arrangements (as opposed to rights in rem such as ownership and ground lease): the lease and the usufructuary lease. Public bodies may also grant public works constructions for certain infrastructure projects.

6.2 Types of Commercial Leases

There are no different types of commercial leases, but leases may qualify as regular, double-net or triple-net agreements.

6.3 Regulation of Rents or Lease Terms

Swiss tenancy law contains various mandatory provisions (typically in favour of the tenants). Excessive rents are prohibited, and tenants have the right to challenge them in court as being abusive.

6.4 Typical Terms of a Lease

Typically, the lease term is not below five years (due to the requirement of a minimum term of five years for the rent to be subject to indexation). Frequently, the parties agree on the tenant's options to extend the lease. Lease terms may also be concluded for an indefinite period.

With the exception of minor repair works, all maintenance and repair costs must be borne by the landlord. Double-net and triple-net structures are valid, subject to certain conditions (eg, the tenant must confirm that the transfer of maintenance and repair obligations to them has been sufficiently reflected in the calculation of the rent).

As a result of COVID-19, parties to leases often include force majeure clauses dealing with the handling of pandemic situations and responsibilities in this respect, amongst other issues.

Typically, rent is paid in advance, either monthly or quarterly.

6.5 Rent Variation

The parties may agree on certain adaptations, subject to changes of the interest rate level and, alternatively for leases with a minimum term of five years, of the Swiss Consumer Price Index (so-called indexed rent). The parties may also agree on staggered rents (although not in combination with indexed rents for the same period) and special types, such as turnover rents.

If the landlord makes value-adding investments in the leased premises, it has the right to unilaterally increase the rent, subject to certain statutory regulations.

6.6 Determination of New Rent

Typically, Swiss tenancy law provides the framework for the calculation of any rent increases.

6.7 Payment of VAT

Basically, pursuant to Article 21 paragraph 2 No 21 of the Swiss VAT Law, real estate rent is not subject to VAT (with certain exceptions). However, for commercial leases, the landlord may opt for the VAT taxation of the rent.

6.8 Costs Payable by a Tenant at the Start of a Lease

Typically, the lease agreement includes an obligation for the tenant to provide security for the payment of the rent before the handover of the leased premises (rent deposit, bank guarantee). If the tenant carries out the fit-out, it must obviously bear such costs, unless the landlord voluntarily contributes to such tenant modification costs.

6.9 Payment of Maintenance and Repair

Maintenance and repair costs for a building and its surroundings (landscaping) are included in the ancillary costs to be paid by the tenant. The costs related to the common areas are allocated to each tenant separately (typically based on its share of the leased premises).

6.10 Payment of Utilities and Telecommunications

Costs and charges arising solely from the business operations of the tenant are typically borne by the tenant, even if invoiced to the landlord. The costs related to the common services and infrastructure are allocated to each tenant sepa-

rately (typically based on the share of its leased premises).

6.11 Insurance Issues

The owner must insure a building and pay such costs; insurance costs must not be included in the ancillary costs.

6.12 Restrictions on the Use of Real Estate

Basically, the parties are free to agree on limitations in relation to the use of leased premises; they can even agree on an obligation to use – eg, for tenants in shopping facilities.

A sublease by the tenant is subject to the landlord's approval, but such approval may only be withheld if:

- the tenant refuses to disclose the terms of the sublease;
- the terms of the sublease are abusive; or
- the sublease has major disadvantages for the landlord.

6.13 Tenant's Ability to Alter and Improve Real Estate

If a tenant wants to alter or improve the rented property, the landlord's written permission is required. The landlord's consent may be subject to the obligation of the tenant to remove its alterations at the end of the lease and to waive any rights to be compensated for the added value of such works.

6.14 Specific Regulations

Basically, Swiss tenancy law differentiates between commercial and residential leases only. Certain mandatory provisions apply only to residential leases.

6.15 Effect of the Tenant's Insolvency

In the case of a tenant's insolvency, all rent receivables due become assets in bankruptcy. However, the lease does not end automatically: the landlord can request security for future rents. If security is not provided within a grace period, the landlord is entitled to give extraordinary notice and immediately terminate the lease contract.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The following forms of security can be provided to a landlord to protect against a failure by the tenant to meet its obligations:

- rent deposits;
- bank guarantee/surety; and
- the additional liability of a third party/affiliate.

6.17 Right to Occupy After Termination or Expiry of a Lease

Once a lease is terminated, the tenant has no right to further occupy the leased premises. However, tenants may request the extension of the lease within 30 days of the termination by the landlord or two months before the end of the fixed lease term, where termination of the lease would cause a degree of hardship for them or their family, which cannot be justified by the interests of the landlord.

Due to a tenant's mandatory right to claim an extension of the lease, a landlord's rights in relation to legal measures are rather limited, unless it becomes obvious that the tenant will not leave on the agreed (and court-ordered, respectively) date. Under these circumstances, it might be possible to evict the tenant on the date of termination.

6.18 Right to Assign a Leasehold Interest

Pursuant to mandatory tenancy law, the tenant may transfer the lease or sublease all or a portion of the leased premises, subject to certain conditions. The landlord may withhold consent only for good cause (transfer of lease) in the following circumstances:

- if the tenant refuses to inform it of the terms of the sublease;
- if the terms and conditions of the sublease are unfair in comparison to those of the principal lease; or
- if the sublease gives rise to major disadvantages for the landlord.

6.19 Right to Terminate a Lease

Unless otherwise agreed, the notice period with regard to indefinite business leases is six months. Tenants are entitled to submit a request for an extension of the lease term to a judge if the termination would cause undue hardship that cannot be justified by the landlord's interests. The maximum extension for commercial leases is six years.

Default in the payment of rent entitles a landlord to terminate a lease. However, the landlord must first grant a deadline of a minimum of 30 days for payment, combined with the announcement of termination in case of further default, and may then terminate the lease with a notice period of another 30 days. The landlord may also terminate the lease if the tenant becomes insolvent (see **6.15 Effect of the Tenant's Insolvency**).

A tenant may terminate a lease if the landlord does not hand over the leased premises at the time agreed upon, or if, at the handover, the premises have defects that significantly impair their suitability for the intended use. During the lease, the tenant may give notice with immediate effect if the landlord is notified about such a defect and fails to remedy it within an adequate period of time.

In addition, both a landlord and a tenant may terminate a lease for valid reasons that make it impossible to continue the lease.

6.20 Registration Requirements

There are no registration requirements and/or execution formalities. However, the parties to a lease may agree to have it entered under priority notice in the land register, with the effect that every future owner must allow the property to be used in accordance with the lease. Typically, the fees relating to such registration do not exceed CHF1,000.

6.21 Forced Eviction

Tenants can be forced to leave. The duration of the process to enforce this depends on court instances, but it can take several months or years.

6.22 Termination by a Third Party

The government or other authorities may not terminate private leases.

6.23 Remedies/Damages for Breach

Generally, the court determines the financial consequences of early termination, taking due account of all the circumstances. Typically, a security is required by the landlord in the form of either a security deposit or a bank guarantee.

7. Construction

7.1 Common Structures Used to Price Construction Projects

As consideration for the services performed by the contractor, prices are usually agreed as unit prices (*Einheitspreise*) or lump sums (*Globalpreise*), or at a flat rate (*Pauschalpreise*). These prices are normally considered as fixed prices. Due to the war in Ukraine and increased inflation,some total contractors have started to renegotiate fixed prices.

Unit prices determine the consideration for individual services that are listed as separate items in the schedule of services. They are defined for the individual units of quantity, so that the consideration owed for a service is computed after its completion. The quantities of services performed at unit prices are determined according to the terms of the contractor agreement, in accordance with their actual measure (by measurement, weighing or counting) or with their theoretical measure based on the underlying designs.

A lump sum may be agreed for individual services, for part of the project or for the whole of the project carried out by the contractor. It shall consist of a fixed amount of money. Agreements on lump sum payments should be made only on the basis of complete and clear documentation (detailed project specifications, designs, etc).

Flat rate prices differ from lump sum payments solely in that they are not subject to price adjustment clauses.

7.2 Assigning Responsibility for the Design and Construction of a Project

General and total contractor models are often used.

In the general contractor model, the owner uses an architect and engineering team for the planning. The owner either enters into a single planning contract with a consortium of planners/designers (often in the form of a simple partnership) or concludes individual contracts with each architect or engineer involved. For the execution of the construction work, the owner enters into a contract with a contractor who, in turn, uses subcontractors.

In the total contractor model, the owner contracts with a single company that assumes full responsibility for the planning and realisation of a project.

7.3 Management of Construction Risk

The contractor is liable for ensuring that the project is carried out free of defects, and bears such liability regardless of the cause of the defect (eg, negligent workmanship, use of unfit materials, unauthorised deviation from designs and instructions of the construction manager), and independently of fault.

If defects occur, the owner is entitled to defect warranty rights, such as the right of remediation, deduction and/or rescission. Unless otherwise agreed, the owner is to notify defects immediately (ie, within seven days). However, the owner and contractors often agree on an extended notification period of two years.

The owner's defect warranty rights are subject to a limitation period of five years following acceptance of the project or a certain part of a project, respectively.

7.4 Management of Schedule-Related Risk

Parties are allowed to agree that an owner is entitled to monetary compensation if certain mile-

stones and completion dates are not achieved. Moreover, the parties often agree on a penalty to ensure that milestones and completion dates are complied with.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for owners to seek additional forms of security, particularly guarantees or sureties of a Swiss bank or insurance company.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors that have supplied labour and/or materials are permitted to a statutory lien, while designers/planners for the intellectual work (plans, designs, etc) are excluded from such lien. The lien is entered into the land register only if, inter alia, the claim has been acknowledged by the owner or confirmed in a court judgment, and may not be requested if the owner provides the contractor with adequate security.

7.7 Requirements Before Use or Inhabitation

A project undergoes an official inspection by the competent authority of the local community before it can be inhabited or used for its intended purpose.

8. Tax

8.1 VAT and Sales Tax

Generally, the sale of real estate properties is exempt from VAT without credit of input VAT. However, with respect to commercial real estate properties, the landlord can opt to submit the rent to VAT and the seller can opt to submit the property sold to VAT. Accordingly, VAT applies to the sale, provided the buyer is (or will become) a taxable person and is registered for Swiss VAT purposes, and that the real estate property sold is not used exclusively for private purposes. In this case, the standard rate of 8.1% applies.

Please note that all tasks relating to the construction of a new building for a landlord are subject to VAT. Accordingly, input VAT charges incurred on the construction can only be recovered if the landlord is exercising its option to submit the rent and the sale of the property to VAT.

Beside VAT, local transfer taxes and notary and/or land registry fees also apply. Each of the 26 cantons has specific laws and rules on these transfer taxes and fees. Depending on the location of the property transferred, these additional charges may be substantial, particularly as notary and land registry fees in some cantons are calculated based on the value of the property transferred. While a few cantons (such as the cantons of Zürich and Schwyz) have abolished the real estate transfer tax, all cantons levy land registry fees. In cantons where the real estate transfer tax is not known or has been abolished, notary and land registry fees may be substantial and can include a tax component as well, if computed based on the value of the property transferred.

While a change of control in a real estate property company by the sale of (typically) a majority stake in the shares triggers transfer tax in those cantons that have a separate real estate transfer tax, notary and land registry fees are only triggered in the event of a change of title of the underlying property (and not by a sale of a majority stake in a real estate property company). With due regard to these local taxes, it may therefore be worth conducting a comparison between the tax consequences of an asset versus a share transaction. In a few instances, the overall charge of transfer taxes and notary

and land registry fees may be lower in a share deal than in an asset deal.

The buyer is liable for the payment of real estate transfer tax in most of the cantons that have it. However, in a few cantons the seller is liable, or there is a 50:50 split between the seller and the buyer. In a corporate restructuring, an exemption from the transfer tax may be available and in some cantons the notary and/or land registry fees are reduced and the tax should not hinder corporate restructurings. This also applies to real estate companies or a group of real estate companies contemplating an internal group restructuring. Real estate transfer taxes and notary and land registry fees are charged without regard to whether the seller is realising a gain or a loss. In most of the cantons, payment of the tax (or even payment of notary and/or land registry fees) is secured by a first-ranking legal lien on the property sold, and the seller and the buyer are often jointly liable for payment of the tax (or even payment of notary and/or land registry fees). Therefore, well-advised parties to a property sale and banks providing mortgage-secured funding to the buyer will take care to ensure that all taxes triggered – and all notary and land registry fees incurred – are paid in advance or put in escrow by the relevant party.

8.2 Mitigation of Tax Liability

The pros and cons of an asset versus a share deal for the acquisition of a property portfolio need to be considered carefully. Beside the implications on the corporate income and/or real estate capital gains tax, transfer taxes and notary and land registry fees also need to be taken into account. The outcome of such analysis may vary depending on the location of the properties sold. Furthermore, the set-off of gains and losses, the extraction of future profits, security deposits for Swiss taxes (in particular VAT) to be made by foreign companies and approval requirements for a future exit by the competent Swiss tax authorities need to be carefully considered.

In a share deal, a debt pushdown into the target is hardly possible and, as limitations on upstream securities apply, the structure chosen needs to be discussed with the bank; savings made with respect to notary and land registry fees may be lost due to less advantageous funding conditions by the banks or the loss of tax-efficient interest deductions and/or acquisition costs. Case-by-case analysis should be performed, and the location of the underlying properties has a crucial impact on the outcome of such analysis.

While a share deal does not trigger VAT, an asset deal might. However, if a portfolio of assets is sold, in general the notification procedure should be open, so there should be no cash leakage due to a time-consuming payment and refund procedure.

8.3 Municipal Taxes

Some cantons and/or municipalities levy special taxes on the value of the real estate located in their territory. These have to be paid by the property owner.

Moreover, rental income is subject to federal, cantonal and municipal income tax in the canton/municipality where the property is located. While the federal corporate income tax rate is uniform in the whole country, the cantonal and municipal income tax rates may vary widely.

8.4 Income Tax Withholding for Foreign Investors

Generally, rental income from investments in Swiss properties earned by corporate investors

is subject to Swiss federal, cantonal and municipal corporate income tax in the canton and the municipality where the property is located. The aggregate corporate income tax rate varies depending on the location of the property. If the property held by an individual investor qualifies as a business asset (and not as a private asset), social security contributions may be triggered on top of this. The tax is assessed based on a tax return filed by the Swiss or foreign investor. No withholdings apply.

Interest accrued on debt funding is deductible, which is also true with respect to shareholder or other related party advances. However, thin capitalisation rules apply and the amount of the debt funding and the interest rate applied should remain within the periodically published safe harbour limits. Otherwise, a constructive distribution may be assumed that would not allow for an income tax-effective deduction and trigger the (dividend) withholding tax of 35%. Buildings may be depreciated over their useful lifetime, and the depreciation deductions may be deducted from taxable income. The straight line or the reducing balance depreciation method may be chosen freely.

Land cannot be depreciated, but a blended rate may be applied if land and building values are not split and do not have separate book entries. Safe harbour depreciation rates are available for the depreciation methods and the blended rate. In the event of a sale of the property, recaptured depreciation deductions are subject to corporate income tax. Accordingly, depreciation deductions that do not reflect real losses of value lead to a mere income tax deferral. In general and with due regard to the current negative interest rate environment, in a share deal scenario deferred income taxes are fully deducted from the purchase price as a deferred liability.

Interest paid on mortgage-secured funding advanced by a bank (or other lender) outside Switzerland to a Swiss borrower is subject to a local interest withholding, with the applicable rate depending on the location of the property securing the loan. The interest withholding is not levied if the investor is a resident of a benign treaty jurisdiction where the interest clause in the treaty excludes taxation in the source country.

The holding of a property in Switzerland is also subject to Swiss wealth tax (for individual investors) or capital tax (for corporate investors), the maximum rates for which vary significantly between the different cantons and municipalities.

Appreciation gains realised on the disposal of properties are subject to taxation. One of the following two systems applies, depending on the cantonal regime:

- the monistic system, where any appreciation gain, be it on a private or a business asset, is subject to a separate cantonal and municipal real estate capital gains tax – this system applies in the cantons of Zürich and Bern, amongst others; or
- the dualistic system, where any appreciation gain realised on the disposal of a business asset remains subject to corporate income tax (and no real estate capital gains tax is levied) – this system applies in the cantons of St Gallen and Zug, amongst others.

While corporate income tax is a flat tax that applies regardless of whether the property disposed of was held for a short or long period, progressive tax rates apply under real estate capital gains tax. If the holding period was less than one year, some cantons and municipalities levy a real estate capital gains tax of 60% (on

top of the federal income tax). If a long holding period applies, the real estate capital gains tax may be 20%, or even less than that in some cantons. Accordingly, whether the gain realised by a corporate investor will be subject to corporate income tax or real estate capital gains tax may have quite some impact on the after-tax performance of an investment. Again, in the case of a corporate or group internal reorganisation, the tax may be deferred as it should not hinder such restructurings.

Dividends (and other distributions) paid by Swiss companies are subject to a withholding tax of 35%. The withholding has to be deducted from the dividend in advance and has to be paid by the debtor of the dividend – ie, the company paying the dividend (a reporting procedure is only available in the case of a Swiss parent company or a parent company in a benign double tax treaty state). For withholding tax purposes, it is therefore advantageous if the investor (a shareholder of the SPV) is domiciled in a country that has entered into a double taxation treaty with Switzerland. Unless this is the case, it is advantageous to use a foreign SPV to avoid withholding tax.

8.5 Tax Benefits

A corporate investor may apply income tax-effective interest and depreciation deductions. Furthermore, the costs for maintaining the property in good shape and fit for its purpose, as well as income and capital taxes accrued and provisioned, may be deducted from the income tax base. The same is true with respect to all expenses relating to the property management and letting.

Trends and Developments

Contributed by:
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Baker McKenzie has one of the largest real estate transaction practice groups in the Swiss market, with a strong focus on real estate M&A and private equity, tax-efficient restructurings, real estate investment schemes (funds), listings of real estate investment companies, real estate developments, and corporate real estate and hotel transactions. Led by highly experienced real estate lawyers, the practice is spread across two offices – Zurich and Geneva – and includes four partners and approximately 17 qualified lawyers. Clients in Switzerland include the largest publicly listed Swiss real estate companies, high-profile Swiss enterprises, Swiss developers, hotel owners and operators, real estate asset managers, international investors and international corporate clients, as well as industrial companies, private clients and real estate investors. The real estate practice focuses on real estate M&A, including sale and leaseback transactions, hotel and hospitality structures, portfolio optimisation, corporate real estate, development projects, real estate funds and club deal structures.

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The Real Estate Market in Switzerland: An Overview

In general

The Swiss economy in general and the real estate sector in particular remained comparatively strong in 2023, despite some notable macroeconomic challenges such as increased interest rates and shortages in raw materials, and microeconomic challenges such as the takeover of Credit Suisse by UBS.

Switzerland ended the year with a real economic growth of 1.3%, thanks in particular to strong private consumption. The unemployment rate fell to below 2%, the lowest level since the turn of the millennium.

After a historical period of negative interest of -0.75% that lasted over seven years, the Swiss National Bank (SNB) raised its key interest rate in several successive steps to 1.75% from June 2022. In March 2024, the SNB slightly lowered the rate to 1.50%. Partly as a result of these measures, inflation was kept at much lower levels in Switzerland than in virtually all other developed economies. At the same time, the interest rate increases led to a certain shift of investor interest and money from the real estate sector to other asset classes.

Slowing construction activity

Construction activity decreased, partly because the construction sector was faced with further shortages and price increases mostly in connection with the ongoing war in Ukraine. Construction companies were not always able to pass on such price increases to their contractual counterparties, which reduced their margins accordingly.

The increase in construction prices combined with higher financing costs in the mortgage market and increasingly complex building approval procedures led to a dampening of housing production, despite a strong demand. According to Wüest Partner, the number of new rental units authorised for construction was 11% below the average for the past ten years. Meanwhile, the projected construction of new office space in 2024 and 2025 is set to slow to approximately half the long-term annual average, according to JLL.

At the same time, the construction industry is expected to benefit from technological developments going forward, which were partially further bolstered by respective legislation. For instance, several cantonal authorities are now using fully digital building permit procedures.

Real estate investment

In line with the new market conditions, real estate investors have adopted a more defensive stance with a reduced willingness to pay premium prices. Prime yields for office properties rose by 60 to 80 basis points over the past two years, reaching approximately 2.7% and 3.0% in Zurich and Geneva respectively, at the end of 2023 according to CBRE.

Although the spread between prime office yields and ten-year Swiss government bonds increased in 2023 to 141 and 181 basis points respectively, it is still 30 to 40 basis points below the long-term average.Furthermore, higher interest rates on debt impair the usage of leverage to boost returns on equity. Demand for prime real estate is therefore subdued. As a result, several players who were active as buyers in recent years either completely retreated from the real estate market or started to sell their properties. This is particularly true for several insurance companies and pension funds, which reduced their exposure to real estate and sold significant country-wide

portfolios (residential portfolios in particular) in some of the largest transactions in the market in 2023.

Commercial properties

In 2023, the office availability rate in Switzerland's five largest markets (Zurich, Geneva, Bern, Basel and Lausanne) rose slightly from 4.5% to 4.6%. In addition, inflation may generally be reflected in office leases quicker than in residential leases. Despite a vibrant period of lettings and relocations, with flex space providers and private banks expanding, demand began to ease towards the end of the year, although this did not have a significant impact on space availability, according to JLL.

In the Zurich region, for example, the total amount of available office space rose to 234,000 sq m, which can still be considered as a tight market. However, the availability rate in the Zurich suburbs reached 14.6%, a new record high in both absolute and relative terms, according to CBRE.

On the other side of the country, Geneva experienced a gradual increase in prime rental rates from the longstanding CHF850 per sq m per year to CHF900 per year and more. In addition to higher rents, companies seeking office space within Geneva's CBD face two significant hurdles:

- firstly, finding sufficiently large contiguous office space on a single floor is proving to be very challenging; and
- secondly, there is a trend of businesses demanding higher sustainability standards, a criterion that only very few buildings in the CBD can satisfy.

As a result, the suburbs are becoming increasingly attractive as they tend to offer newer buildings. Construction activity is continuing in such locations, with Geneva's first skyscrapers currently being built in the Lancy Pont-Rouge area, as well as various residential projects that are set to further increase the attractiveness of the area outside of business days and hours.

Residential properties

Adjusted for inflation, residential investment has seen negative growth since 2021, and the vacancy rate amounted to approximately 1.15% by the summer of 2023. On the demand side, net immigration to Switzerland is expected to remain high in 2024. Meanwhile, construction activity is expected to remain relatively low on the supply side.

In the final quarter of 2023, the UBS Swiss Real Estate Bubble Index fell slightly to 1,041 index points, the same level as at the end of 2021. This decline in the index can be attributed to a slowdown in the growth of household mortgages and a slight decline in applications for buy-to-let financing.

Despite these developments, the index still points to significant overvaluation in the Swiss market for owner-occupied homes. Prices for such properties have remained stable even as financing costs have risen. Combined with a low rate of new construction and increased immigration, a significant price correction seems unlikely in the foreseeable future. However, it is worth noting that the price gap between existing property and new builds widened in 2023. New-build condominiums usually have high prices, as they were built when their construction costs were high and the land was purchased at a high price. In contrast, the price of existing properties tends to adjust to stagnating demand.

In contrast to condominiums, the price increase for single-family homes continued almost unabated in 2023. In particular, prices in the 3rd quarter of 2023 rose by 6.4% in the lower segment and by 5.3% in the middle segment. The upmarket segment did not develop quite as positively, with an increase of 2.9% between the third quarter of 2022 and the third quarter of 2023. This is nowhere near the performance of previous years, and the increase is mainly due to the rise in inflation.

The two-step increase in the reference interest rate in 2023 caused existing and asking rents to rise. As of March 2024, the reference interest rate is at 1.75%. Existing leases could be adjusted accordingly, and inflation and general costs could also be partially passed on the tenants. However, political efforts are underway to limit the latter by amending the relevant ordinance.

More political activism

Despite being a liberal economy, Switzerland has known some forms of state intervention to regulate the housing market for many years. Historically, governmental efforts were focused on increasing the availability of affordable housing through land use and financial measures.

For example, the City of Zurich is creating a housing fund of CHF300 million to invest in properties and buildings on the free market in competition with private investors. In recent years, it has become a significant player in local real estate transactions. In addition, two initiatives aimed at regulating the housing market have been launched in the Canton of Zurich.

- The first aims to introduce legislation according to which landlords must obtain authorisation for any renovation, transformation, demolition or new construction project. Rent caps may be set for up to a maximum duration of ten years in connection with such authorisation.
- The second initiative would give municipalities a right of first refusal on third-party transactions, providing them with a direct tool to influence real estate development.

The model for these initiatives is the existing cantonal legislation in the French-speaking cantons of Geneva (LDTR) and Vaud (LPPPL). In addition, the German-speaking canton of Basel-Stadt introduced rent control legislation in 2022 that has resulted, inter alia, in a significant decrease in construction permit applications.

Legal Developments

Transactions

General trends and developments

The activities of investors have changed significantly in recent quarters. For several years, institutional actors such as insurance companies and real estate funds dominated the acquisition market. Under the new framework conditions, these two groups have become predominantly passive or appeared as sellers. Family offices, ultra-high net worth individuals, public entities (eg, the City of Zurich) and housing co-operatives are now increasingly involved in real estate transactions, making the universe of active buyers both more diverse and more volatile.

The Swiss real estate transactions market remains liquid

Despite the described challenges, the Swiss real estate market remained active in terms of transaction number and volumes, particularly in comparison with other countries.

As an example, German fund management company Union Invest sold its two office buildings – Westpark and Fifty-One in Zurich West

– to Swiss heavyweights PSP Swiss Property and Swiss Prime Site, respectively, in two major transactions that rank among the largest single asset transactions in Switzerland and Europe of the past year.

Several major institutional actors remained active as buyers in the market, such as Swisscanto/Zürcher Kantonalbank. For example, Swisscanto Anlagestiftung acquired a major real estate portfolio including nine properties across the cantons of Bern, Zurich, St. Gallen and Aargau by way of an asset transfer under the Swiss Merger Act, a novel transaction structure between investment foundations.

Meanwhile, the relative retreat of other well-established players provided opportunities to newer players, such as Geneva-based Swissroc and Arab Bank Switzerland. While the former purchased 60,000 sq m of freehold land in the heart of Geneva's industrial zone from the Stellantis Group in a share deal, the latter carried out two major real estate club deals in French-speaking Switzerland.

Finally, there were several noteworthy hotel transactions, with the acquisition of the famous 5-star hotel "Le Richemond" in Geneva by Dubai-based Jumeirah Group in early 2023 representing a standout example.

Sustainability

The newly passed Climate and Innovation Act provides that real estate portfolios must be carbon-neutral by 2050. In Switzerland, heating buildings accounts for approximately 40% of total energy consumption, and generates almost a quarter of greenhouse gas emissions. Consequently, the replacement of heating systems is a priority for the authorities and is incentivised with major subventions.

The CO2 Act serves as a further instrument for implementing climate targets and is currently undergoing the parliamentary amendment process for the period after 2025. Following the rejection by the Swiss voters of an earlier draft of the law, it no longer contains any far-reaching obligations for the construction sector. The only relevant levy is the CO2 levy, which remained unchanged at CHF120 per ton of CO2.

Nevertheless, the proportion of office space meeting ESG criteria was assessed for the first time at the end of 2023 and was estimated to be approximately 30% of office space in Switzerland. The largest office markets, Zurich and Geneva, have the highest percentage of ESG-compliant office space, in both absolute and relative terms. In Zurich, 32.9% of the total supply of office space meets ESG standards, while in Geneva this figure rises to 47.5%, according to JLL.

ESG is becoming an increasingly important topic for investors, and is now one of the key drivers in real estate acquisitions or sales. Many institutional investors are seeking to make their portfolios sustainable by either renovating or selling properties that do not meet ESG criteria. Meanwhile, ESG conformity is becoming more and more important in buyside due diligence processes.

A new dynamic in the retail market

The estimated proportion of vacant retail space in Switzerland has fallen slightly since the temporary peak during the pandemic, and is now just over 4%. One reason for this may be that construction investment in the retail space market has fallen sharply since 2020. Some retail space has even been converted into office space. This happened even in prime locations such as Zurich's Bahnhofstrasse, which saw

conversions of buildings that had been used exclusively for retail purposes for decades.

Other regulatory changes

During the autumn session of 2023, the Swiss Parliament adopted two important legislative proposals relating to tenancy law favouring landlords. However, the Swiss Tenants' Association successfully submitted a referendum against these amendments in January 2024.

The first planned amendment aims to strengthen the provisions on subletting, thereby giving landlords more power over tenants who sublet the property. Previously, there was an exhaustive list of reasons why a landlord could refuse to sublet. The amendment explicitly states that subletting can be refused if it is for more than two years. If premises are subleased without the landlord's written consent, the landlord would be able to terminate the lease more easily than before, with 30 days' notice.

The second planned amendment concerns the termination of a lease for personal needs upon the sale of a property. For residential or commercial leases, the new owner may terminate the lease as of the next legally permissible date if they claim an urgent need for such premises for themselves, their close relatives or their in-laws. With the enactment of the amendment, the new owner would no longer have to prove an urgent need; instead, termination can be based on an objective assessment of a significant and current need. This introduces a much lower threshold for termination.

A potential forthcoming amendment to the Lex Koller is expected to have a significant impact on the hospitality sector. The Lex Koller imposes restrictions and requires permits for the acquisition of real estate by foreigners. Under the current law, the acquisition of hotel properties is (generally) not subject to Lex Koller approval, unlike the acquisition of employee housing, unless the purchase is made at the same time as the hotel. This approach was confirmed by the Federal Court in a decision dated 21 December 2023.

However, on 25 September 2023, a motion to amend the Lex Koller to allow hotels to build staff housing was approved by the Swiss Parliament and is currently pending before the Federal Council. This change would be significant for the hotel industry in the mountains, where market rents are often unaffordable for staff housing and the hotel industry thus has a real need for in-house solutions.

Summary and Outlook

Over time, the interest rate hikes and the recessionary European states have left their mark. In the third and fourth quarters of 2023, profit warnings, declining orders and job cuts were reported. Nevertheless, 2024 is likely to be a transitional year. The federal government's economic experts expect a similar real GDP growth of 1.1%. However, the vacancy rates will continue to fall, and it is possible that the limit of 1% vacancy will be undercut at a national level in summer 2024.

The introduction of a collective investment scheme called L-QIF in March 2024 will provide the Swiss financial centre with a new fund structure that can be set up more quickly, flexibly and cost-effectively, and is particularly suited to certain types of real estate investments.

In February 2024, at the second round table on the housing shortage, representatives of the public and the construction and real estate sectors agreed on an "action plan", recommend-

ing 35 measures. Given the complexity of the Swiss federal system, none of the recommended measures are expected to have a rapid impact on the shortage, but some may induce positive changes in the mid or long term. One key element will be the possibility of reducing the number of manifestly abusive objections in planning and building permit procedures; in this regard, the Federal Chambers have adopted two postulates aimed at making objectors pay a part of the procedural costs.

In conclusion, there is no shortage of ideas and instruments that would benefit existing and future real estate investments and developments and strengthen the already very attractive real estate market in Switzerland.

THAILAND



Law and Practice

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Duensing Kippen, Ltd. has a real estate team composed of four partners and four qualified lawyers who combine international transactional legal expertise and experience with a keen awareness of local custom and culture. The firm's offices are located in Bangkok and Phuket, the two largest markets in Thailand, but the firm services clients throughout Thailand. Its clients include international investors ranging from individuals and multinational corporates to multibillion-dollar, NYSE-listed companies. The practice draws on its partners' multiple decades of experience in real estate work, both in Thailand and cross-border transactions involving Thailand. The team regularly assists clients in evaluating, negotiating and closing real estate sales and acquisitions, commercial development structuring and implementation, M&A, joint ventures, and related tax matters. Its real estate work is complemented by its other core practices in construction, hospitality, corporate/commercial, tax and dispute resolution. Members of the real estate team regularly publish legal articles and are frequently invited to speak on Thai real estate-related matters.

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1. General

1.1 Main Sources of Law

Thailand is a civil law country. Therefore, although Thai Supreme Court opinions have a strong persuasive value, the source of all law in all areas, including real estate, is statutory.

Civil and Commercial Code

The Civil and Commercial Code (CCC) is perhaps the single most important law applicable to real estate in Thailand. Besides governing contracts, the CCC also creates ownership of immovable property and dictates how it may be transferred. It also creates and controls the various rights that may be registered over immovable property, such as mortgage, lease, superficies, usufruct, charge and servitude.

Land Act

The Land Act creates and controls the various titles of use and ownership of land.

Condominium Act

The Condominium Act creates a licensed development in which condominium units may be owned on a freehold basis and regulates the relationships between the owners.

Land Allocation Act

The Land Allocation Act does the same with respect to land, or land with a house on it.

Land Use Laws

Thailand's three main land use laws are:

- the Enhancement and Conservation of National Environmental Quality Act, which restricts land use in certain ways in various areas;
- the Town and City Planning Act, which controls what may be built and where; and
- the Building Control Act, which permits and dictates the requirements for structures.

1.2 Main Market Trends and Deals

The residential condominium market is grappling with an imbalance characterised by excessive supply and sluggish demand, exacerbated by the prevailing low economic growth and high interest rates. Meanwhile, the residential land inventory is anticipated to expand at a rate of 7% annually. Nevertheless, Thailand's real estate

landscape is witnessing a spike in demand for upscale condominiums, particularly in sought after tourist hubs. The surge in Russian buyers, in particular, has bolstered the real estate sector, notably in Phuket.

In the commercial office sector, the next two years will see the completion of over 850,000 square metres of office space which will compete with an aging office inventory, where more than 60% of current buildings are over 25 years old.

Real estate investors, developers and lenders have not yet started to adapt to recent technological innovations such as blockchain, decentralised finance (DeFi) and proptech, which have begun to have a disruptive effect in the industry in some other locations. It is therefore unlikely that any such technologies will have any significant impact on the real estate market in Thailand over the next 12 months and no alternatives to traditional financing are visible in the market.

1.3 Proposals for Reform

In Bangkok, a new city plan has been approved by an advisory committee of the Bangkok Metropolitan Administration (BMA). Public hearings will be held after which the new city plan is expected to be enacted in 2025. Some of the expected changes would be an increase in certain use areas, for example, more areas that can build high-rise condominiums.

Also, there is a draft Announcement of the Ministry of Natural Resources and Environment Regarding Environmental Protection Areas and Measures in Phuket Province (the "Draft") under the National Enhancement and Conservation of Environmental Quality Act (1992), which is expected to be enacted in May this year.

One of the major limitations under the current environmental law applicable to Phuket is that land above 80 metres from mean sea level is reserved only for activities related to national security, public utilities and environmental conservation efforts. However, the Draft would ease such limitations by allowing private sectors to develop land above 80 metres but not exceeding 140 metres from mean seal level, subject to certain restrictions prescribed by the said Draft.

2. Sale and Purchase

2.1 Categories of Property Rights

There are five main real estate titles. The *chanote* is one of only two true ownership titles in Thailand and is issued for land. The second is the Condominium Unit Title issued for a condominium unit.

There are also three possessory rights title documents for land. In order of preference they are:

- Nor Sor 3 Gor;
- Nor Sor 3; and
- Sor Kor 1.

Property rights, including transfer of ownership, can only be registered on the *chanote*, the Condominium Unit Title, Nor Sor 3 Gor and Nor Sor 3 deeds, but a Sor Kor 1 can usually be upgraded to a *chanote* or Nor Sor 3 Gor.

Immovable property may be leased for up to 30 years under the CCC, whereas leases for industrial or commercial purposes are eligible for a lease term of up to 50 years in some circumstances.

A registered usufruct gives the grantee the right to possess and benefit from immovable property

for up to 30 years. A habitation may be registered and gives the holder the right of occupation of a structure for either up to 30 years or the life of the holder.

A superficies is the right to own a structure that is built on another party's land for up to 30 years.

A servitude grants the owner of a property rights (eg, access) over another property owned by someone else. However, a servitude is not a personal right, it is registered in favour of one piece of real estate over another piece of real estate, and this remains the case regardless of who owns the properties. Thus, a servitude has no time limitation.

A charge is similar to a servitude, but it is a personal right that gives the holder rights over real estate owned by someone else, for either the holder's life or up to 30 years.

2.2 Laws Applicable to Transfer of Title

The CCC applies to the transfer of real estate in Thailand. Special laws do not apply to a transfer of title for specific types of real estate, such as: residential, offices, retail, factories or hotels. However, some of these, eg, factories and hotels, are regulated uses of the real estate that require a licence to operate. Thus, if a new owner purchases real estate that is being used as a factory or hotel, that new owner would need to obtain a licence to use the real estate for either of those purposes.

2.3 Effecting Lawful and Proper Transfer of Title

All real estate in Thailand is registered and held under various forms of title (see **2.1 Categories of Property Rights**) as prescribed by the Land Code.

The CCC requires an agreement to sell and purchase real estate to be in writing and registered at the local land office where the property is located. For a limited time during the COVID-19 pandemic some additional health protocols were added to this process, which led to some delays in completing transactions.

Title insurance is not common in Thailand, but it is available. Buyers who are "land banking" (ie, whose sole purpose for the investment is to hold the real estate for a period of time and then resell for an anticipated profit), or who hold land for commercial purposes, are most likely to purchase title insurance which generally insures the owner against any flaw in the title which would invalidate it.

2.4 Real Estate Due Diligence

Buyers typically engage a law firm to perform legal due diligence into the property. This typically includes searches at the:

- land office;
- local administrative office;
- forest resources and management office;
- natural resources and environment office;
- public works and town and city planning office;
- civil courts;
- bankruptcy courts; and
- the department of legal execution, where the land is located.

Title searches are particularly important, as wrongfully issued titles are not unknown in Thailand. Even if the title is not clearly invalid, official real estate records are sometimes lost or destroyed, which may make it impossible to verify the title to the real estate.

Additionally, commercial real estate investors typically conduct economic and physical due diligence into the property. The former will usually include an assessment of the revenue generated by the property, eg, from rental tenants, while the latter will typically include one or more physical surveys (eg, topographical, hydrological) of the property.

Other than potential delays due to periodic national and regional lockdowns, the COVID-19 pandemic has not affected the typical due diligence process.

2.5 Typical Representations and Warranties

The seller typically provides contractual representations and warranties of ownership and proof that no third-party rights, such as any mortgage or lease, encumber the property. Such warranties generally do not expire nor do they vary based on whether or not the real estate is commercial in nature.

In the case of any defect in a property sold, of which the buyer was not, nor would have been expected to be, aware, this impairs either its value or fitness for ordinary purposes or for the purposes of the contract, and the seller is liable by statute regardless of whether or not the seller knew of the defect.

It should be noted that no action for liability for defect can be entered later than one year after the discovery of the defect. Though not typical, caps for liability can be used and parties can agree that the seller shall not incur any liability for defects or eviction. However, it is not possible to exonerate a debtor from their own gross negligence. Such an arrangement would be void. And any such caps are subject to the Unfair Contract Terms Act (if applicable) and must therefore stand the test of being "fair and reasonable" in the specific case.

The seller is also liable by statute for the consequences of any disturbance caused to the buyer's possession of, or eviction from, the property by any person having a right over the property at the time of sale, of which the buyer was unaware, or by the fault of the seller.

The law allows parties to contract out of these statutory warranties, thus the sale and purchase typically releases the seller from liability or disturbance. However, such a non-liability clause does not exempt the seller from repayment of the purchase price, unless the clause specifies otherwise. Thus, this release is also typically included. At the same time, a non-liability clause may not exempt a seller from the consequences of their own acts or facts which they knew and concealed.

Finally, if an immovable property is declared to be subject to a servitude (elsewhere often known as an "easement") by law, the seller is not liable unless they have expressly guaranteed that the property was free of servitudes, or from that servitude. Thus, sellers often refuse to so warrant or explicitly represent otherwise.

Other than money damages, there is typically no security for such representations and warranties.

2.6 Important Areas of Law for Investors

The CCC, which governs contracts such as sale and purchase and lease agreements, as well as real estate rights such as ownership, leaseholds and servitudes/easements, is a crucial area of law for all real estate investors. This is also true of Thailand's three main land use laws (see **1.1 Main Sources of Law**) which should be carefully evaluated by all buyers prior to investing.

Depending on the type of property, the Land Act and the Condominium Act are also crucial areas of law as they determine the validity of title to land and condominiums.

Where the investor is a foreigner, laws that provide possible exemptions to Thailand's restrictions on foreign ownership of real estate, such as the Investment Promotion Act and the Industrial Estate Authority Act, may also be relevant.

2.7 Soil Pollution or Environmental Contamination

Under the Enhancement and Conservation of National Environmental Quality Act, the owner or possessor of any property that is a source of contamination that causes physical harm to any person or damage to someone else's property is liable and must compensate the harmed party or parties. Furthermore, the owner or possessor must also compensate the government for all its costs in connection with cleaning up the contamination. The liability standard under the Act is strict – the owner or possessor need not have intended or been negligent with regard to the contamination from their property – and the very limited exemptions from this liability do not include the property having originally been contaminated by a prior owner or possessor. Thus, where there is any possibility of contamination, buyers typically require the seller to warrant that they have adhered to applicable environmental law and to indemnify the buyer against any liability arising from contamination from the property during the buyer's ownership or possession thereof.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Thailand has three principal land use laws:

- the Town and City Planning Act, which defines several zones of land use and controls what is allowed to be in each;
- the Building Control Act (BCA), which controls the issuing of construction permits and details what is required to obtain such permits; and
- the Enhancement and Conservation of National Environmental Quality Act, which limits the use of land, including construction thereon, to varying degrees depending on where the land is located.

The Town and City Planning Act is applied by means of ministerial regulations issued under it that apply to specific regions. The BCA is applied by means of the royal decree issued under it which applies to specific geographic regions. The Enhancement and Conservation of National Environmental Quality Act is applied by means of the ministerial regulations issued under it which apply to specific geographic regions, or by announcements issued under it that apply to specific geographic regions for specified periods of time.

Other Applicable Laws

Some other laws may apply to land use in some areas, such as the Marine and Coastal Resources Management Act and the National Reserved Forest Act. Thus, it is important for a buyer to review all such laws applicable to the purchase property at the time.

There is no provision for a private party to apply for exemptions from applicable land use law in order to facilitate a development project. However, it is possible for local government offices to issue regulations that would allow for more permissive variations to land use restrictions in a specified location.

2.9 Condemnation, Expropriation or Compulsory Purchase

Land may be expropriated by the government for public purposes in accordance with the Immovable Property Expropriation Act. Once it is determined that a property is to be expropriated, the process is as follows:

- a regulation is issued under the Act that identifies the property to be expropriated and for what purpose;
- a government committee is convened to appraise the value of the property and determine the compensation to be paid for it;
- the government then attempts to agree on a purchase price for the property, and if the price cannot be agreed the owner or possessor may file an appeal; and
- once the price has been determined, a new law that applies to that specific expropriation is issued and the affected owners or tenants of the expropriated land, buildings, perennial plant, or easements are paid and the property is transferred to the government.

2.10 Taxes Applicable to a Transaction

The ownership transfer of immovable property in Thailand is subject to the following.

- Transfer fee – in an amount equal to 2% of the government's official valuation of the property.
- Stamp duty – in an amount equal to 0.5% of the actual sale price or the government's official valuation of the property, whichever is higher.
- Specific business tax – in an amount equal to 3.3% of the actual purchase price or the government's official valuation of the property, whichever is higher.
- Personal income withholding tax – if the seller is a natural person and has owned the property for less than eight years. This tax is calculated using the government's official valuation of the property as the tax base and applying a sliding scale from 0% to 35%, which is adjusted downward depending on how long the seller has owned the property. If the seller has owned the property for eight years or longer, the full tax amount is applicable without such reduction. This tax may be treated as a final tax for this transaction with neither the income nor tax included in the seller's annual personal income tax.
- Corporate income withholding tax – if the seller is a juristic entity, a withholding tax equal to 1% of the actual sale price or the government's official valuation of the property, whichever is higher, is applicable. This withheld tax is then credited to the seller's overall payable income tax for that tax year.

Most of these fees and taxes are the legal liability of the seller. However, it is not uncommon for the parties to agree to share these costs on a 50/50 basis.

In the case of a lease, a registration plus stamp duty fee in an amount equal to 1.1% of the total rent payable for the entire lease term being registered is applicable. The payment of this is subject to negotiation – however, the lessor will most commonly require the tenant to bear this cost.

Stamp duty of 0.001% of the share value applies to share transfers. There is no additional tax triggered by any change of corporate ownership and control of a company.

Effective from 10 April 2024, the registration fees for registering the sale and mortgage at the same time of detached houses, semi-detached houses, terraced houses, commercial buildings or any of the said structures with the accompa-

nying land or condominium units, where (i) the sale price and the official appraised value of the property; and (ii) the mortgage amount, each does not exceed THB7 million and the purchaser is a Thai individual, are currently as follows:

- sale: 0.01% of the official appraised value (reduced from the normal rate of 2%); and
- mortgage: 0.01% of the mortgage amount (reduced from the normal rate of 1% but not exceeding THB200,000).

The reduced rates will be valid until 31 December 2024.

2.11 Legal Restrictions on Foreign Investors

The Land Code generally restricts foreign ownership of land unless otherwise permitted by law. Such exemptions are available under certain conditions if the foreign party intends to make a business investment of the type that the Thai government wishes to attract at that time, and in some cases, at a particular location under either the Investment Promotion Act or the Industrial Estate Authority Act.

There is no prohibition against foreign investors owning a building or against leasing land or a building.

Foreign investors may also own up to 49% of the titled floor space of a condominium project. However, the money to purchase a condominium must either be brought into Thailand as foreign currency or held by the foreigner in a Thai foreign currency account.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Although sometimes financed by private equity, commercial real estate transactions in Thailand are most commonly financed by loans made by banks. The terms of such bank loans vary depending on the property, the type of development project, the borrower's history and reputation, any available guarantee (and in such case, the guarantor's standing) and the lender's preferences. The loan may be made all at once or provided via a draw-down facility. Interest may be fixed or variable.

Thailand recently enacted a formal real estate investment trust (REIT) structure. Thailand's REIT is similar to what is found under the same name elsewhere, eg, the USA. REITs in Thailand are listed on the stock exchange of Thailand and, although they initially got off to a slow start, they are picking up momentum and are now providing a modernised financing vehicle for large-scale commercial real estate investments in Thailand.

3.2 Typical Security Created by Commercial Investors

Typical security provided by commercial real estate developers to their lenders includes one or more of the following: mortgage, pledge, business collateral, assignment and guarantee.

Mortgage

A mortgage is a non-possessory security and may be registered over immovable property (eg, land or buildings) and some movable properties (eg, machinery) that has been registered under the Machinery Registration Act.

Pledge

A pledge is a possessory security where the lender takes possession of the security; it applies only to movable property such as machinery, whether registered or not, promissory notes, bills of exchange and, most commonly, shares of the borrower. A pledge is not registered but some types of pledged property may require additional steps to be legally valid, such as shares, which in addition to the share certificates being delivered to the creditor must have the pledge record in the share-issuing company's share register book in order for the pledge to be enforceable.

Business Collateral

Under the Business Collateral Act, essentially all of a borrower's business assets (eg, immovable property, movables, receivables and intellectual property) may be registered as security.

Assignment

A developer will also often assign its contractual rights, particularly those related to the project (eg, its contractual right to supply, construction, leasing, maintenance, insurance and bond).

Guarantee

Lenders typically also require a third-party guarantee which provides that if the borrower defaults, the guarantor will be obliged to satisfy the debt on behalf of the borrower.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders. However, it is unclear whether a non-affiliated foreign lender would be considered to be conducting a service business under the Foreign Business Act. If this is the case, the lender would first need to apply for and receive a foreign business licence under the Act prior to entering the loan agreement.

There are no restrictions on repayments being made to a foreign lender. However, other requirements, such as exchange controls, may be applicable.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Normally, the registration fee for a mortgage over immovable property is an amount equal to 1% of the loan, but not exceeding THB200,000. However, see **2.10 Taxes Applicable to a Transaction** for the current reduced rate.

Mortgages over machinery attract a registration fee of 0.001% of the amount of the loan, but not exceeding THB120,000. The fee to register business collateral is an amount equal to 0.1% of the loan but not more than THB1,000 unless the collateral is immovable property, in which case, the fee is an amount equal to 1% of the loan. De minimis stamp duties apply to loan, mortgage, pledge and guarantee transactional documents.

Enforcement fees may include court and execution office fees, as well as fees in connection with the official auction and sale of any property, eg, mortgaged land or pledged assets.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Where the borrower is a Thai company limited, as long as the borrower has reason to believe that the authorised director is acting within the scope of their authority to provide security to the lender over the company's property, there are no further legal rules or requirements, such as financial assistance or corporate benefit rules, that must be complied with before such an entity can give valid security over its assets. However, if the articles of association do not specifically provide for the right of the director to mortgage property, a shareholder resolution is required.

3.6 Formalities When a Borrower Is in Default

Mortgage

Where the security provided is a mortgage, the lender must notify the debtor in writing to settle the debt within a reasonable time to be fixed in the notice. If the debtor fails to comply with the notice, the lender may then file an enforcement action in the Thai civil court to have the property seized and sold by public auction.

The typical range of time needed to realise and enforce on a real estate security varies most significantly depending on the parties' chosen dispute resolution mechanism. Where the parties have chosen Thai courts, the typical range is 12 to 24 months. However, where the parties have chosen a competent arbitration procedure, the typical range is six to 12 months.

Pledge

Where the security provided is a pledge, the lender must also notify the debtor in writing to settle the debt within a reasonable time to be fixed in the notice and if the debtor fails to comply, the lender may sell the property but only by public auction, prior to which the lender must notify the debtor in writing of the place and time of the auction.

Business Collateral

If the security is provided under the Business Collateral Act, then the lender must send a notice to the debtor to settle the debt within 15 days of receipt of the notice. A copy of this notice must also be sent to any preferential creditors registered under the Act. If the debtor fails to comply, the lender may then sell the property.

There have been no restrictions on a lender's ability to foreclose or realise on collateral in real estate lending that have been implemented by governmental entities in response to the pandemic.

3.7 Subordinating Existing Debt to Newly Created Debt

In general, registered security rights over immovable property rank in order of registration. However, if the security is given by way of mortgage or registration under the Business Collateral Act, and a later preferential right in the property is registered based on preservation of or work done on the property, then such later registered right may be exercised in preference to a mortgage or business collateral security interest.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over real estate cannot be held liable under the Enhancement and Conservation of National Environmental Quality Act for any pollution emanating from real estate that secures a loan, unless the lender actually caused the pollution.

3.9 Effects of a Borrower Becoming Insolvent

Security interests created by a borrower in favour of a lender are not made void if the borrower becomes insolvent. However, insolvency is grounds for any relevant lender to force the debtor into bankruptcy. Under the Bankruptcy Act, a secured creditor may enforce their security rights without need of permission from the bankruptcy court, but the lender must allow the property to be examined by the bankruptcy receiver. Furthermore, if the juristic act that created the security occurred within the three months prior to the bankruptcy petition and such act is found to have been done in order to intentionally advantage one creditor to the disadvantage of any other creditor, the act may be cancelled. If the advantaged creditor is an

insider of the debtor, the three months will be extended to one year prior to the petition.

3.10 Taxes on Loans

Normally, the registration fee for a mortgage over immovable property is an amount equal to 1% of the loan, but not exceeding THB200,000. However, see **2.10 Taxes Applicable to a Transaction** for the current reduced rate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Town and City Planning Act and the Enhancement and Conservation of National Environmental Quality Act control land use and zoning in Thailand.

However, the specific, detailed and varied application of these Acts is implemented by regulations or announcements, as the case may be, issued under the Acts that apply to specific geographic localities in Thailand.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The BCA controls the construction, refurbishment and demolition of buildings. The standard provision of the Act applies to all such activity. However, under the Act, structures intended for a specific use (eg, hotels, condominiums and shopping malls) are considered "controlled structures" and more detailed and rigorous regulations issued under the Act and specific to each are applicable. Regulations may also be issued from time to time, applicable in specific localities, that prescribe particular design and appearance requirements for newly constructed or modified buildings.

4.3 Regulatory Authorities

The Town and City Planning Act, the Enhancement and Conservation of National Environmental Quality Act and the BCA regulate the development and designated use of individual parcels of real estate throughout Thailand. However, the specific, detailed and varied application of these Acts is implemented by royal decrees, regulations and announcements, as the case may be, issued under the Acts that apply to specific geographic localities in Thailand. Local government administrations are responsible for the application and enforcement of the Acts and regulations issued thereunder.

4.4 Obtaining Entitlements to Develop a New Project

In general, the right to develop any new project or complete a major refurbishment is provided by obtaining a construction permit issued under the BCA by the relevant local government administration. The local administration's decision as to whether such permission will be granted must also take into account compliance with all other applicable land use law, such as the Town and City Planning Act and the Enhancement and Conservation of National Environmental Quality Act, as well as other controls applicable to some types of construction. These include any requisite initial environmental examination or, for larger projects, any environmental impact assessment report, including analysis of a project's expected effects on third parties.

4.5 Right of Appeal Against an Authority's Decision

A denial of construction permission under the BCA may be appealed to the relevant local government administration within 30 days of

acknowledgement of such denial. The local government administration must then forward the appeal to the Appeal Consideration Committee, which must rule on the appeal within 60 days thereafter. Should the appellant disagree with the ruling, the appellant may then file an action in the Administrative Court within 30 days. During the appeal process, both the appellant and local government administration are prohibited from doing anything to the construction except where it poses danger to persons or property.

4.6 Agreements With Local or Governmental Authorities

Local government authorities are responsible for formally granting, denying and enforcing construction permission, and thus agreement with the local authorities regarding a construction project is required as a matter of course in Thailand. However, it is also not uncommon for permission to be conditional on the provision of some benefit to the locality such as new or upgraded public infrastructure.

All owners and possessors of real estate in Thailand have a right to access utilities. However, where utilities do not yet connect to the project property it may be necessary to negotiate with the relevant local utility authority to have utilities extended to the project property.

4.7 Enforcement of Restrictions on Development and Designated Use

In the event of there being construction, alteration, demolition or removal of a building in violation of the BCA or regulation issued thereunder, the local government administration has the power to:

- order such action be stopped;
- order that no one enter any part of the building or the area where the action is occurring;
- if the issue can be rectified, consider issuing an order to the possessor of the building to apply for permission to proceed with the action within a fixed time of not less than 30 days;
- if the issue cannot be rectified, consider issuing an order to the possessor of the building that it be either partly or wholly demolished within a fixed time of not less than 30 days; and
- if any demolition order is not complied with, file an ex parte court filing for permission to proceed with the demolition itself, after which it can then proceed with the demolition and the party that failed to demolish the building will be liable for all costs incurred by the local government administration.

A party that fails to comply with a demolition order may be imprisoned for up to six months and fined up to THB100,000.

Where a construction requires permission for a specific use, the local government administration may order a party not to use the construction in that manner until such permission has been obtained. Any party that is using a structure without the requisite permission may be imprisoned for up to six months, fined up to THB60,000 and additionally fined up to THB10,000 for each day of such impermissible use.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Any juristic person, such as a registered partnership, limited partnership, private company limited or public company limited, is eligible to hold real estate assets. Of these, the preferred

entities for investors are private and public companies limited.

Furthermore, listed property funds and REITs are used for investment purposes.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A private limited company is required to maintain at least two shareholders at all times. The company must be managed by one or more directors, all of whom must be natural persons. The directors are not required to be shareholders of the company.

Public Limited Company

A public company limited is required to maintain at least 15 shareholders at all times. There is no minimum capital requirement. At least five directors must manage the company and at least 50% of such directors are required to reside in Thailand.

Limited Partnership

A limited partnership has two different kinds of partner subject to different liabilities:

- one or more partners are liable only to the amount they contributed to the partnership; or
- one or more partners are jointly and unlimitedly liable for all obligations of the partnership.

Registered Partnership

In a registered partnership the individual partners are jointly and unlimitedly liable for the obligations of the partnership; the partnership is established through a contribution of money, other properties or service to the partnership by the partners; and the share of each partner in the profits and losses is determined by the amount of such contribution.

Property Fund

A property fund is established in the form of a juristic person listed on the stock exchange of Thailand. A property fund is established in order to collect funds from investors and use these funds to invest in real estate. The return of the fund's investment is generally in the form of regular income through rent. The property fund is required to hold at least 75% of its net asset value in real estate or the leasehold rights of real estate, which must be located in Thailand and be at least 80% constructed.

5.3 REITs

A REIT takes the form of a trust and does not have juristic person status but is also listed on the stock exchange of Thailand. A REIT can also invest in real estate located abroad and can develop real estate projects.

5.4 Minimum Capital Requirement

The minimum registered capital for a private company limited is THB10.

There is no minimum capital requirement for a public company limited, limited partnership and registered ordinary partnership.

Property funds in Thailand are required to be closed-end funds with a minimum capital of THB500 million.

A REIT must also invest at least THB500 million in real estate assets.

5.5 Applicable Governance Requirements

The following governance requirements apply to each type of entity:

- a private limited company is managed by the directors in accordance with the resolution of the shareholders, its articles of association and the CCC;
- a public limited company (listed and not listed) is managed by the directors in accordance with the resolution of the shareholders, its articles of association and the Public Limited Companies Act;
- a limited partnership and registered partnership are managed by the managing partners in accordance with the decision of the partners and the CCC;
- a property fund is managed by a management company under the supervision of the mutual fund supervisor in accordance with the approved mutual fund project and the commitment made to the unitholders; and
- a REIT is managed by a REIT manager in accordance with the trust instrument, as permitted by the Securities and Exchange Commission.

5.6 Annual Entity Maintenance and Accounting Compliance

Accounting costs usually depend on the type of entity and the amount of the transaction.

A private company limited is required to prepare an audited balance sheet, file corporate income tax returns, as well as file its latest shareholder list yearly. Furthermore, it must maintain and update a register of shareholders.

A public company limited is required to hold an annual general meeting, prepare an audited balance sheet, file corporate income tax returns and file its latest shareholder list yearly. Furthermore, it must maintain and update a register of shareholders. It is also required to publish the balance sheet in a newspaper.

Limited partnerships and registered ordinary partnerships must prepare and submit annual financial statements.

Property funds and REITs must comply with Securities and Exchange Commission regulations.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The law recognises the following arrangements.

- Lease (as further described in **6.2 Types of Commercial Leases**, **6.3 Regulation of Rents or Lease Terms**, etc).
- Usufruct – this provides the right to possess, manage and exploit a property. It can be either for the life of the grantee or a period of up to 30 years, with the possibility to renew it for up to another 30 years. The usufruct may also be transferred. However, the usufruct ends with the death of the original grantee.
- Habitation – this is the right to occupy a building for either the life of the grantee or up to 30 years. Habitation can be renewed for up to 30 years. Habitation is not transferable. Unless otherwise prohibited, the grantee's family may occupy the building with the grantee.
- Superficies – this is a fully transferable right to own freehold title to a building on another person's land. Superficies may either be granted for up to 30 years or for the life of the grantee. Superficies may also be renewed for another 30 years. Unless prohibited by the act creating it, a superficies is fully transferable by the grantee.

- Sap-ing-sith – this is a new right over real estate by registration at the land office and issuance of a certificate that is similar to a lease. It is applicable only to land ownership (ie, chanote) titles, buildings on such titles, and condominium units. The duration cannot exceed 30 years. It allows the holder to use the real estate as outlined in its certificate. It is inheritable and transferable without the consent of the owner. Furthermore, it allows the holder to make additions and alterations to the real estate without the owner's consent. The certificate holder can also mortgage their right.

6.2 Types of Commercial Leases

All leases are governed by the CCC as a specific contract.

Apart from standard lease provisions, the Hire of Immovable Property for Commerce and Industry Act introduces a specific form of commercial lease. The Act defines commercial purposes with regard to leasing commercial property. A lease that qualifies under the Act as "commercial" must be:

- for a commercial or industrial purpose, as defined by the Act;
- for a property located in an area designated by the Act; and
- registered.

The commercial lease under such Act may have a term of up to 50 years. The maximum term for any other lease, whether residential or not qualifying under the conditions of the Act, is merely 30 years. In addition, a lease under the Act may also be mortgaged as security for a loan. A commercial lease under the Act is automatically inheritable by the tenant's heir. Finally, a commercial lease may be sublet or transferred without the lessor's prior consent.

6.3 Regulation of Rents or Lease Terms

Registration requirements exist in relation to the lease term. Any lease term exceeding three years must be registered with the land department in order to be enforceable for the term exceeding three years.

Furthermore, any lease term cannot exceed 30 years (see **6.2 Types of Commercial Leases** for exceptions).

Other terms are only freely negotiable if the lease is not considered a "residential property leasing business", which means a business that leases five or more property units to individual lessees for residential proposes. A residential property leasing business is a controlled business and certain contract terms are required by law. Any violation is subject to a fine and/or imprisonment (see **6.14 Specific Regulations**).

There are no material ongoing regulation of rents or lease terms that resulted from the COVID-19 pandemic.

Impact of COVID-19

No specific legislation has been enacted in relation to leases as a result of the COVID-19 pandemic. However, lessees of state properties have received certain benefits in relation to their lease.

Many commercial properties remained empty during 2021 and there was no significant uptick in commercial activities at the beginning of 2022.

In support of owners of real estate, the government enacted a 90% reduction of property tax rates for 2021. This reduction expired and in

2022 real estate owners paid the normal rate for the first time.

6.4 Typical Terms of a Lease

Typically, short-term leases do not exceed a three-year term, in order to avoid the registration requirement. Land leases are usually for a longer term.

Tenants have specific liabilities to the owner of a property and any relevant provisions of their rental contract.

The use of the property is restricted to ordinary purposes or those provided for in the rental contract. A tenant is required to take ordinary care of the property, which includes maintenance and petty repairs, as such care would dictate. If the tenant fails to do so, the tenant may be required by the lessor to comply with such requirements. In the case of non-compliance with such request, the lessor may terminate the lease contract.

The tenant is liable for any resulting damage where the tenant fails to advise the lessor of the following facts of which the lessor is unaware:

- the rented property is in need of repairs by the lessor;
- a preventative measure is required to protect the property; or
- a third party is encroaching on or claiming a right over the property.

The frequency of rent payments is dependent on the project. Payments are usually made monthly. It is also not uncommon for the full lease amount to be prepaid, which is usually the case with long-term land leases.

Force Majeure Clauses

With regard to the COVID-19 pandemic and its effects, importantly the CCC includes a statutory definition of "force majeure". Section 8 of the CCC outlines that "force majeure denotes any event the happening or pernicious results of which could not be prevented even though a person to whom it happened or threatened to happen were to take such appropriate care as might be expected from him in his situation". In order for the debtor to be relieved of the obligation, the performance must become impossible as a consequence of a circumstance, for which the debtor is not responsible, that occurred after the creation of the obligation. Taking into account that Thai court decisions on "force majeure" tend to follow a strict and narrow definition of the above-mentioned terms, it will be a challenging task for a tenant to invoke force majeure for the non-payment of rent due to the COVID-19 pandemic, since the payment itself is not impossible. In order to avoid such future uncertainty, it is recommended to include "pandemic events" in specific force majeure clauses in rental agreements. Also, supply chain issues due to COVID-19 that make it merely difficult or costly to obtain certain materials would most likely not reach the threshold of impossibility and would not, without specific contractual provisions, be interpreted as a force majeure event.

6.5 Rent Variation

If the initial lease agreement is silent on this point, the parties are free to negotiate the new lease term and amount.

6.6 Determination of New Rent

Variation in the rent will depend on the contractual arrangement between the parties.

Additionally, some leases shift the local property tax burden to the lessee. Any changes in the

local tax would then affect the financial burden of the lessee.

6.7 Payment of VAT

Variation in the rent will depend on the contractual arrangement between the parties.

Additionally, some leases shift the local property tax burden to the lessee. Any changes in the local tax would then affect the financial burden of the lessee.

6.8 Costs Payable by a Tenant at the Start of a Lease

The following are typically payable by a tenant at the start of a lease:

- security deposit (for rental and service fee);
- security deposit for any fitting-out period; and
- telephone line/internet installation charges.

6.9 Payment of Maintenance and Repair

The total amount payable by a tenant is commonly split into a rental component and a service component. The service component covers the payment for the maintenance and repair of the shared area.

6.10 Payment of Utilities and Telecommunications

Utilities and telecoms are typically charged as follows.

- Air conditioning is provided at certain hours and is part of the service agreement. Any additional time outside of these fixed hours will be billed separately at the contractually agreed rate.
- Electricity will be charged at the agreed rate according to usage.
- Water is charged at the agreed rate according to usage.
- Telecommunications charges will depend on the telecommunications service provider. However, the owner might charge the installation fee to the tenant.

It should be noted that the utility rate must reflect the actual rate paid by the owner if the lease falls under certain regulations issued in accordance with the Consumer Protection Act, which regulates residential structure leases (as further explained in **6.14 Specific Regulations**).

6.11 Insurance Issues

The tenant is usually required to insure against public damages and might insure its own assets as well.

The landlord effects insurance of the landlord's assets, such as the building, decoration and furniture. Events covered are typically physical loss caused by fire, lightning, explosion, smoke, water damage, hail, windstorms, earthquakes and floods.

6.12 Restrictions on the Use of Real Estate

The tenant must use the property for the contractually agreed purpose and refrain from using the property in any way that is not considered ordinary and usual. Further, the tenant has a duty to take care of the property as a person with ordinary prudence would do.

6.13 Tenant's Ability to Alter and Improve Real Estate

The tenant must use the property for the contractually agreed purpose and refrain from using the property in any way that is not considered ordinary and usual. Further, the tenant has a duty to take care of the property as a person of ordinary prudence would do.

6.14 Specific Regulations

Leases are generally governed by the CCC. However, there are two specific laws that additionally govern certain leases:

- the Hire of Immovable Property for Commerce and Industry Act defines commercial purposes with regard to leasing commercial property (as described in **6.2 Types of Commercial Leases**); and
- regulations issued under the Consumer Protection Act, which regulates residential structure (eg, house, apartment and condominium) leases in accordance with which any person or company that leases out five or more residential structures (with some limited exceptions) is considered a residential structure "business operator".

The regulations require that:

- all residential lease agreements between a business operator and the lessee include a readily legible version in Thai; and
- the details of the physical condition of the property and equipment (if any) be inspected and acknowledged by the lessee and be attached to the lease agreement.

6.15 Effect of the Tenant's Insolvency

A tenant's insolvency would commonly trigger the termination provisions of the rental agreement where the tenant fails to perform its obligation, such as paying the agreed rental amount.

Bankruptcy proceedings cannot be initiated by the debtor. However, a debtor can, under certain circumstances, apply for reorganisation. If the property is essential for the operation of the debtor's business, the owner may not exercise their right to reclaim the property.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

A security deposit is usually held to protect the landlord should the tenant fail to meet its obligations. In addition, the landlord might require the tenant to provide a guarantor for the performance of the tenant's obligations.

6.17 Right to Occupy After Termination or Expiry of a Lease

The tenant has no right to occupy the property once the lease has terminated/expired. However, if after expiration of the agreed period the tenant remains in possession of the property with the knowledge of the landlord and the landlord does not object, then it is considered a renewal of the contract for an indefinite period.

Any eviction of the tenant requires an eviction order of the court. Only a court-appointed execution officer is entitled to take possession of the premises.

6.18 Right to Assign a Leasehold Interest

An assignment or sub-lease is only possible with the approval of the landlord. An exception to this rule is a legally defined "commercial lease" (as described in **6.2 Types of Commercial Leases**).

6.19 Right to Terminate a Lease

According to the CCC, termination of the lease by the landlord requires:

- non-payment of rent (with a notice requirement of not less than 15 days, if the rent is payable in monthly or longer intervals); or
- that after having been given notice to comply, the tenant is using the property for purposes other than those ordinary and usual or agreed in the contract; or

- that after having been given notice to comply, the tenant fails to take care of the property as a person of ordinary prudence would.

A tenant may terminate a lease in accordance with the CCC if:

- the property is delivered in a condition not suitable for the purpose for which it is let; or
- the landlord breaches any of the specific contract conditions outlined in the CCC and does not reimburse the tenant for any necessary and reasonable expenses incurred for the preservation of the property hired (except ordinary maintenance and petty repairs).

6.20 Registration Requirements

Any lease term of more than three years must be registered with the land department that has jurisdiction over the relevant immovable property in order to be enforceable for a term exceeding three years.

The lease will be registered on the land title. The parties to the lease must provide the documents for the relevant transaction in accordance with the Licensing Facilitation Act, which requires that the land department specifies what document must be provided in advance for each transaction. A Thai translation of the lease agreement must further be provided for registration purposes.

To complete the relevant registration, the parties must pay a registration fee and stamp duty equal to 1.1% of the total rental amount of the registered lease term.

6.21 Forced Eviction

A tenant is legally required to leave the premises when the underlying right to possess such premises is extinguished, be it by termination or expiration.

However, the eviction of a tenant requires an eviction order from the court against such tenant. After having obtained such order, the landlord will request the appointment of an execution officer who will then have the power to take possession of the premises.

The length of the proceedings varies from case to case.

6.22 Termination by a Third Party

A lease can be terminated by a government entity.

Under the Expropriation and Acquisition of Immovable Property Act (2019), subject to certain requirements, government entities can expropriate immovable property for the purposes of public utilities, military, natural resources or for any other benefits of the public including town planning, environmental preservation, agricultural development, land reform, historical sites preservation, special economic zones development and industrial purposes. The Act provides the government entities with the absolute and unilateral right to exercise this power and the expropriated property owners must comply with any expropriation order. Any existing lease agreement over the expropriated property will be terminated due to the expropriation. However, both the landlord and the tenant will be entitled to receive compensation from the government entities as provided by the Act.

The length of the proceedings varies from case to case.

6.23 Remedies/Damages for Breach

For a landlord not in breach of contract, the remedies that a landlord may pursue include seeking compensation and pursuing specific performance of the agreement. Additionally, injunctive relief may be sought to prevent actions that obstruct contractual duties or exacerbate harm to the non-breaching party, or to enforce compliance with contractual obligations.

Damages claims are generally confined to those resulting from the non-performance. However, the non-breaching party may demand damages stemming from special circumstances if they were foreseeable. Court intervention may adjust contractual damages if deemed excessive.

A security deposit is usually held to protect the landlord should the tenant fail to meet its obligations. In addition, the landlord might require the tenant to provide a guarantor for the performance of the tenant's obligations. Under certain conditions, the security deposit cannot legally exceed one-month's rent. The form of the deposit is negotiable between the parties.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The following are the most common structures used to price construction projects.

- Fixed price contract – a lump sum is paid for the completion of the work. The business risk lies with the contractor.
- Cost plus contract – payment of actual expenses and costs on a reimbursable basis, plus percentage or fixed fee. The employer bears the risk.

7.2 Assigning Responsibility for the Design and Construction of a Project

The liability for the design and build depends on the contractual arrangements of the parties. If the contractor in a design-build contractual relationship assumes the responsibility for the whole project, such contractor will be the sole responsible party. However, if the owner employs different entities in a design-tender approach, the design and construction will be performed by different parties. In that case, the responsibility of the parties is divided according to their respective contractual performance.

7.3 Management of Construction Risk

Indemnification is commonly used in construction contracts. Parties also usually agree to limit their liability to a fixed amount or in the form of a waiver of consequential damages.

Thai law implements consumer protection provisions in relation to agreements for the construction of residential houses. Such contracts cannot include any exclusion or limitation of liability for breach of contract by the contractor. Furthermore, warranty periods are specified and are not freely negotiable: liability for defects, such as five years for structure and one year for component parts and equipment, must be included in a consumer-related construction agreement.

7.4 Management of Schedule-Related Risk

Parties typically manage schedule-related risks by implementing milestone payments. Such payments are connected to penalty payments in the case of a delay, but also include incentives for early completion. Furthermore, early termination clauses are commonly agreed.

Thai law provides for automatic penalty provisions (ie, regardless of whether these are includ-

ed in the contract between the parties) in certain commercial projects such as condominium buildings and consumer-related construction agreements. In both cases, any delay in completion of the project is subject to a daily penalty of 0.01% of the total contractual amount, limited to 10% of the contractual amount.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

One or more of the following securities is typically provided:

- a bank guarantee by the contractor for advance payment received from the owner;
- a performance bond by the contractor to secure the owner against the contractor's failings in performance of the contract;
- a warranty bond provided by the contractor during the warranty period; and/or
- retention of part of the payment of each required instalment by the owner until expiry of the warranty period.

7.6 Liens or Encumbrances in the Event of Non-payment

By law, a contractor obtains a preferential right on the immovable property for work done on such immovable property. Such preferential right allows the creditor to receive performance of the obligation out of such immovable property in preference to other creditors. Since the preferential right is an ancillary right to the obligation, it will be extinguished by the performance of the obligation.

7.7 Requirements Before Use or Inhabitation

Use-Controlled Buildings

Certain "use-controlled buildings" are required to receive "use certification" after completion of construction. Such buildings are:

- hotels, condominiums, warehouses, hospitals, hazardous goods storage rooms, dormitories or common residential buildings (eg, apartment blocks) which are classified as a "large building" under the law;
- convention halls or office buildings having a total floor area of 300 square metres or more;
- any building used for any commercial purpose and having a total floor area of 300 square metres or more; or
- any building used for any industrial or educational purpose is a building subject to control over its use.

Inspection and Use Certification

On completion of the construction of the use-controlled building, notification must be given to the local government administration to inspect the structure. After the inspection, if the local government administration determines that the construction was completed in accordance with its building permit, permission to use the building will be granted and use certification for the purpose applied for in the building permit will be issued. If, however, the local administrative office does not inspect the building within 30 days of the notification of completion, the owner or possessor of the building may go ahead and use, or allow others to use, the building for the purpose stated in the building permit.

8. Tax

8.1 VAT and Sales Tax

VAT is not applicable to the sale and purchase of real estate. However, specific business tax (SBT) of 3.3% applies to the sale of immovable property by juristic persons. Exemptions to the SBT requirement may apply to a sale by a natural person. Where SBT is not applicable, stamp duty at a rate of 0.5% applies.

8.2 Mitigation of Tax Liability

If the real estate asset to be transferred is the only or main asset of the selling entity, an entire business transfer might be beneficial. The transfer of the real estate asset that is part of an entire business transfer is not subject to SBT. However, in order to take advantage of the tax benefits, the selling entity must be dissolved within the same accounting period as the business transfer takes place.

8.3 Municipal Taxes

Municipal taxes do not apply specifically to business premises. However, real estate is subject to property tax, which is a local tax.

8.4 Income Tax Withholding for Foreign Investors

Withholding taxes apply to the rental and sale of immovable property.

A "tax resident" of Thailand is any person staying in Thailand for a period or periods aggregating 180 days or more per year. However, it is important to note that the duty to pay tax on rental income in Thailand does not depend on being a tax resident of Thailand or whether the income is received in Thailand. Rental income is considered taxable income regardless of Thai tax residency under the Thai Revenue Code. The relevant law states that a taxpayer (ie, "anyone") who in the previous tax year derived assessable income from a property situated in Thailand must pay tax, whether such income is paid within or outside Thailand. Thus, anyone, tax resident or not, who earns rental income from a property in Thailand, must pay tax on that income, no matter whether the rental income is paid on-shore or off-shore.

It is the duty of the payer of the rent to deduct withholding tax from the rental payment and submit it to the local revenue department. However, both the lessee and the lessor are jointly liable for the payment of this withholding tax.

The amount of withholding tax depends on whether the lessor is a tax resident of Thailand and also whether the lessee is a juristic person or an individual. If the lessor is not a tax resident of Thailand the withholding tax rate is 15%. The legal status of the lessee does not matter if the owner is not a tax resident of Thailand. If the lessor is a tax resident of Thailand and the lessee is a juristic person, the withholding tax rate is 5%. If the lessor is a tax resident of Thailand and the lessee is a natural person, there is no withholding tax applicable.

The taxation of a "capital gain" on the sale of real estate in Thailand depends on whether the seller is a natural or juristic person.

Juristic Person or Company

When a corporate entity sells an immovable property, withholding tax at the rate of 1% of the sale price is required to be deducted from the sale price and paid to the authorities on transfer. This is a prepayment of the corporate seller's income tax for that tax year, and it will be credited against any tax owed for that year. However, both parties – the seller and any buyer – jointly bear the legal duty to withhold and pay this tax. A surcharge on any late or inadequate payment of the withholding tax at a rate of 1.5% per month of the late amount is applicable.

Any gain realised on the sale of immovable property must be declared by the selling company in the accounting period when the sale took place. Section 65 of the Revenue Code defines "net profit" as the result of income from business or arising out of business in one accounting year, less certain expenses. In other words, the net

profit of the whole accounting year is the basis of taxation and not a single taxable event, such as the sale of immovable property.

Natural Person or Individual

When an individual sells an immovable property, the withholding tax is generally calculated based on the official appraised value of such property, less certain deductions. The deductions depend on the duration of ownership of the property to be transferred. The calculation is done using a specific formula created by the legislature which takes into account how long the property has been owned and the progressive tax rates applicable to individuals, but may be calculated without including any of the seller's other annual taxable income. It should be noted that even if the transfer of immovable property is without consideration (ie, a gift) by an individual, it will be deemed a sale subject to personal income tax.

8.5 Tax Benefits

The following maximum depreciation rates apply.

- Permanent buildings – generally 5% per year; however, under certain conditions, 25% in the first year and 5% per year in the following years for the remainder of the value.
- Temporary buildings – 100%.

Land does not depreciate.

Deductions on rental income are applicable and actual expenses may be deducted in the case of houses, buildings or other constructions. If the property is let by the owner, a standard deduction of 30% is allowed as expenses. Rental income tax recipients have the option to define the taxable income by sufficiently documenting their actual rental income-related expenses. If these expenses are higher than the standard 30% deduction, are reasonable and sufficiently documented, then such deduction can be effected.

THE BAHAMAS



Law and Practice

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Graham Thompson has been one of the pre-eminent law firms in The Bahamas since 1950. The firm has more than 30 attorneys and operates four offices in The Bahamas. As one of the leading and largest civil and commercial law firms in The Bahamas, Graham Thompson has an enviable reputation in the real property, resort development, banking and capital markets, and tax and regulatory sectors. The firm is also highly regarded for its expertise in trust and estate planning, commercial matters, civil litigation, family law, securitisation, employment and immigration matters. The commercial and property practice group excels at private client matters but has also played a leading role in almost every major acquisition sale or financing sale of hotel and resort properties in The Bahamas, and represents innumerable developers and financiers of mixed-use resorts, condominiums and second home development projects.

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1. General

1.1 Main Sources of Law

The Bahamian legal system is based on the English common law system. The main sources of real estate law are local legislation, local case law and case law from Commonwealth jurisdictions.

1.2 Main Market Trends and Deals

The global COVID-19 pandemic, whilst having a profoundly adverse effect on tourism in The Bahamas, also heralded an unprecedented real estate boom, which lasted from late-2020 to mid-2023.

During this period, frenetic activity was seen in the mid-level, high-end and ultra-high-end market ranges. By and large, most purchases were cash transactions from foreign investors and buyers, with gated residential and resort communities being amongst the most sought-after areas. However, domestic borrowings and purchases by residents also returned with renewed vigour and strength, in a marked turn for that aspect of the industry.

Most non-Bahamian purchasers appeared to be individuals or families keen to establish alternative options for their lifestyles, schooling and work (particularly as hybrid working arrangements became the norm around the world). Often, more simply, purchasers sought a sanctuary or retreat from their home bases and the issues or frustrations that challenged life in the preceding year of social, health, financial and sometimes political turmoil. In all such cases, the historic attractiveness of The Bahamas as a politically stable jurisdiction with common language and currency exchange rate, and being nearshore or easily accessible to their home jurisdictions, was a tell-tale feature in the decision-making of many buyers.

The losses from the global shutdown and the shattering impact of Hurricane Dorian (in 2019) were so dismal a backdrop as to make any positive improvement appear to be all the greater, but many in the industry quite justifiably view the period beginning in late 2020 through to mid-2023 as one of the greatest and most aggressive real estate markets that The Bahamas may ever see.

By the beginning to mid-2023, rising inflation and the fears of a recession, coupled with stock market volatility and the drop in cryptocurrency values, had impacted the strength of the real estate market. Although demand and values have remained strong in particular ultra-high-end developments, the real estate market has otherwise returned to a much flatter or even declining trajectory characterised by more limited inventory and softer values.

At the same time the government of The Bahamas appears to be putting greater focus on ensuring a more equitable and stringent approach to the collection of revenue from the real estate sector. This has been seen for example in the extension of legal remedies for the non-payment of real property taxes (together with the practical enforcement of such remedies) and in the introduction of a condo-hotel tax payable by owners who benefit from real property tax concessions for rental properties but who only achieve limited rentals and thus limited VAT revenue for government.

Impact of Disruptive Technologies

Real estate purchasers and developers have taken a guarded approach to the introduction of digital or decentralised purchase and finance technologies, and continue to approach transaction structuring through conservative and established practices. Although The Bahamas government previously sought to encourage the development of the digital asset space, including the establishment of a framework for the regulation of such business by the enactment of the Digital Assets and Registered Exchange Act in 2020, the collapse of the cryptocurrency exchange FTX in late-2022, which had established its headquarters in Nassau, has led to a withdrawal from the promotion of this sector of the economy, which is not expected to recover within the next 12 months.

1.3 Proposals for Reform

The current government administration has stressed the importance of improving the "ease of doing business" as a priority in its agenda, particularly reform of land administration and tenure. In February 2022, a government-appointed Land Reform Committee was constituted by The Bahamas government to review land-related issues for potential reform and make recommendations for consideration and advancement by the government. It is anticipated that proposals will be put forward in the near future for the implementation of a system of registered land in The Bahamas.

2. Sale and Purchase

2.1 Categories of Property Rights

Real estate can be held as freehold title absolute or leasehold.

2.2 Laws Applicable to Transfer of Title

In The Bahamas, the Conveyancing and Law of Property Act, 1909, principally governs the determination of title to real property and conveyancing transactions. The title to condominium units is governed by the Law of Property and Conveyancing (Condominium) Act, 1965 (as amended). The laws applicable to transfer of title do not vary between commercial and residential properties, but certain acquisitions by non-Bahamians would require prior government approval (see **2.11 Legal Restrictions on Foreign Investors**).

2.3 Effecting Lawful and Proper Transfer of Title

The transfer of title must be effected in writing and is done by deed. Electronic signatures are not permitted for the conveyance of real property and strict formalities must be complied with requiring original wet signatures, notarisation and (often) further authentication. Once completed, the deed must be stamped by the Department of Inland Revenue, and any applicable taxes on the transaction must be paid. Every deed must include the real property tax assessment number on the front page when submitted for stamping.

The deed is then lodged in the Registry of Records to establish its priority against subsequent purchasers, encumbrances or liens. The original deed, once recorded, is returned to the purchaser for safekeeping, together with any other original deeds in the chain of title that may change hands on closing.

Whilst not yet a mainstay of Bahamian conveyancing transactions, title insurance is becoming increasingly popular and more frequently relied upon (in lieu of a buyer's or lender's counsel carrying out due diligence on property to be acquired or mortgaged). The customary arrangement for title insurance is for a buyer or lender to be issued a commitment prior to closing, and for the actual policy to be issued once the relevant purchase or security documents have been stamped by the Public Treasury and recorded in the Registry of Records.

2.4 Real Estate Due Diligence

As there is no land registry in The Bahamas, good and marketable title to land is determined by searches conducted against the names of predecessors in title and the seller in the Registry of Records, the Supreme Court Registry, the Companies Registry and the Probate Registry. Certain searches must be conducted manually, and this can have an impact on the time it takes to conclude a real estate transaction in The Bahamas due to some continuing restrictions on access to undertake such searches following the COVID-19 pandemic.

In a purchase and sale transaction, Bahamian law requires that title traces back to a "root of title" (ie, to a deed not less than 30 years old), to a "Crown Grant" or to a Certificate of Title issued in accordance with the Quieting Titles Act, and that there be an unbroken chain of documentary title from such point to the seller's ownership.

During a standard purchase and sale transaction, it is usually necessary for a purchaser's attorney to raise "requisitions" in respect of the title to a property, which can vary widely in nature, to ensure that areas of uncertainty and inconsistencies or defects in title are addressed by a seller or their counsel prior to closing.

The majority of purchasers or mortgagees rely upon Bahamian counsel to investigate title and provide a written legal opinion certifying the good and marketable nature of the title to be acquired or held as security before closing on the transaction. The opinion is backed by the firm's professional indemnity insurance. However, title insurance is offered in The Bahamas by a number of title insurance agents representing major international title insurance companies, and the procedure to acquire insurance is usually handled by local counsel but is no different to what foreign buyers may be accustomed to in their home jurisdictions. In some cases, certain developers will provide only for title insurance to be issued to buyers under their purchase contracts and will not adduce title to a property or address requisitions, in order to streamline and expedite the sales process.

2.5 Typical Representations and Warranties

In The Bahamas, real estate purchase and sale agreements increasingly include basic representations and warranties by the parties, particularly in commercial real estate transactions, but this is subject to the nature of the transaction and the sophistication of the parties, and not all firms have adopted such practice. Given the relatively limited and rudimentary use of representations and warranties in commercial real estate transactions, representation and warranty insurance is not typically sought by the parties to the transaction.

A purchaser may have remedies commonly available under common law for misrepresentation or breach of agreed representations/warranties. In the absence of agreed seller disclosures, representations and warranties, the representations and warranties of a seller are limited under Bahamian law and generally relate to implied covenants for title only (regarding the right to convey, quiet enjoyment, freedom from incumbrance, and further assurance).

In general, where representations and warranties are included in commercial real estate transactions it is not typical for them to be time limited, nor for the seller's liability to be subject to any cap.

The general position under Bahamian law, and a matter of good commercial local practice, is that the buyer must satisfy themselves as to the condition and fitness for intended use and purpose of the land they intend to purchase before proceeding and carry out all the necessary due diligence it would be prudent to undertake.

2.6 Important Areas of Law for Investors

While obtaining general guidance on Bahamian real estate law and contracts is important, an investor should ensure that they are advised on:

- how closing and carrying costs may arise (whether as taxes or additional fees);
- the preferable structure for the holding of title to their property (and how this may interplay with estate planning or exchange control considerations);
- how zoning or planning may affect desired development plans;
- in the case of non-Bahamians, the regulatory requirements for owning and developing real estate or operating a business in The Bahamas; and
- in the case of non-Bahamians interested in establishing immigration status in The Bahamas by virtue of their purchase and investment, the considerations to be understood in planning and co-ordinating these two goals.

2.7 Soil Pollution or Environmental Contamination

The environmental liability laws of The Bahamas are contained in various statutes, but the Environmental Health Services Act, 1987 and the Environmental Planning and Protection Act, 2019 are of primary importance. Generally, the environmental laws are not onerous and seek to hold liable the person responsible for any environmental damage.

A buyer of real estate in which there is soil pollution or environmental contamination may (practically speaking, as much as legally speaking) inherit the responsibility of remediating pre-existing environmental issues. However, Section 28 of the Environmental Planning and Protection Act, 2019 provides that the liability for historical pollution is imposed on any person found

to have polluted the environment before the Act came into force on 20 January 2020; many of the Act's administrative provisions have not yet been fully implemented, and the provisions imposing duties of care or liability have not yet been tested in practical application and effect. It remains to be seen (but certainly appears that it might be the case) whether environmental liability and remediation costs may be borne by a prior landowner under Section 28, notwithstanding that they had subsequently disposed of or sold the land to a third-party purchaser, or whether such liability would simply be inherited by a successor in title or the current owner of the damaged or polluted land.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

There are a number of Bahamian statutes that include provisions relating to the development and use of land but, generally speaking, development, planning, zoning and land use regulations are set out in the Planning and Subdivision Act, 2010 (P&S Act) and related subsidiary legislation.

The P&S Act contemplates that a "Land Use Plan" shall be adopted for each island in the Commonwealth of The Bahamas; work on developing those plans is underway, but is as yet unfinished. In the interim, it is standard practice for a buyer who wishes to ascertain the permitted uses of a parcel of real estate under applicable zoning or planning law to contact the Town Planning Committee in the Department of Physical Planning for confirmation of the permitted or zoned use of that property under historic zoning orders or the current non-statutory land use plans.

Approvals in Principle

Where a purchaser has development plans in mind for a parcel of land, the securing of requisite approvals (or, more often, "approvals in principle") from the Town Planning Committee to facilitate the development, operation and management of the desired activity on that land would be a condition for closing the purchase transaction. The issuance of further project-specific final approvals from the Town Planning Committee would often be undertaken following completion of the purchase.

Such approval in principle is often sought from the highest levels of government in the purchase and development approval process and covered in a buyer's or developer's application to the National Economic Council and Bahamas Investment Authority (see **2.11 Legal Restrictions on Foreign Investors**). In the case of major development projects, the buyer/developer and The Bahamas government will often enter into written and signed "Heads of Agreement" confirming approved uses, permitted development plans and related matters.

2.9 Condemnation, Expropriation or Compulsory Purchase

The Bahamian constitution protects private property rights. The Bahamian government's powers or rights of condemnation, expropriation or compulsory purchase (referred to as "compulsory acquisition" in The Bahamas) are limited and can only be exercised strictly in accordance with relevant statute law, as follows:

- under the Acquisition of Land Act, 1913, land may be compulsorily acquired for public purposes and subject to the process set forth in the Act;
- under the Proceeds of Crime Act, 2018, confiscation orders may be issued where proper-

ty was acquired or gifted with proceeds from illegal activities;
- under the Environmental Planning and Protection Act, 2019, administrative orders may be issued to halt or prevent environmental damage;
- under the Real Property Tax Act, the public treasurer has the power to sell certain land where annual property taxes are in arrears; and
- under the Building Regulations Act, 1971, the minister responsible for building regulations has the power to condemn and/or destroy unsafe or derelict structures.

2.10 Taxes Applicable to a Transaction

Generally speaking, all sales and transfers of land between third parties, whether direct or indirect, attract VAT payable to the Public Treasury under the Value Added Tax Act (VAT Act).

VAT on a transaction is calculated on either the consideration paid for the property or the fair market value of the property, whichever is greater. The fair market value may be determined by an appraisal from a professional valuer, or is taken as the assessed value for real property tax purposes, if higher. The rate of VAT payable on the sale and purchase of land depends upon whether the conveyance is made to an Bahamian or a foreign person. Conveyances to a Bahamian individual or a permanent resident with the right to work in The Bahamas are calculated on a sliding scale of 2.5% for transactions valued at less than BSD100,000 up to 10% for transactions over BSD1 million. In the case of a foreign person, company or other entity, all transactions are charged at 10%.

It is customary for a buyer and seller to agree in a typical sale and purchase transaction to share the payment of the applicable tax equally, but this is a business decision for the parties and not required by law.

The transfer of shares of a land-owning company (or its parent) similarly attracts VAT and, under the Value Added Tax (Supply of Real Property) (General) Rules, 2023, any real property owned by a land-owning company is deemed to be transferred in the same proportion of value as the interest transferred/acquired in the land-owning company.

There are certain exempt (or rather, "zero-rated") transfers of real estate, or transfers that may be eligible for partial exemptions. These include certain voluntary intra-family transfers, corporate intra-group transfers, estate planning transfers, purchases and mortgages by first-time homeowners, and transfers of residential mortgages.

In the case of financing transactions (including purchase or construction financing), under the VAT Act a debenture or mortgage that secures a monetary obligation also attracts VAT at a rate of 1% of the monetary obligation secured.

2.11 Legal Restrictions on Foreign Investors

While foreign direct investment in targeted sectors of the economy is generally encouraged in The Bahamas and successive government administrations have supported and facilitated it, such investment is also regulated, and foreign investors and purchasers must obtain government approvals that differ in nature and process, depending (in the case of real estate-related investments) on the type of purchaser, the land to be acquired and the intended development or use planned for the land.

The Bahamas Investment Authority (BIA) and the National Economic Council (NEC)

Applications for requisite approvals are submitted to the BIA, a government department based in the office of the prime minister. Applications for approval of major investment or development projects are considered by the NEC, a non-statutory committee within the BIA that is comprised of the prime minister, members of the cabinet of The Bahamas government and other senior policy advisers. Once an application is approved by the NEC/BIA, all other approvals required from other departments and agencies will follow (subject to compliance with the further necessary steps and procedures).

The International Persons Landholding Act (IPL Act)

International Persons Landholding Permit

In the case of land transactions (other than one-off purchases of residences or vacation homes), a foreign purchaser must obtain an "International Persons Landholding Permit" in respect of the land they intend to acquire, in accordance with the IPL Act. The application is made to a government department called the Investments Board. Where a permit is required under the IPL Act, it must be obtained as a condition for closing on the purchase transaction; in the absence of obtaining it, a buyer's conveyance would be deemed null and void in law.

Certificate of Registration

Where a foreigner is purchasing real estate for single-family residential use only (whether for long-term use or for periodic use as a vacation home), under the IPL Act the purchaser does not have to obtain a permit as a condition for completion and may simply register their purchase of the land following the closing of the transaction and the payment of the tax on the transaction. The purchaser is issued a "Certificate of Registration" in such instances.

One-time fee payment

In either case, the permit or certificate obtained by the foreign purchaser is attached to their title deed when it is lodged for recording in the Registry of Records and recorded with it. The current one-time fee due to the Public Treasury for a permit or certificate is USD1,000.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The manner in which commercial real estate transactions are financed can vary widely, depending on the size of the project and loan, and the parties involved.

In The Bahamas, well-established licensed local banks and financial institutions that offer traditional financing for projects of all types and commercial banking options, or that often act as security trustees, have a very strong presence.

In addition, The Bahamas government has historically also permitted the financing of local commercial projects by international lenders, subject to exchange control regulations and the usual vetting and approval procedures for foreign investors. Where a foreign lender intends to advance a loan and hold Bahamian real estate as security for it, an application is made to the Investments Board for a mortgagee's landholding permit to be issued under the IPL Act, and to the Central Bank of The Bahamas for the requisite approvals to be issued to the lender under the Bahamian Exchange Control Regulations.

Major Transactions, Including Syndicated Lenders

In major financing transactions, where there may be a group of syndicated lenders, a collateral trust would often be established and the mortgages, security instruments and other Bahamian collateral securing the loan would not be held directly by any lender but would be held by a specially formed Bahamian security trustee as a collateral agent for the named beneficiaries of the trust from time to time. The trustee of the collateral trust is typically a Bahamian company that holds an unrestricted Banking and Trust Licence in The Bahamas. Quite often, it is preferred for the collateral trustee to hold the trust assets under the collateral trust in a wholly owned special purpose Bahamian International Business Company, the issued shares of which would constitute the corpus of the collateral trust, with the company, in turn, holding the security instruments.

3.2 Typical Security Created by Commercial Investors

Forms of security for financing the acquisition and development of commercial real estate can vary widely, but the most common forms of security include:

- legal charges;
- debentures (by companies);
- legal or equitable mortgages;
- pledges/charges over shares of a land-owning company or its parent;
- assignments of rent or other revenue;
- assignments of insurance;
- promissory notes; and
- corporate or personal guarantees.

The Conveyancing and Law of Property Act, 1909

Under this act, a legal mortgage of real property, personal property and fixtures has the effect of conveying and transferring title to the lender, leaving the borrower with an equitable right to redeem the mortgage by payment of the mortgage debt.

The Companies Act, 1992 and the International Business Companies Act, 2000

Under these acts, a company may by debenture charge real property and specific personal property by way of legal mortgage and create a first priority floating charge on all other present and future assets and undertakings (including intangibles), which would crystallise in the event of default.

A legal mortgage or debenture must be made or issued as a deed, and should be recorded in the Registry of Records in order to preserve priority against subsequent encumbrances.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Investments Board Permits

While a lender is not required to hold a bank or trust licence in order to lend money to an entity based in The Bahamas, a foreign lender intending to acquire an interest in real estate as a mortgagee by virtue of a legal mortgage must obtain a permit from the Investments Board under the IPL Act. A legal mortgage is deemed to be null and void in law in the absence of such a permit.

As with the granting of a permit to a foreign purchaser of real estate, a permit granted to a lender is transaction-specific, but such permits are routinely issued by the Investments Board upon submission of a completed application and standard due diligence.

Exchange Control Department Approvals

In addition, as required by the Exchange Control Regulations Act (which regulates transactions between "resident" and "non-resident" entities), a lender (whether deemed to be "resident" or "non-resident" for exchange control purposes) will have to obtain certain approvals from the Exchange Control Department of the Central Bank of The Bahamas in order to lend money in foreign currency, including to a Domestic Company or an International Business Company (IBC) that is deemed to be "resident" for exchange control purposes. Such exchange control approvals typically also include the lender obtaining confirmation from the Central Bank that, upon drawdown of the loan by the borrower, the lender will be granted "approved loan status" (also referred to as "approved investment status") in order for the lender to receive repayments in foreign currency from the borrower.

Subject to the pre-closing approvals mentioned above, a lender is not required to obtain any further government approvals to facilitate a proposed loan transaction or to seek government approval in respect of any of the remedies the lender may wish to exercise in respect of its security (other than judicial approvals).

Registration as a Foreign Company

It should be noted that, as a matter of policy rather than law, the Investments Board requires a foreign entity (whether a lender or a purchaser) that intends to acquire an interest in real estate in The Bahamas to register as a foreign company under the Companies Act of The Bahamas as a condition for obtaining a certificate or permit from the Board.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Under the VAT Act, a debenture or mortgage that secures a monetary obligation would attract VAT at a rate of 1% of the monetary obligation secured. Where additional security is granted in respect of the same loan and the principal instrument attracts tax at a rate of 1%, no tax is charged on the collateral security documents provided that they are submitted for stamping at the same time. The industry standard is for applicable tax and related closing costs to be paid by the borrower.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no rules or requirements that must be complied with before an entity can give valid security, except for the government approvals noted in **3.1 Financing Acquisitions of Commercial Real Estate** and the matters of general law which specify the following, where a party is a corporate entity:

- the proposed loan transaction and granting of security are completed in accordance with the corporate governance requirements; and
- where a corporate guarantee is given as security, the giving of the guarantee is considered as having reasonably been in the interests of the guarantor and done with commercial justification.

3.6 Formalities When a Borrower Is in Default

A legal mortgage over real property in The Bahamas has the effect of conveying title to a lender, and under Bahamian law a lender may do the following, in the event of default by the borrower:

- exercise its power of sale of the property to a third-party purchaser without judicial sanction;
- seek (voluntarily, and not by requirement of law) judicial sanction of the sale of the property to a third-party purchaser; or
- apply to the courts for a Foreclosure Order, which would extinguish the borrower's right to redeem the mortgage and result in absolute ownership by the lender.

Under the Conveyancing and Law of Property Act, 1909, a lender is entitled to exercise the power of sale (the most common and expedient remedy used by lenders) under one of the following circumstances:

- notice requiring payment of the mortgage money has been served on the borrower, and default has been made in payment of the mortgage money, or of part thereof, for three months after such service;
- some interest under the mortgage is in arrears and unpaid for two months after becoming due; or
- there has been a breach in observing or performing some provision contained in the mortgage deed or in the Act, on the part of the borrower or of some person who agreed to arrange the mortgage, other than and besides a covenant for payment of the mortgage money or interest thereon.

Formal written notice of default is required to be served under any mortgage, and the notice period would be stipulated in the mortgage. It is also not uncommon for a mortgage to stipulate shorter default timelines in substitution for the above provisions of the Act, although, in the case of mortgaged properties that constitute a borrower's primary residence, certain required procedures and minimum notice periods must be complied with under the Homeowners Protection Act, 2017.

3.7 Subordinating Existing Debt to Newly Created Debt

A legal mortgage or debenture should be recorded in the Registry of Records in order to preserve priority against subsequent encumbrances. It is possible for a secured lender with senior priority, as a commercial business decision, to contractually agree to subordinate its debt and/or a newly created debt to another lender. A subsequent action for foreclosure can be brought by any lender of property, whether it is the first or subsequent lender.

3.8 Lenders' Liability Under Environmental Laws

A freehold or leasehold mortgagee who is not in possession would not be liable for environmental damage, provided that the mortgagee has not itself caused damage to the property. Where a mortgagee is responsible for the actual damage, they would be liable for the remediation costs and fines.

3.9 Effects of a Borrower Becoming Insolvent

Valid security interests created in favour of a lender do not become void if the borrower becomes insolvent, and a lender may exercise the remedies granted under a debenture or mortgage (see **3.6 Formalities When a Borrower Is in Default**), regardless of the borrower's solvency. Typically, a properly drawn mortgage would reflect that the insolvency of the borrower (or the commencement of such proceedings that are not subsequently stayed) would be deemed to be an act of default and entitle the lender to exercise its remedies under the mortgage.

3.10 Taxes on Loans

Following the expiry of the London Inter-Bank Offered Rate (LIBOR), local commercial banks took measures (where necessary) to address and agree the use of alternative reference rates with their customers. However, a large majority of domestic lending transactions are calculated by reference to the domestic bank's prime lending rate and have not been impacted by the expiration of the LIBOR index.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

A number of Bahamian statutes include provisions relating to the development and use of land but, generally speaking, development, planning, zoning and land-use regulations are set out in the P&S Act and related regulations (see **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law**).

The P&S Act provides the overall structure for the administration of development, planning and zoning matters by the Department of Physical Planning, the Town Planning Committee and related subcommittees and appeal boards. The P&S Act also provides for:

- the establishment of land-use plans, zoning plans, development controls, environmental controls and related by-laws;
- the requisite approvals that must be obtained in respect of proposed developments; and
- the process for obtaining such approvals.

All manner of development matters fall within the purview of the Department of Physical Planning under the P&S Act, ranging from minor lot or parcel-specific boundary line adjustments and setbacks to the planning of major resort and marina development projects.

In the case of significant development projects or projects that may affect coastal, wetland or other environmentally sensitive areas, the BIA and the Department of Physical Planning work in close conjunction with the Department of Environmental Planning and Protection (DEPP) when reviewing development applications. In connection with proposed development projects, the DEPP reviews and provides commentary on environmental impact assessments (EIAs) and environmental management plans (EMPs), and issues a Certificate of Environmental Clearance as a required precondition to the commencement of any development project.

Other environmental agencies that are often involved in elements of a major purchase or development project include:

- the Ministry of the Environment and Housing, which has responsibility for protecting and conserving the health and sustainability of the natural environment in The Bahamas;
- the Ministry of Public Works and Utilities, which has responsibility for overseeing and maintaining public roads and other physical infrastructure of The Bahamas, and (together with the Ministry of the Environment) for administration and enforcement of The Bahamas Building Code ("the Code");
- the Ministry of Agriculture, Fisheries and Local Government, which has responsibility for leases of agricultural land and (together with the Fisheries Department) managing the fisheries industry and protected marina areas;
- the Department of Environmental Health Services, which has responsibility under the Environmental Health Act, 1987 and related

regulations for the protection of public health, certain environmental controls, waste collection, sanitation and landfill operations;
- the Bahamas Public Parks & Public Beaches Authority, which has responsibility for public parks, beaches and recreational areas;
- the Forestry Unit, which has responsibility under the Forestry Act, 2010 for certain forested areas, parks and protected areas, and for relations with non-government organisations;
- the Bahamas National Trust, which is a non-profit quasi-government agency responsible for conserving and protecting the natural and historic resources of The Bahamas and its ecosystems, and for establishing and managing the country's numerous national parks;
- the Antiquities, Monuments, and Museum Corporation, which is a non-profit quasi-government agency responsible for protecting, preserving and promoting the historic cultural resources of The Bahamas;
- the Bahamas National Geographic and Information Systems Department, which is responsible for oil and natural gas exploration and regulation, alternative and renewable energy, and aragonite mining; and
- the Water and Sewerage Corporation, a statutory corporation responsible for the management of the country's water resources.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Construction in The Bahamas is regulated under the P&S Act and the Building Regulations Act, 1971, supplemented by the Code. The purpose of the Code is to provide certain minimum standards, provisions and requirements for safe and stable building design, methods of construction and uses of materials.

A building permit issued by the Building Control Department of the Ministry of Works is generally required for all new construction, additions and alterations (including decks, sheds, retaining walls and fences), and must be obtained prior to the commencement of such work.

4.3 Regulatory Authorities

The Town Planning Committee of the Department of Physical Planning is responsible for regulating the development and designated use of individual parcels of real estate under the P&S Act. In the case of "Out Islands" (islands in the Commonwealth of The Bahamas other than New Providence Island), certain functions and powers of the Town Planning Committee may be delegated to District Councils under the Local Government Act, 1996.

4.4 Obtaining Entitlements to Develop a New Project

The P&S Act provides the regulatory framework for new developments, major refurbishments or changes of use of a developed property, and no development of land is permitted without the appropriate approval.

Application Process

All applications relating to the development of properties in a zoned area are to be submitted to the director and must be in the form stipulated in the Planning and Subdivision Act (Application Requirements) Regulations, 2011. An applicant must also post "Development Application Signs" and give notice of the pending development application in accordance with the Planning and Subdivision Act (Public Notice) Regulations, 2011.

The Town Planning Committee ("the Committee") then holds public hearings to engage public consultation on development projects,

and provides notice of such meetings. Within seven days of its eventual decision, the Committee must give written notice of such to the applicant and each person who made a written request to be notified. In reply to an application (eg, for site plan control), the Committee may then grant a Preliminary Support of Application, with such conditions or amendments as deemed appropriate.

Rights of Third Parties

Interested third parties have the right to attend the public hearing and express their views (whether in support or opposition). Upon request, an interested third party may have the Department of Physical Planning make any application available for public review during normal business hours. An interested third party may – in support of or opposition to a development application – tender written submissions to the department prior to a public hearing, or make oral or written submissions to the Committee at a public hearing.

4.5 Right of Appeal Against an Authority's Decision

The decision of the Town Planning Committee under the P&S Act is final and binding, unless it is appealed to the Subdivision and Development Appeal Board ("Appeal Board") within 21 days after making the decision.

A party aggrieved by a decision of the Committee may appeal to the Appeal Board, including against any decisions by the Committee relating to a development application including the Committee's decision to extinguish the effect of a restrictive covenant. The right of appeal lies not only with the applicant but also with any person who has an interest in the matter.

An appeal to the Appeal Board must be conducted in accordance with the relevant regulations (the Subdivision and Development Appeal Board Rules, 2011). No development or building may proceed on any land that is the subject of an appeal to the Appeal Board.

The decision of the Appeal Board is final and binding, unless an appeal is made to the Supreme Court within 21 days of the decision being reached. An appeal to the Supreme Court may only be based upon a point of law, and not on any matter of fact or the merits of any decision by the Appeal Board.

It is worth noting that, in recent years, non-compliance with the requirements and procedures set forth in the P&S Act and regulations, and procedural impropriety, have become the grounds for a number of successful judicial review actions, some of which have been ultimately appealed to the Privy Council (at considerable cost). With that in mind, a developer would be well-served to ensure that careful regard is given to the process and requirements of the P&S Act, to safeguard themselves against the potential risk of opponents to the development later finding a foothold for overturning approvals that may have been hard-sought.

4.6 Agreements With Local or Governmental Authorities

A purchaser or developer intending to carry out a major development project will often enter into written and signed "Heads of Agreement" with The Bahamas government to agree and confirm approved uses, permitted development plans and related matters (which may include a range of additional licences, permits, consents or sub-approvals that are necessary to facilitate the successful acquisition, development and management of the project, and which may also include

special exemptions, concessions or incentives to be granted to the developer under the Hotels Encouragement Act, 1954 or otherwise).

Developers of major projects may also need to secure utility franchise agreements from the local utility statutory corporations and, at the time of applying for acquisition and development approvals, might seek approval-in-principle from the NEC/BIA for the right to enter into such agreements.

4.7 Enforcement of Restrictions on Development and Designated Use

The failure to adhere to and observe restrictions on development and designated use may result in fines under the P&S Act. The minister responsible for the environment has certain statutory powers to access and inspect premises to ensure that such matters are complied with, and to investigate non-compliance. This may also result in an action for judicial review or for an injunction against works or activities being brought by private citizens.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The following entities are predominantly used by investors in The Bahamas to hold title to real estate:

- a "Domestic Company" (also often referred to as a "Local Company") incorporated under the Companies Act, 1992, which is the preferred entity used by Bahamian investors;
- a Bahamian IBC incorporated under the International Business Company Act, 2000, which is the preferred entity used by non-Bahamian investors; or
- a foreign corporation (eg, a US limited liability corporation) that is registered as a "Foreign Company" with the Bahamas Companies Registry.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Domestic Company

A Domestic Company has limited liability (unless it is formed specifically as an unlimited liability company) and may carry on any business in, or from within, The Bahamas.

A Domestic Company will be designated as "resident" for exchange control purposes under the Exchange Control Regulations if it owns land in The Bahamas or carries on business in the domestic economy, or if the beneficial owner is Bahamian or a work-permit holder or a permanent resident with the right to work.

A Domestic Company can only maintain foreign currency accounts with the prior permission of the Central Bank of The Bahamas.

IBC

An IBC is a limited liability company that may carry on business in any part of the world and is primarily intended to operate outside The Bahamas. To conduct business in or from within The Bahamas, an IBC requires certain government regulatory approvals. An IBC is restricted from carrying on business with persons (corporate and individual) resident in The Bahamas, unless they are designated "resident" for exchange control purposes; where that is desired in connection with the intended or pending purchase of real estate, an application for the appropriate designation of a land-owning IBC would customarily be made in the course of the transaction.

5.3 REITs
No information has been provided in this jurisdiction.

5.4 Minimum Capital Requirement
The authorised capital of an IBC may be divided into shares of a fixed amount, but IBCs may also have shares of no par value. Common shares, preference shares, redeemable shares or any combination thereof are permitted, but only registered shares are permitted; bearer shares are not permitted. Generally, the preferred minimum authorised capital is USD5,000 divided into 5,000 shares of USD1 par value each.

Similarly, the majority of Domestic Companies are incorporated with an authorised share capital of USD5,000 divided into 5,000 ordinary shares of USD1 each, although other options and amounts are available, and these can be tailored to meet the requirements of the investor.

5.5 Applicable Governance Requirements
Every IBC must have a registered agent and maintain a registered office in The Bahamas. An IBC may have a sole director and/or a sole shareholder. The appointment of officers is optional. The powers and objectives of an IBC are typically to engage in any activities that are not prohibited under any law in force in The Bahamas.

A Domestic Company must also have a local registered office. The company must have a minimum of two directors, two shareholders, a president and a secretary.

The constitutional documents of both an IBC and a Domestic Company (ie, the memorandum and articles of association) determine the powers of its board of directors and officers, and the management of the affairs of the company's operations and business.

5.6 Annual Entity Maintenance and Accounting Compliance
For an IBC, the annual government fees are determined based on the authorised share capital. Where the authorised share capital for one year does not exceed USD50,000, the fee is USD365; where the authorised share capital exceeds USD50,000, the fee is USD1,030.

For a Domestic Company, the annual government fees are determined based on beneficial ownership. A government fee of USD350 per year is payable for companies beneficially owned by Bahamians, and USD1,000 a year is payable for companies owned by non-Bahamians.

For a non-Bahamian Company registered in the Bahamas Companies Registry as a Foreign Company, the annual government fee payable to the registrar general (not in the year of registration) is USD1,000.

For all companies mentioned here, professional fees are typically also payable to the financial and corporate service provider in connection with the maintenance of the company and registered agent/office services.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time
The occupation and use of a property may be established in The Bahamas without outright ownership under a lease or a licence.

Under a Bahamian lease, a tenant is contractually granted the right of exclusive possession of a property for a specified period, subject to the terms and conditions of the agreement and the rents thereby secured. Under a licence, an owner grants permission to a licensee for the use and occupation of a property. However, unlike a tenant under a lease, the licensee does not have exclusive possession or proprietary rights to the property.

6.2 Types of Commercial Leases

Standardised forms of commercial leases have not yet been adopted and agreed for use in The Bahamas. While the preferred forms of lease agreement used are generally comparable and similar in style and content, there may also be wide variation between those used by smaller local developers or landlords and those used in larger resort, tourist or commercial complexes, which require more sophisticated provisions.

6.3 Regulation of Rents or Lease Terms

Lease agreements and the terms between the parties are freely negotiable and subject to contract. Certain limited covenants are implied by the Conveyancing and Law of Property Act, 1909, but the material commercial terms are open to agreement between the parties.

6.4 Typical Terms of a Lease

In July 2019, The Bahamas government overhauled the tax regime for real estate transactions and made leases (along with many other real estate transactions) subject to VAT. The tax treatment of leases varies depending upon the length of the term of the lease, with leases for five years or more (other than leases of dwellings) attracting VAT on both the capital sum payable for the lease and the periodic rent payments (with the VAT payable on periodic rent payments only being able to be claimed as an input tax deduction).

Under a typical Bahamian lease agreement, the following is generally industry standard:

- the tenant is responsible for repairing the leased premises;
- the landlord insures and maintains the building and the common parts; and
- rent and additional charges (such as common area maintenance charges and/or utility charges) are paid monthly or quarterly, and generally in advance.

6.5 Rent Variation

The variation of rent is freely negotiable and subject to the contractual agreement of the parties. Well-drawn commercial leases often make provisions for rent to be reviewed or updated at a certain agreed stage or date but, practically speaking and more commonly, the issue is addressed when the lease falls due for renewal.

6.6 Determination of New Rent

There is no legal or regulatory restriction governing the agreement between the parties of how new rent may be calculated. The industry standard commonly used is that increases are in line with the Consumer Price Index (CPI) or a pre-agreed percentage.

6.7 Payment of VAT

Under the VAT Act, leases are subject to the payment of VAT unless exempted.

The rental of a “dwelling” (meaning a building or premises intended to be used as a place of residence or abode of a natural person) is exempt from VAT. However, for vacation homes that are rented or let for a continuous period not exceeding 45 days, VAT is payable at a rate of 10%

on all rentals by non-Bahamians, and on rentals above the VAT threshold of BSD100,000 by Bahamians. 10% VAT is payable on all rentals made through an online marketplace like Airbnb, HomeAway or Vrbo. There is a mandatory VAT registration requirement for foreign homeowners who intend to rent their property as a vacation home.

A long-term lease (ie, a lease of property other than a dwelling for five or more years) attracts VAT at a rate of 2.5% where the value is under BSD100,000 and otherwise at 10%. In addition, VAT is payable at the rate of 10% on all periodic rent payments. A lease-to-own contract attracts VAT on each stage or interim payment.

A short-term lease or tenancy agreement of property (other than a dwelling) for under five years attracts VAT of 10% on the periodic rent payments.

6.8 Costs Payable by a Tenant at the Start of a Lease

At the start of a lease, the tenant would customarily pay the applicable VAT (see **6.7 Payment of VAT**) and a security deposit, which is usually equivalent to one month's rent. Registrar general recording fees (USD4.50 per page) are paid if the parties opt to record the agreement, but that practice tends to be quite rare.

6.9 Payment of Maintenance and Repair

Areas of a commercial premises that are used by more than one tenant are generally maintained by the landlord or their property manager, and the tenants pay a proportionate reimbursement of the cost incurred or a pre-agreed common area maintenance charge.

A number of larger commercial or tourist developments have been structured as multi-use condominiums with residential and commercial elements, or have master declarations of restrictions, covenants and conditions that contemplate mixed-use. In such cases, common area costs would usually be apportioned and charged to tenants as condominium assessments or maintenance fees/charges.

6.10 Payment of Utilities and Telecommunications

In general, utility charges would be paid by the landlord or their property manager, and a tenant would reimburse the monthly charges incurred. Where a leased area is not separately metered from other areas occupied or used by the landlord or other tenants, it is common for a tenant to contract to pay a fixed pre-agreed monthly amount or their pro rata share of common area maintenance charges. That said, it is also often possible for a tenant to set up a tenant service account in its own name and pay utility charges directly to the service provider.

6.11 Insurance Issues

While subject to contract and the agreement of the parties, it is generally the industry standard that the landlord is responsible for insuring the building and common parts and that the tenant must insure the leased area. The risks that are typically insured against include fire, earthquake, hurricane, flood and civil commotion. Business interruption insurance is very uncommon in The Bahamas, and it is exceedingly rare for a tenant to hold such a policy.

6.12 Restrictions on the Use of Real Estate

It is common for a standard form of commercial lease to include various restrictions governing the use of the leased real estate. In addition, restrictive covenants and conditions to which the real estate is subject would usually

be acknowledged, observed and performed by a tenant, as well as any property-specific town planning or zoning restrictions.

6.13 Tenant's Ability to Alter and Improve Real Estate

Unless the tenant is contractually obliged to complete certain works or improvements, it is industry standard for a tenant to be prohibited from making alterations or improvements to the leased real estate without the prior approval of the landlord.

6.14 Specific Regulations

Certain business leases or letting agreements by which a non-Bahamian acquires an interest in real estate in The Bahamas and which are over 21 years in duration are required to be registered with the Investments Board, and a Certificate of Registration must be obtained in accordance with the International Persons Landholding Act, 1993. A non-Bahamian tenant would also require a business licence issued by the Business Licence Department and all other immigration approvals and other regulatory permits or approvals that may be necessary in order to operate a commercial enterprise or undertaking on the leased commercial premises.

6.15 Effect of the Tenant's Insolvency

It is a common feature of standard commercial leases that a landlord has the right to terminate the lease in the event of the insolvency of the tenant.

In the case of bankruptcy, a landlord or other person to whom any rent is due from a bankrupt tenant may seize the goods or effects of the bankrupt tenant for the rent due to them at any time, either before or after the commencement of the bankruptcy. However, if such distress for rent is levied after the commencement of the bankruptcy, the landlord is only able to recover one year's rent accrued prior to the date of the order of adjudication. The landlord may apply under the bankruptcy for the balance due, for which distraint may not have been available. A landlord is not permitted to seize goods or effects of a bankrupt tenant held in trust for any other person, nor to seize the tools of the bankrupt's trade and the necessary wearing apparel and bedding of the bankrupt, their spouse and children.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is standard in The Bahamas for a landlord to require a security deposit to be paid at the outset of a lease (usually equivalent to one month's rent), and for the first and last months' rent to be paid in advance. The lease agreement would provide that the security deposit may be forfeited in the event of default or damage. In addition, under the laws of The Bahamas, a landlord may distrain against the tenant's goods, chattels and effects to recover arrears of rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

Hold-over provisions that speak to the continued occupation of a tenant beyond the expiration of the agreed term, with the consent of the landlord, are common in standard lease agreements. In the absence of such provisions and the landlord's consent, the tenant has no security or right of occupation under Bahamian law. A tenant in continued occupation would be deemed to occupy the leased real estate with the consent of the landlord on a periodic tenancy under the same conditions as those of the expired lease (insofar as applicable to a periodic tenancy).

6.18 Right to Assign a Leasehold Interest

While the parties can freely negotiate their desired terms between themselves, it is unusual for a tenant to be permitted to assign its leasehold interest in the lease or to sublet all or a portion of the leased premises. Where that is permitted, it is usually subject to the express and prior written consent of the landlord.

6.19 Right to Terminate a Lease

Under a typical lease agreement, the parties would usually enter into covenants to be observed and performed by a landlord or tenant respectively; failure to observe or perform such covenant may entitle a party to terminate a lease. A lease may also typically be terminated by either the landlord or the tenant if the leased real estate is substantially destroyed or damaged and not repaired within a specified period.

6.20 Registration Requirements

As noted in **6.14 Specific Regulations**, a non-Bahamian tenant may have an obligation to register long-term leases in excess of 21 years with the Investments Board under the International Persons Landholding Act, 1993. Except for such long-term leases, there is no requirement to obtain government approval to lease real estate, nor to record the lease in the Registry of Records. Parties predominantly elect not to record leases (whether commercial or residential), unless they represent or comprise part of a very significant investment and are long term in nature.

6.21 Forced Eviction

A standard lease would have provisions entitling the landlord to evict the tenant in certain instances. A tenant that alleges wrongful distress or eviction may commence an action to seek relief and defend their interest in the real estate and to the right of possession. The tenant may often also seek an interlocutory injunction to restrain the landlord's action in the interim, until the matter can be brought to trial. Given the steps involved in such applications and that a hearing is dependent on the court's calendar, the timeline of an eviction process can vary considerably.

6.22 Termination by a Third Party

The Bahamas government or any other third party cannot terminate a lease agreement between private parties, except when exercising the governmental rights and powers noted in **2.9 Condemnation, Expropriation or Compulsory Purchase**, which must be exercised in accordance with statute law and (in the case of compulsory acquisition) with suitable compensation being paid to a landowner or occupier.

6.23 Remedies/Damages for Breach

No details have been provided concerning remedies/damages for breach in The Bahamas.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There is no commonly accepted market standard of contract, so parties are free to agree terms as they see fit, with the format and complexity of the contract often being driven by the sophistication of the parties, the type of project and the third-party consultants required by the customer (eg, independent certifying architects, quantity surveyors or project managers).

However, most larger construction contracts will typically follow a US style (such as that of the American Institute of Architects), a UK style (such as that of the joint contracts tribunal), a

combination of the two, or even the contractor's (or developer's) own standard terms.

7.2 Assigning Responsibility for the Design and Construction of a Project

See **7.1 Common Structures Used to Price Construction Projects**.

7.3 Management of Construction Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.4 Management of Schedule-Related Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is possible, albeit rare, for owners to require formal guarantees or other additional forms of security as surety for a contractor's performance on a project. Such matters predominantly arise in the case of pre-construction condominiums, particularly those being developed by a developer/owner that is also the construction company or directly affiliated with it. In such projects, letters of credit or performance bonds from a financial institution are generally relied upon, rather than other forms of security.

7.6 Liens or Encumbrances in the Event of Non-payment

Under Bahamian law, contractors and/or designers are not permitted to lien or otherwise encumber a property in the event of non-payment. A contractor seeking to recover payment of a debt due would be required to enforce their contractual rights by commencing an action against the owner/customer in the Supreme Court of The Bahamas (or such other jurisdiction contractually agreed between the parties to be the appropriate forum for disputes) and obtaining a judgment against that debtor party.

7.7 Requirements Before Use or Inhabitation

Before use or inhabitation, a Certificate of Occupancy must be issued under the Building Regulations Act, 1971. The certificate is issued by the building control officer upon being satisfied that a building operation has been completed in accordance with the building permit issued by the Ministry of Works, and it certifies that the building is fit for occupation and use.

8. Tax

8.1 VAT and Sales Tax

As noted in **2.10 Taxes Applicable to a Transaction**, all sales and transfers of land between third parties, whether direct or indirect, attract VAT payable to the Public Treasury under the VAT Act, except for certain, specifically exempted transactions.

In a typical sale and purchase transaction, it is customary for a buyer and seller to agree to share the payment of the applicable tax equally, but this is a business decision for the parties and is not required by law. In the absence of an agreement to the contrary, the liability under the VAT Act to pay VAT falls jointly and severally on the supplier and the recipient of the real estate.

The VAT payable on supplies/sale of real estate (charged at 10%) may not be accounted for as input tax deductions.

8.2 Mitigation of Tax Liability

As a matter of general good commercial practice by prudent buyers, and particularly in large purchase transactions, it may be advantageous

for a purchase transaction to be structured as a "net" sale rather than a "gross" sale, as this can help to mitigate the amount of tax payable in respect of the transaction.

8.3 Municipal Taxes

Municipal taxes are not payable in The Bahamas, but operating businesses are required to hold a business licence and pay annual business licence fees. In July 2023, under the Business License Act 2023 foreign persons who wish to rent their properties are required to register for a Bahamian business licence.

Business licence fees may be paid in instalments which must be paid by the following dates:

- 31 March;
- 30 June;
- 30 September; and
- 31 December.

Failing notification to the Financial Secretary, the amount owed must be paid in full by 31 March.

Where VAT is payable, a VAT return must be filed within 21 days after the end of each tax period. Fines may be imposed for late filing which may be up to 2% of the tax owed and in instances of late or non-payment, 10% of the tax owed.

In addition, all real estate in The Bahamas is subject to real property tax, unless specifically exempted, and business premises are charged tax at a commercial rate.

Pursuant to the Real Property Tax (Amendment) Act 2023, directors of landholding companies are jointly and severally liable to pay the real property tax owed by the company. A director who fails to pay outstanding real property tax within a specified time may be liable for a fine of up to BSD30,000.

Furthermore, all units within a condo-hotel or a hotel rental pool are subject to the payment of a condo-hotel tax, unless the net VAT paid in respect of the unit exceeds the condo-hotel tax applicable to that unit. The condo-hotel tax is calculated at 75% of the rate of tax applicable to residential property (currently 0.625%) on the assessed value of each unit within the condo-hotel or hotel rental pool, up to a maximum amount of BSD150,000 per unit.

8.4 Income Tax Withholding for Foreign Investors

The Bahamas does not tax income or capital gains. However, rental income from real estate is subject to VAT, as outlined in **6.7 Payment of VAT**.

8.5 Tax Benefits

There are no local tax benefits from owning real estate in The Bahamas.

Trends and Developments

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Glinton Sweeting O'Brien was founded in 2005, and is a full-service boutique law firm based in Nassau, The Bahamas. The firm's client-focused approach and innovative practices have propelled us to the forefront of the legal industry. Serving clients locally and globally, Glinton Sweeting O'Brien prioritises personalised service and technological efficiency. Its extensive practice areas encompass real estate, construction, commercial transactions, financial services, regulatory compliance, immigration, estate planning, probate, tax, and civil litigation. Catering to a diverse clientele, including UHNW individuals, developers, financial institutions, and law firms, the firm's team of attorneys and professionals delivers tailored, pragmatic advice to achieve optimal outcomes with maximum efficiency. Glinton Sweeting O'Brien's commitment to building strong client relationships ensures that it understands their needs thoroughly, enabling the firm to provide cohesive, comprehensive, and compliant solutions.

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Navigating Property Rental Regulations in The Bahamas – A Comprehensive Guide for Investors and Stakeholders

The Bahamian archipelago, renowned for its pristine beaches and vibrant culture, attracts visitors from around the globe seeking idyllic vacation escapes. With the rise of short-term vacation rentals facilitated by platforms like Airbnb and VRBO, the regulatory landscape governing property rentals in The Bahamas has evolved. The regulations surrounding value added tax (VAT) and business licences for property rentals in The Bahamas are comprehensive and apply differently based on factors such as rental duration, ownership status, and rental type. Understanding the intricacies of VAT and business licence requirements is paramount for both foreign investors and Bahamians engaged in property rental activities. Let us delve into the details of the law and procedures for owners of short-term, long-term and commercial rentals.

For the purposes of this article, note the following definitions:

Bahamian – defined in Section 2 of the VAT Act as:

- a citizen of The Bahamas or a permanent resident with the right to work;
- a company 100% beneficially owned by Bahamians not directly or indirectly controlled by any foreign persons;
- a partnership or any other unincorporated association 100% owned by citizens of The Bahamas or permanent residents with the right to work; or
- a trust where each trustee and any person having a beneficial interest in the trust is a Bahamian.

Dwelling – defined in Section 2 of the VAT Act as a building, premises, structure or other place, or any part thereof that is used or intended to be used as a place of residence or abode of a natural person together with any appurtenances belonging thereto or enjoyed therewith, excluding a commercial rental establishment or commercial enterprise.

Foreign person – defined in Section 2 of the VAT Act as:

- an individual that is not a citizen of The Bahamas or is not a permanent resident with the right to work in The Bahamas;

- a company incorporated in The Bahamas but any of its shares or capital are owned by non-Bahamians or controlled by non-Bahamians;
- a company incorporated outside of The Bahamas;
- an unincorporated association or body firm where any of the partners or members are non-Bahamians or the company is controlled by non-Bahamians;
- a trust where the trustee or any person with a beneficial interest in the trust is non-Bahamian.

Hotel rental pool – defined in Section 2(2) of the Hotels (Amendment) Act, 2023 as any collective rental arrangement by which properties not owned by a hotel form a part of the hotel's bedroom inventory.

Long-term lease – defined in Section 2 of the VAT Act as a lease of five or more years.

Marketplace – defined in Section 2 of the VAT Act as a person or entity other than the homeowner that provides a platform for the accommodation of vacation home rentals and which collects payments for the supply of vacation home rentals. Examples include VRBO and Airbnb.

Registration threshold – defined in Section 2 of the VAT Act as the amount of turnover from a taxable activity obtained by a person on an annual or lesser basis which requires, or entitles, such person to apply for registration as a taxable person under this Act. It is presently noted in the VAT Act and the Registration Guidance to be BSD100,000.

Turnover – defined in Section 2 of the VAT Act as the total revenues in money and money's worth accruing to a person from his/her taxable activities during the preceding 12 or fewer months, or such other accounting period as allowed under Part IV, including all cash, credit sales and commissions, without any deductions whatsoever.

Vacation home rental – defined in Section 2 of the VAT Act as a residence that is offered as a short-term rental for a continuous period not exceeding 45 days.

Registration requirements for foreign persons

Residential use

VAT & business licence

VAT on short-term & long-term rentals – a foreign person supplying short-term vacation home rental for 45 days or less within The Bahamas must register for VAT, regardless of the VAT threshold. Long-term residential rentals of more than 45 days and less than five years are exempt from VAT.

Business licence for short-term & long-term rentals – all foreign persons who rent residential property in The Bahamas must obtain a business licence, whether the foreign person owns the property solely or jointly with a Bahamian. This applies to both short-term (45 days or less) and long-term (over 45 days) rentals.

Commercial use

VAT & business licence

VAT on commercial rental – a foreign person supplying commercial property within The Bahamas, must register for VAT if they meet or anticipate that they will meet the registration threshold of BSD100,000 within a fiscal period. Additionally, a business licence is required for foreign landlords providing commercial rentals regardless of the turnover.

Registration requirements for Bahamians

Under the VAT Act and the Business Licence Act, 2023 (BLA) the definition of "Bahamian"

includes a permanent resident with the right to work in The Bahamas.

Residential use

VAT & business licence

Bahamian individuals or wholly Bahamian owned holding companies supplying short-term vacation home rentals of 45 days or less within The Bahamas do not require a business licence and are not required to register for VAT if their turnover through rental activity does not exceed the VAT threshold of BSD100,000 within a fiscal period. However, if the turnover exceeds BSD100,000, VAT registration is required. Also, long-term residential rentals of more than 45 days and less than five years are exempt from VAT.

Bahamian non-holding companies (businesses) supplying short-term vacation home rentals of 45 days or less within The Bahamas are required to obtain a business licence regardless of the turnover but are not required to register for VAT unless their turnover meets or exceeds the VAT threshold of BSD100,000 within a fiscal period.

If an individual is Bahamian and is in the business of renting properties (eg, an apartment complex), then the rental of a dwelling for 45 days or less is subject to VAT regardless of the VAT threshold. Such an individual will need to register for VAT and obtain a business licence.

Commercial use

For the supply of rental property for a commercial purpose, Bahamian individuals and Bahamian companies are required to register for VAT if they meet or anticipate that they will meet the registration threshold of BSD100,000 within a fiscal period and to obtain a business licence.

General requirements

A. Long-term leases (five years or more) – for all Bahamian and foreign persons, long-term leases of five years or more attract a one-time VAT payment on the annual rental rate of the lease, and if periodic rental payments are made, then VAT registration is required for the landlord and VAT payments are also assessed on such periodic rental payments.

B. Business licence required to register for VAT – no VAT registration certificate shall be issued under the VAT Act unless the comptroller is satisfied that the applicant has complied with requirements of the Business Licence Act.

C. VAT on cleaning fees and vehicle rentals – VAT will apply to additional services such as cleaning fees and vehicle rentals. Regarding vehicle rentals it should be noted that all vehicles included with vacation home rentals should not permit another driver to use the vehicle for a fee. If a vehicle is offered as an amenity or service with the rental home, that vehicle should have a self-drive public service licence.

D. Marketplace liability for VAT on vacation home rentals – subject to the rules that distinguish Bahamian and foreign ownership, if a homeowner supplies the vacation home rental and other services through a marketplace (eg, VRBO or Airbnb), the marketplace shall be liable to pay and account for VAT for the rental of the home and other services provided as a part of the rental of the home. VAT shall be payable on the total rental of the home and additional services provided along with any commission earned by the marketplace on the rental of the home. However, it is important to note that if the marketplace fails to make the required VAT payment, the homeowner remains accountable for any resulting VAT obligation.

It is uncertain whether marketplaces have caught up to the most recent changes in Bahamian laws on rental property. The authors have been informed by clients with listings on at least one marketplace that the platform would not pay the landlord's rental revenue until after the landlord obtained a business licence and registered for VAT regardless of any threshold requirements. Given this marketplace policy example, landlords should review their marketplace contracts to confirm who is responsible for paying Bahamian VAT. Bahamian landlords who offer their property as vacation rentals through such platforms may be asked to provide documentation that is not otherwise required in The Bahamas.

E. Condo hotel rentals and collective rental arrangements – where a residential accommodation is part of a rental pool, the hotel or person responsible for the administration of the residential accommodation that forms part of the rental pool or other collective rental arrangement must obtain a business licence and register for VAT regardless of the threshold. There is no mention or distinction between Bahamians and foreign persons in these categories.

F. Registration portal for short-term vacation homes – there are no legislative requirements for registration in the portal for short-term vacation homes. However, such registration is recommended by the Department of Inland Revenue.

Conclusion

In conclusion, navigating the regulatory landscape of property rentals in The Bahamas requires a comprehensive understanding of the intricate VAT and business licence requirements, which vary based on factors such as rental duration, ownership status, and rental type.

For foreign investors, compliance entails registering for VAT and obtaining a business licence for both short-term and long-term residential rentals, as well as commercial rentals, with thresholds and exemptions to consider.

Similarly, Bahamian stakeholders must adhere to specific guidelines, with Bahamian individuals and wholly Bahamian owned holding companies subject to different VAT and business licence obligations compared to non-holding companies.

Furthermore, the enforcement of VAT on additional services such as cleaning fees and vehicle rentals underscores the importance of thorough compliance, especially within the evolving landscape of online marketplaces like Airbnb and VRBO, where homeowners may face additional documentation requirements.

In this evolving regulatory landscape, staying abreast of changes and understanding the particulars of Bahamian law is crucial for property owners and investors alike, ensuring compliance and fostering a thriving rental market that continues to attract visitors to the beautiful shores of The Bahamas.

TÜRKİYE



Law and Practice

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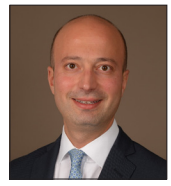
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Hergüner Bilgen Üçer Attorney Partnership is composed of approximately 140 individuals with a variety of educational and professional backgrounds. The 90-member legal team, 17 of whom are Hergüner partners, is involved in cases that require a full grasp of Turkish and cross-border jurisdictions as well as different cultures and languages. The firm's real estate team advises the world's leading international retailers, real estate funds and developers in Türkiye's most famous shopping and residential complexes, urban regeneration projects and tourism facilities. In addition to pure real estate transactions, the team also provides permitting and licensing-related advice, and cross-disciplinary input in infrastructure projects along with the firm's infrastructure and project finance team, as every infrastructure project has a real estate leg including both privately owned and government-owned/controlled land. The real estate team also specialises in sophisticated real estate litigation and arbitration, and represents local and international developers and investors before the courts and arbitral tribunals.

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1. General

1.1 Main Sources of Law

Real estate law in Türkiye is not governed by a separate and dedicated body of law. Instead, Turkish real estate law is integrated into the general operation of civil law, and different aspects of real estate law are governed by chapters in codes of general operation.

At the very top, property rights are secured by the Turkish Constitution and the European Convention on Human Rights (as an international treaty duly subscribed to by Türkiye).

The Civil Code (*Türk Medeni Kanunu*) defines different property types and regulates how property interests are created, transferred and extinguished. The Turkish Code of Obligations (*Türk Borçlar Kanunu*), which regulates contracts in general, also governs real estate-related contracts, including lease agreements, and specifies the procedural requirements for their formation or termination in addition to supplying certain substantive mandatory terms or default principles as necessary.

The Code on Zoning and Construction (*İmar Kanunu*) establishes the rules governing construction, including zoning requirements, and the various licences and permits necessary to construct and occupy buildings.

The Code on Land Registration (*Tapu Kanunu*) governs the registration and record-keeping of real estate.

Under the general framework established by the foregoing fundamental laws, there are more detailed codes and regulations addressing more specific areas of law. The most frequently cited of these in recent years has been the Urban Regeneration Law (*Kentsel Dönüşüm Kanunu*) as well as the Capital Markets Board's respective communiqués on Real Estate Investment Companies (*Gayrimenkul Yatırım Ortaklıklarına İlişkin Esaslar Tebliği*) and Real Estate Investment Funds (*Gayrimenkul Yatırım Fonlarına İlişkin Esaslar Tebliği*).

1.2 Main Market Trends and Deals

Real Estate Sector in Last 12 Months

In 2023, the real estate sector in Türkiye was relatively active due to:

- high inflation and the search for reliable investment options;
- he government's incentives leading to the general elections that dominated the country's agenda;
- worries about a major earthquake in Istanbul after the earthquake that took place in South-eastern Türkiye in early 2023; and
- the Russian-Ukrainian and Palestinian-Israeli conflicts, resulting in a surge of immigration into Türkiye.

Türkiye's Return to an Orthodox Economic Policy

Shortly after the 2023 general elections, the Central Bank of the Republic of Türkiye began increasing interest rates to slow down inflation, heralding a change to a more orthodox economic policy. However, these measures have not yet led to a significant decrease in real estate prices. The latest available statistics indicate that, in December 2023, the Housing Price Index increased by 75.5% in TRY compared to December 2022 even though banks no longer offer low interest rates on loans to customers.

Residential Real Estate Sales

All of the factors explained above led to a decrease in residential real estate sales. According to the statistics published by the Turkish Statistical Institute, the number of residential real estate sales in 2023 decreased by approximately 17.5% compared to 2022, amounting to 1,225,926 sales in total. The number of houses sold to foreign individuals, which had increased in recent years due to the "golden passport" possibility, also decreased by 48.1%, amounting to 35,005 sales in total.

Mortgages play a significant role in the housing market by providing essential financing to consumers. The Association of Real Estate and Real Estate Investment Companies indicated that, as of September 2023, the total volume of mortgages reached approximately TRY445.9 billion, a 26% increase from the previous year. This growth trend reflects the ongoing demand for housing financing. It is worth noting that as of October 2023, home loan interest rates have surged to the highest levels seen in the past two decades.

Impact of High Inflation

As per the Turkish Code of Obligations, if the rental fee is denominated in TRY, the rental fee may be increased according to the consumer price index (12 months' average) but no higher. With the consumer price index skyrocketing, rent variation rates have had a crippling impact on the average consumers' budgets. In an attempt to curb this effect, in June 2022, the Turkish parliament promulgated a law that temporarily capped rental increase rates at 25% for residential leases. Accordingly, leases that have been or will be renewed for a new lease term between 11 June 2022 and 1 July 2023 may not be renewed at a rental fee that exceeds the previous lease term's rent by more than 25%. This regulation was also extended for one more year on 14 July 2023, and the law that temporarily capped rental increase rates at 25% will remain in force until 1 July 2024. Whether it will extend beyond 1 July 2024 is yet uncertain.

Tourism and Short Term Leasing

The Ministry of Culture and Tourism reported that 2023 was a highly successful year for tourism in Türkiye. According to data released by the Ministry, 56.7 million individuals visited the country in 2023. These numbers resulted in the implementation of new legal regulations regarding short-term accommodation options, which are commonly utilised by tourists.

Short-term leases for residential units for tourism purposes became popular due to the ease of adapting rental fees for a given unit with the high inflation rate. However, the loss of tax income resulting from undeclared rental fee income generated by such activities caused the government to regulate this practice. As of 1 January 2024, residential leases for a period not exceeding 100 days became subject to additional procedures and principles. For instance, in order for the owners of independent sections to rent out their immovable properties for tourism purposes, the board of condominium owners must unanimously approve these activities. More details can be found in the firm's client alert on this subject.

1.3 Proposals for Reform

Urban Regeneration

The urban regeneration campaign has been ongoing over the past few years in the western region of Türkiye, which sits on an active earthquake zone, with the goal of replacing weak buildings with earthquake-resistant buildings. These projects tend to be small or medium-scale works with each individual project often concerning no more than a single residential building; however, these projects have covered virtually all of Istanbul with multiple new ongoing constructions on nearly every block in the downtown area.

As a result of the tragic earthquake in Southeastern Türkiye in 2023, the urban regeneration legislation was amended to expedite the regeneration efforts in these areas. For example, the quorum for reconstructing a building under the risk of collapsing was reduced from two thirds to an absolute majority. More details can be found in the firm's client alert on this subject.

Mandatory Mediation for Disputes Relating To the Condominium Law

Back in 2018, applying for mediation became a pre-condition for initiating litigation for the collection of commercial receivables. As of 1 September 2023, applying for mediation has become a pre-condition for filing a lawsuit in disputes between lessees and landlords as well as disputes between neighbours that relate to Condominium Law.

Development of Online Platforms

As of 2019, individuals willing to carry out transactions before land registries can submit all of the required documents to an online land registry platform (*webtapu*) so that officials can examine such documents in advance and request missing documents, if any. Right-holders can also grant proxies through the online platform. Additionally, the General Directorate of Land Registers has announced that in the near future individuals will be able to obtain more comprehensive information regarding the land in question thanks to another platform, MAKS. Through this platform, people will be able to see information regarding the lessee, any geographical risks that the land is exposed to, and other annotations attached by government authorities, among others. However, it is still a requirement to be physically present at the relevant land registry office and to sign the relevant documents in the presence of land registry officials to consummate transactions. The sector would no doubt benefit immensely from individuals having the opportunity to consummate transactions relating to the transfer of title, the establishment and cancellation of pledges, and the attachment and cancellation of annotations through the online platform.

Specific Lease Regime

In addition to the above, it appears that a lease regime specific to offices and shops may be

introduced. The current regime under the Turkish Code of Obligations mostly aims to provide protection to tenants; however, such protection does not always fit office and shop leases, which often results in outcomes beyond its purpose. Based on sector reactions, the application of some "protective" provisions under the Turkish Code of Obligations have been postponed for eight years for merchants and private and public legal entities when the Turkish Code of Obligations came into force on 1 July 2012. As the eight-year period expired on 1 July 2020, these provisions have become applicable to merchants and private and public law entities. These provisions could also become burdensome on both tenants and lessees of workplaces. Lease agreements for shops in shopping centres in particular require a more flexible, freedom-of-contract-based approach. An amendment providing such an approach would be appreciated by the real estate sector, but for the moment, there does not appear to be any such endeavour by the government. Nevertheless, certain associations representing investors of commercial properties still keep this issue on their agenda.

Real Estate Sales to Foreigners

Lastly, it would be beneficial to the Turkish real estate sector if houses sold to foreigners qualified as imports. This has been evaluated by the government on different occasions but has never been realised.

Property Tax Reform Suggestions

To curb the inflation's effect on the average consumer, the Central Bank of the Republic of Türkiye proposed a series of measures to prevent the rise in house prices and rent, including levying an additional tax based on the number of houses and unoccupied houses, but these proposals have yet to be presented before the parliament.

2. Sale and Purchase

2.1 Categories of Property Rights

Simple Freehold Ownership

Under Turkish law, the most basic category of property right is simple freehold ownership (*mülkiyet*). Freehold ownership gives the property owner the right to use, benefit from, and dispose of a piece of property. These rights are conceptually separable from one another; more limited property rights can be created by carving out certain of these rights from simple freehold ownership.

Leasehold Ownership

Turkish law permits granting a third party the right to build on a piece of property (*üst hakkı*), and the holder of such a right becomes the owner of any structures that are built on this land in exercise of this right. If the right to build is intended to be independent and indefinite (*bağımsız ve sürekli*), then the holder of the right can register it in the land registry as a separate property interest, and this right is essentially treated no differently from independent real estate.

Condominium Ownership

Turkish law also recognises condominium ownership, which allows independent units in a completed structure to be owned separately from the main structure, with the common areas of the main structure remaining under joint ownership with the owners of the other independent units in the building.

Usufruct/Servitude Right

Under Turkish law, it is also possible to separate the right to use and to benefit from a piece of property from the right to disposal, and the complete right of use and benefit can be granted to a third party in what is called a usufruct/servitude right (*intifa/irtifak hakkı*). In a strict sense, usu-

fruct under Turkish law is a personal right rather than a property right because this right cannot be alienated or devised and does not include the right to make fundamental changes to the established use of the property. Granting a usufruct right to a third party leaves the property owner with the sole right of disposal.

2.2 Laws Applicable to Transfer of Title

Transfer of title is governed by:

- the Civil Code, in so far as it defines the extent of the interest that is transferred;
- the Code on Land Registration, which regulates the procedures to be followed for the transfer and introduces restrictions against, and specific clearance requirements for, foreign ownership of real estate; and
- the Turkish Code of Obligations, which supplies the rules and background principles governing sales agreements.

There are no specific laws that govern transfers of real estate by type of use. Residential property and commercial property alike are transferred under the same rubric. However, specific procedures have been put in place that determine the alienation of property rights held by the government, such as by way of usufruct.

2.3 Effecting Lawful and Proper Transfer of Title

Real estate transfers become effective at the time they are registered at the Land Registry Office, which provides a definitive record of real estate ownership rooted in the Ottoman land registry system. Land records are kept in duplicate in the central database in Ankara and at the local land registry office. These records are open to the public and are reliably accurate.

Transfers of title must be recorded in order to gain effect. Similarly, all interests in real property, including mortgages, usufruct rights, rights of purchase, and repurchase, must be registered to ensure validity. Given the definitive authority carried by title records, which are open to the public for inspection, title insurance is not at all prevalent with virtually no risk to insure against.

2.4 Real Estate Due Diligence

When purchasing real estate, buyers generally engage lawyers for due diligence purposes. Lawyers inspect the land registry records and the usage restrictions included in the zoning plans for the particular locality through the relevant municipalities. As the land registry records are authoritative, a thorough inspection of these public records generally suffices to provide assurance to purchasers in terms of the property rights of the seller and any encumbrances over the target property. In addition, a review of the municipality files reveals any non-compliances with the zoning plans and the relevant construction and occupancy permits determined by the relevant municipality.

Specifically for real estate used for tourism activities, agreements and deeds establishing the relevant investor's right to enjoy shores and forests are reviewed as well. Additionally, technical consultants are appointed for environmental and technical due diligence matters.

2.5 Typical Representations and Warranties

The types of representations and warranties given in real estate sales differ significantly depending on how the sale is structured. Asset sales typically entail very limited representations and warranties, given that comprehensive and definitive information about the encumbrances on land, including granted easements, established

security and pre-emptive rights, are all revealed in public records. On the other hand, if the deal is structured as a share sale, with the entity holding the asset changing hands rather than the underlying asset itself, extensive representations and warranties are generally demanded.

Customary buyer's remedies include compensation or purchase price adjustment, and a letter of guarantee from the seller or retention of a part of the purchase price typically act as security for the enforcement of these remedies. It is customary for the seller's representations and warranties to expire after two to three years, and in the case of tax obligations, after six years. There is typically a cap on the seller's liability in the amount of 15–30% of the purchase price. However, for some important representations and warranties, eg, relating to the ownership rights of and encumbrances on the target property, this cap can increase to up to 100% of the purchase price. Environmental representations and warranties are occasionally demanded but are seldom granted.

2.6 Important Areas of Law for Investors

Real estate law sits at the crossroads of constitutional law, private law and administrative law. As noted at **1.1 Main Sources of Law**, property rights are guaranteed by the constitution and international treaties. At a more local level, the most important area of law for a purchaser to keep in mind is property law, given that it determines the rights and obligations conferred to owners of real property. The law of obligations is also important in that it defines the rules and principles governing contracts related to real property (sale agreements, lease agreements, etc). Next, the zoning law should be kept in mind as this determines the uses to which real estate can be put. A purchaser should also be mindful of secondary rules governing the issuance of construction and usage permits. Lastly, land registration laws are also fairly important, given that they determine what information about real property can be gleaned from land registry records.

2.7 Soil Pollution or Environmental Contamination

The obligation to comply with environmental regulations is generally imposed on owners of real property rather than the property itself. As such, a buyer of real property is in principle not responsible for any contamination that has taken place prior to their taking ownership. However, contamination may carry with it the presumption that the current occupant has caused contamination, and in such an event, the occupant may need to defeat that presumption by proving that it was an earlier owner who caused the pollution. This is one area where due diligence findings may prove useful.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can ascertain the permitted uses of a parcel of real estate by consulting the zoning plans, plan notes for the concerned plot, and zoning legislation. The zoning plans concerning each locality contain specific instructions on how each parcel may be developed or used; these instructions reveal both the general plan for the use of land in the locality and indicate how each parcel fits into the whole.

It is generally not possible to alter zoning restrictions for particular parcels on a project basis through agreements with local zoning authorities, especially after an amendment introduced to the Zoning Law in 2020 which specifically prohibits zoning plan amendments for particular parcels that increase the population, building density, number of storeys and building height.

2.9 Condemnation, Expropriation or Compulsory Purchase

Turkish law permits the government to take land if there is a public need. The transfer can either take place voluntarily or the government can file suit to condemn a piece of private property and, in due course, assume ownership. Voluntary transfers can be in exchange for cash or for another piece of government-held property.

If the parties cannot come to an agreement on the consideration for a voluntary exchange, the government can file suit to establish the value of the land to be condemned. In a condemnation suit, the court appoints an expert to establish the value of the land to be condemned, and the parties can contest the expert's valuation in open court. The court then establishes the value of the land and, upon payment of this sum, orders the registration of the land in the name of the condemning agency. The condemnation compensation may be split into instalments, and, if this is ordered, registration may begin after the payment of the first instalment.

In practice, developed land is rarely condemned.

2.10 Taxes Applicable to a Transaction

Transfers of real estate through asset deals are subject to title deed registration fees, VAT, and income/corporate income tax. Share sales are subject to VAT and capital gains taxes. However, VAT, income tax and capital gains tax are subject to exemptions that are relatively easy to satisfy.

Title Registration Fees

Title registration fees of 4% of the value of the asset are assessed on sales of real estate by asset sale. These fees are generally split equally between the parties.

VAT

If the seller is a legal entity, VAT is assessed on the transferred property at 20% for office space and commercial property and at 1%, 10% or 20% for residential property, depending on the total square metres and/or the value per square metre.

Capital Gains Tax

Income tax is assessed on the selling asset-holder. For individuals, the applicable rate is between 15% and 40% but capital gains tax is not assessed for individuals who are not professionally engaged in the trade of real estate and who have held the sold property for five years or longer. For corporations, the capital gains tax rate is 25%.

Exemptions

In share sale transactions, VAT, and capital gains, tax exemptions apply as long as the transferred shares have been held by the selling entity for two years or more. Share purchase agreements are exempt from stamp tax with a recent change in the law.

2.11 Legal Restrictions on Foreign Investors

Foreign legal entities may not acquire real property in Türkiye unless they are allowed to do so under special laws, such as the Petroleum Law, Tourism Law or the Industrial Zones Law. To overcome this legal barrier, investors often choose to establish Turkish SPVs. Turkish-incorporated companies with 50% or more foreign share ownership and/or management control are subject to approval by the governorship before they can acquire real property in Türkiye. Turkish-incorporated companies in which foreign ownership is under 50% and where management is not under foreign control can acquire

real property just like domestic concerns where all shareholders are Turkish nationals.

The governorship approval procedure involves an investigation of whether the real property is in a military forbidden zone, military security zone, strategic zone, or a private security zone. If it is, then the acquisition is subject to clearance from the military or the provincial police directorate, depending on which of these exercises jurisdiction over the relevant sensitive area. If not, approval for the acquisition is routinely granted. The process is completed within approximately one month. The establishment of mortgages in favour of foreign capital companies, leases of real property by foreign capital companies, and the acquisition of real property in organised industrial zones, technology development zones, and free zones are not subject to the foregoing approval process.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are generally financed by loans and sales revenue generated from the project. Real estate investment funds, lease certificates, and real estate investment companies are capital market instruments used for financing options for acquisitions of large real estate portfolios or companies holding real estate.

3.2 Typical Security Created by Commercial Investors

There is no security specifically used by commercial real estate investors. Generally, securities such as a mortgage, share pledge, personal guarantee, assignment of receivables, etc, are used for real estate-related funding.

Mortgages

Two types of mortgage are recognised under Turkish law: the principal amount mortgage and the maximum amount mortgage.

Principal amount mortgages

Principal amount mortgages are established to secure amounts that have already been lent to borrowers and contain the unconditional and absolute debt acknowledgement of the borrower. Although the amount of the mortgage only shows the principal amount of the loan lent, the lender may request:

- the principal amount;
- foreclosure expenses and default interest;
- accrued contractual interest; and
- expenses incurred by the mortgagee(s) that were mandatory to preserve the value of the mortgaged property (including disbursement of insurance premiums that were the mortgagor's responsibility).

Maximum amount mortgages

Maximum amount mortgages secure an amount that is higher than the principal amount, incorporating in advance various expenses that may be incurred by the mortgagee, and do not permit the collection of any amounts above the ceiling amount.

Other Structures Available

Sale-and-leaseback structures can also be used for acquisitions of commercial real estate. Finally, Islamic finance-designed instruments such as *sukuk* may also be utilised.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Securities are granted over real estate to foreign financial institutions without any restrictions. Repayments to foreign lenders under a security

document or loan agreement are made without any restriction unless repayment constitutes a criminal act (eg, money laundering).

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Stamp tax (0.948% of the amount subject to mortgage) and a mortgage fee (0.455% of the amount subject to mortgage) are paid for the establishment of a mortgage. Foreign financial institutions are exempt from taxes and fees arising out of securities granted over real estate. The fee for enforcement proceedings is approximately 0.5% of the amount subject to mortgage. In accordance with a recent change in the legislation, there is now an exemption for half of the mortgage fee (0.227%) for mortgages established between traders.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Under Turkish law, target companies are prohibited from providing funds, loans, securities or guarantees to a third party to facilitate the acquisition of its own shares, and such financial assistance transactions will be deemed null and void. This provision does not apply to (i) transactions conducted for the purpose of the activity of financial institutions and (ii) securities, advance payments and loans granted to employees of the target company or its parent company in order to acquire the shares of the company.

When granting upstream security or guarantees for a parent company, it may be difficult for board members to specify a convincing reasonable cause for the subsidiary to enter into such an arrangement to the benefit of its holding company or group companies.

3.6 Formalities When a Borrower Is in Default

Under Turkish law, the creditor beneficiary of a mortgage must initiate an execution proceeding to liquidate the mortgage. Depending on the workload of the execution offices and courts, and whether the borrower challenges the proceedings, these proceedings can take from six months to two to three years. Priority between claimants is listed as an obligatory rule of the applicable law. By law, a creditor beneficiary of a mortgage has priority over other creditors with respect to mortgaged property.

An accelerated foreclosure procedure exists for principal amount mortgages and mortgages granted in favour of banks and financial institutions.

3.7 Subordinating Existing Debt to Newly Created Debt

In principle, the order of priority between creditors is regulated under the applicable law and contractual subordination is not expressly regulated under the law. According to Court of Appeals precedents, execution and bankruptcy rules relate to public policy and cannot be changed contractually. Accordingly, a subordination agreement is not enforceable against an execution office. However, parties may freely undertake to pay the respective amounts to other recipients upon collecting receivables. In summary, a subordination arrangement may create a contractual obligation on the part of the parties but will not have a preventative effect during any enforcement proceedings to be initiated before execution offices.

3.8 Lenders' Liability Under Environmental Laws

Under the applicable law, polluters must bear all expenses for the prevention, removal and clean-

ing of pollution. The applicable law requires that – where environmental pollution is a possibility – the parties must take the necessary measures in order to prevent pollution, and, if pollution occurs, they must take the required actions in order to stop the pollution or decrease the effects of the pollution. The same law explicitly states that polluters have strict liability with respect to environmental pollution. Therefore, lenders holding or enforcing security over real estate should not be liable under environmental laws, as any pollution to the real estate is regarded as being caused by the borrower.

3.9 Effects of a Borrower Becoming Insolvent

In principle, securities established in favour of a lender do not become void by a borrower's insolvency. However, securities guarantee the creditors' position in such cases.

Declaration of Bankruptcy

In the event of a borrower's insolvency, creditors can ask a court to declare the bankruptcy of the borrower. Bankruptcy results in the total liquidation of a bankrupt entity's assets and the satisfaction, pro rata, of its creditors. An important exception to this rule is mortgagees as their receivables are guaranteed by specific security, so the bankruptcy rules require that they be repaid first, in full, before other unsecured creditors.

Composition of Debts

On the other hand, when borrowers become insolvent, they can seek bankruptcy protection in the form of composition of debts. Under this device, debtors reach an agreement with their creditors regarding the extent of the deduction to be made in outstanding debts and the deferment of payments. Mortgagees are given exceptional rights under the composition of debts mechanism as well. Even under the composition regime, mortgagees may initiate proceedings for the sale of mortgaged assets to have their debts repaid but may not realise the eventual sale of the secured asset while the protection is in place.

Another device of bankruptcy protection that used to be available but is no longer permitted was the deferral of bankruptcy, which was imposed by a court upon the application of the debtor. The shift to a composition regime from a deferral of bankruptcy regime is a positive development in that it promotes agreement between debtors and creditors rather than a court imposing a solution in its own judgment.

3.10 Taxes on Loans

No material provided for this jurisdiction.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Zoning plans must comply with the applicable legislation, and, more specifically, with planning principles, urbanisation principles and public interest, such as regional requirements, transportation opportunities, etc. This implies legislative control over zoning plans.

Moreover, smaller-scale zoning plans must comply with larger-scale zoning plans (hierarchy of zoning plans). Ministries enact larger-scale zoning plans (spatial strategic plans, environmental plans) whereas local municipalities enact smaller-scale zoning plans (implementation zoning plans). This implies the central administration's control over the local authority.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Construction permits from the municipality are required for any new construction, refurbishment or major modifications. The construction permit and design documents should be in accordance with the legislation and zoning plans. The legislation defines the detailed technical requirements for design documents. Additionally, various requirements and restrictions (eg, setback distances, ratio of footprint to parcel area, construction coefficient) are also regulated under zoning plans. Oversight is conducted by the authority issuing the construction permit (eg, the municipality).

4.3 Regulatory Authorities

Zoning plans regulate the permitted use and development of individual parcels of real estate. The Ministry of Environment, Urbanism and Climate Change, which also enacts zoning plans in environmental protection sites, enacts environmental zoning plans with a scale of 1/100,000. General functions (business, residential, etc) of regions are regulated under environmental zoning plans.

Municipalities enact zoning plans with a scale of 1/5,000 and 1/1,000 and detailed zoning conditions including function restrictions (residential, industrial, etc), setback distances, construction coefficient and maximum height are specified thereunder. Moreover, there are restrictions connected to the special status of respective lands (forest, cultural heritage, natural heritage, etc).

The Housing Development Administration also exercises planning authority in certain specific government-subsidised housing development zones that are placed under its jurisdiction.

Finally, the Ministry of Tourism and Cultural Heritage also exercises its approval authority in tourism and cultural heritage zones.

4.4 Obtaining Entitlements to Develop a New Project

The procedure for obtaining entitlements to develop a new project or complete a major refurbishment is as follows:

- an initial application is made to the municipality to obtain a zoning status certificate;
- official designs (projects) are prepared by architects and engineers according to the conditions stated in the zoning status certificate;
- these official designs (projects) are submitted to the municipality along with other documents required for a construction permit application; and
- the municipality approves the official designs (projects) and issues the construction permit.

The application procedure generally takes one to three months, depending on the time spent drafting the official designs (projects). Municipalities generally issue construction permits within one to three months.

Third parties do not directly participate in the construction permit procedure. However, affected third parties may submit an official letter to the municipality for revocation of a construction permit within the scope of the general right of petition. This application does not affect the validity of the construction permit.

4.5 Right of Appeal Against an Authority's Decision

Under Turkish law, as a constitutional principle, all administrative decisions are subject to judicial review. Thus, an affected party may file an

administrative lawsuit to declare the administrative act null and void or to claim damages. Property rights-holders may challenge the denial of construction permits, unfavourable revisions to zoning plans and parcellation plans, or any other administrative act. In addition, affected third parties (neighbours, etc) may initiate a lawsuit for cancellation of a construction permit.

4.6 Agreements With Local or Governmental Authorities

It is not necessary to enter into agreements with local or government authorities to develop a project. Zoning plans grant the right to undertake construction under the conditions specified in the zoning plan and no further agreement with the municipality is necessary to exercise that right. Construction requires the obtainment of a construction licence, which is not an agreement per se but rather an administrative approval process.

Agreements may be necessary in an ancillary fashion, such as contractors needing to subscribe to utilities for consumption during the construction phase. Additionally, developers need to apply to the municipalities for the appointment of a licensed construction audit company.

4.7 Enforcement of Restrictions on Development and Designated Use

If the planned construction does not comply with zoning conditions and designated use, the municipality will not issue a construction permit. Moreover, if the planned activities do not comply with designated use, it is not possible to obtain a workplace opening and operation permit.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Special purpose vehicles (SPVs), real estate investment companies (REICs), and real estate investment funds (REIFs) are the types of entities available to investors to hold real estate assets. REICs and REIFs are preferred by real estate investors due to tax exemptions granted to such entities. REICs and REIFs are also preferable because these entities may create large-scale funds generated from the capital contributions of different investors. SPVs may also be advantageous as they are not subject to the restrictions and specific conditions stipulated under the capital markets legislation, such as valuation conducted under said legislation, etc. For this reason, SPVs are commonly used in practice.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

SPVs may be incorporated as a limited liability company or a joint stock company in the form of a publicly or privately held company. REICs may be incorporated as a joint stock company in the form of a publicly held company. REIFs do not have any legal personality and may only be held by qualified investors.

5.3 REITs

Real estate investment trusts (or trusts in general) are not regulated under Turkish law, and therefore, not available as an option to investors. The closest investment instrument to these is REIFs.

5.4 Minimum Capital Requirement

The minimum capital requirements are as follows.

- The minimum capital amount for a REIC is TRY500 million and TRY750 million for REICs incorporated for infrastructure purposes.
- The minimum asset pool for a REIF should be TRY100 million within one year of initiating the sale of participation shares to qualified investors.
- Joint stock companies should be incorporated with a minimum capital amount of TRY250,000, one quarter of which should be paid at the time of incorporation and the rest paid within 24 months of incorporation of the company.
- Limited liability companies should be incorporated with a minimum capital amount of TRY50,000. There is no minimum payment requirement at the time of incorporation and the total capital amount should be paid within 24 months of the company's incorporation.

5.5 Applicable Governance Requirements

Corporate law provisions are applied to SPVs as they are subject to the Turkish Commercial Code, including the capital maintenance rule, corporate benefit, etc. REICs are also subject to the corporate law requirements stated under the Turkish Commercial Code. REICs and REIFs are also subject to capital markets regulations as they make use of funds provided by investors.

5.6 Annual Entity Maintenance and Accounting Compliance

The amount depends on the type and size of the investment.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Lease

A lease is the basic type of arrangement that allows a person, company or other organisation to occupy and use real estate for a limited period of time without buying it outright.

Right of Construction

A right of construction may also be established as a type of right in rem in order to protect the owner's right against third parties. In practice, a right of construction is preferable to other types of real estate use because it gives property rights to the holder of the right of construction for a period. A mortgage may also be established over a right of construction as it is independently registered in the title deed registry with separate ownership rights.

Usufruct

Another type of right in rem is the usufruct right, which entitles the rights-holder to use and benefit from real property fully. The usufruct right is a right granted to a specific person and may not be transferred. It is a right that is limited in time; usufruct rights granted to legal persons are limited to 100 years, and usufruct rights granted to natural persons are limited to the grantee's lifetime.

6.2 Types of Commercial Leases

There are no different types of commercial leases. All lease agreements are governed by the same regulation. However, leases may be classified as a ground lease or a building lease according to the rental conditions. Currently, there are also ongoing discussions to amend the legislation regulating home leases and com-

mercial leases, though there are no drafts available yet.

6.3 Regulation of Rents or Lease Terms

Rentals are freely negotiable under lease agreements. However, certain lease terms, such as eviction, rent increase, etc, are specifically regulated under the Turkish Code of Obligations as mandatory terms.

Turkish Code of Obligations

The application of some of these mandatory terms was postponed for eight years when the Turkish Code of Obligations came into force on 1 July 2012 for merchants and private and public legal entities. As the eight-year period expired on 1 July 2020, these provisions became applicable to merchants and private and public legal entities as well. Such provisions are mostly considered to protect tenants against landlords, which provides certain limitations with regards to the lease agreement. For instance, the most prominent ones stipulate that obligations regarding additional payments other than rent and ancillary costs cannot be imposed on tenants and penalty clauses for failure to pay and acceleration clauses will be deemed invalid.

A piece of legislation enacted in 2018 prohibits denominating rental fees in foreign currency under certain conditions. This legislation applies to lease agreements where the lessor is a foreign capital company, but it is still possible to denominate rents in foreign currency in lease agreements where the tenant is a foreign real person, foreign company, or a company owned by foreign investors.

6.4 Typical Terms of a Lease

There is no minimum or maximum limit for lease terms. In practice, the terms of leases for residential property are generally agreed to as one year compared to five years or more for commercial assets. The owner of the real estate should carry out the structural maintenance while the lessee is responsible for daily maintenance. Parties may contractually agree otherwise.

The parties generally agree to the frequency of rental payments as a monthly payment, but the parties may also determine the term of rent as quarterly or annually. In commercial leases, rent may be expressed as a fixed amount or as a fixed percentage of revenues derived from the use of the property. Market practice tends to combine the two, with payable rent being set at whichever of the two is higher.

It is also customary to introduce force majeure clauses in lease agreements. Before the COVID-19 pandemic, most force majeure provisions addressed the risk of leased property being damaged by an act of God, in which case the lessor is relieved from its duties to keep the property in operable condition. Now that the market has suffered the effects of the pandemic, lease agreements entered into recently include pandemics as a force majeure event to the extent that they preclude the tenant from using the leased property.

6.5 Rent Variation

As per the Turkish Code of Obligations, if the rent is agreed to in TRY, the rent may be increased according to the consumer price index (12 months' average), but not higher. Rent may not be increased within the first five-year period if the rent is agreed to in foreign currency. Please see **1.2 Main Market Trends and Deals** for the rent variation cap applicable for residential leases until 1 July 2024.

6.6 Determination of New Rent

If the parties fail to mutually agree on a new rental amount, either of the parties can apply to the court to render a new rental amount according to the market price at the end of each five-year lease term.

6.7 Payment of VAT

If the lease property is part of a commercial enterprise or is owned by a limited liability company/corporation, VAT is applicable at 20% of the rent. Withholding tax is applicable to commercial entities for leases of natural person-owned real estate.

6.8 Costs Payable by a Tenant at the Start of a Lease

A commission to the real estate agency and a deposit to the real estate owner are generally paid by the tenant at the start of a lease as per current market practice.

6.9 Payment of Maintenance and Repair

The areas used by several tenants, such as car parks, gardens or swimming pools, are classified as common areas, and expenses arising out of the use of these areas are divided among tenants according to certain criteria (eg, land share, square metre-size of property).

6.10 Payment of Utilities and Telecommunications

If the building housing the premises has been converted to condominium use, then each tenant is able to obtain an individual utilities account for their own use. Expenses incurred for common areas are generally allocated among tenants on the basis of the square metres of the property. Managers of such properties usually reserve for themselves, by contract, the authority to take into account other factors such as the tenant's location within the premises, the extent to which the presence of the tenant generates business for the facility as a whole, the tenant's business volume, etc.

The allocation of common expenses among tenants in shopping centres is governed by the Regulation on Shopping Centres (*Alışveriş Merkezleri Hakkında Yönetmelik*). The regulation specifies mandatory rules to be used when allocating common expense contribution amounts to tenants in shopping centres. The common expenses are, in principle, allocated according to the square metres of the respective stores, restaurants, etc.

6.11 Insurance Issues

Generally speaking, landlords insure the property against structural risks, and tenants insure the property against operational risks. Landlords also insure the common areas of shared-use properties and can increase the cost of this insurance depending on the parties' bargaining positions. The law imposes the cost of mandatory insurance on landlords by default but permits reassignment of these costs.

Landlords typically insure properties against fire, hurricanes, explosion, water damage, flooding, landslides, snow damage, aircraft impact, and earthquakes. Terrorism insurance is also sometimes taken out. A lessee typically takes out a renter's all-risk insurance as well as third-party liability insurance.

6.12 Restrictions on the Use of Real Estate

The use of land is regulated under the zoning plan for the locality. These restrictions operate in the background and supersede any conflicting provisions of any lease agreement that is signed between a landlord and a tenant. Furthermore, under the Code on Condominiums, the opera-

tion of businesses is prohibited in residential buildings. Restrictions on a tenant's use of real property are typically found in lease agreements, and these are binding on lessees under contract law.

6.13 Tenant's Ability to Alter and Improve Real Estate

Tenants may alter leased premises if this is permitted under their lease agreement. Structural improvements may require a licence from the local municipality, and these licences are only issued to landowners. As such, a tenant would have to obtain the landlord's consent to structural improvements. Landlords typically give their consent to such improvements by issuing a power of attorney to their lessees for improvement purposes, under which lessees obtain the requisite licence and commence construction of improvements.

If the landlord has consented to alterations to be made by a lessee, they may not demand the return of the property to its previous condition. Similarly, a lessee may not demand compensation for any increase in the value of the property that may be caused by the lessee's alterations. Both of these default positions may be changed by agreement.

6.14 Specific Regulations

There are very few regulations that govern the lease of property by type of use. One such specific set of rules, the Regulation on Shopping Centres, has had little restrictive impact in practice.

6.15 Effect of the Tenant's Insolvency

A lessee's bankruptcy during the term of a lease gives the landlord the right to demand assurances for the payment of future rental amounts. If the lessee or the bankruptcy administrator is not able to provide such assurances, the landlord is then entitled to terminate the lease.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Landlords typically demand that tenants guarantee their obligations by posting a cash deposit or a bank letter of guarantee. The Turkish Code of Obligations has introduced a quantitative limitation in this respect, limiting the amount of such guarantees to be posted to a maximum of three months' rent – this entered into force as of 1 July 2020. In any event, landlords tend to demand an annual or quarterly payment of rent to obtain further security.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant has the right to occupy a leased premises for another 11 years once the leased period has ended. The landlord may terminate the lease by giving notice no less than three months before the end of the eleventh year after the expiration of the lease or each year thereafter. This is a mandatory provision of the law; therefore, landlords do not have a free hand in circumventing this entitlement given to lessees.

6.18 Right to Assign a Leasehold Interest

Assignment is subject to the lessor's prior written consent, which cannot be withheld unreasonably in respect of workplace leases. Subleases are also subject to the original lessor's prior written consent.

6.19 Right to Terminate a Lease

Landlord's Right to Terminate

The landlord may terminate a lease if the lessor has served written notice on the lessee twice in one lease term for failure to pay rent. The

landlord may terminate a lease if the lessee has undertaken to vacate the leased premises on a certain date but has failed to keep their promise.

The landlord may also terminate a lease on the basis of need; if the landlord or the landlord's family must use the leased premises themselves, then the landlord may terminate the lease. Similarly, the landlord may terminate the lease if material repairs need to be made to the premises and the lessee's continued occupation of the premises under such circumstances is not possible.

Lastly, the landlord may terminate a lease if the lessee fails to use the premises in accordance with the terms of the lease agreement. If the lessee's breach is non-material, the landlord must give at least a 30-day cure period. If the breach is material and the breach is unlikely to be remedied in the cure period, the agreement may be terminated with immediate effect.

Tenant's Right to Terminate

The lessee may terminate the agreement in the event that the premises are materially unfit for use. Furthermore, tenants may terminate a lease early by way of paying the lease amount until the leased property has been rented to another lessee under similar conditions.

Both Parties' Right to Terminate

Both parties may terminate the lease if generally applicable contract termination grounds arise.

6.20 Registration Requirements

Lease agreements are not subject to any form requirement, but written lease agreements are market practice. Turkish law enables the annotation of lease agreements in the land registry records of the leased property. Annotation gives full protection against eviction if the relevant property is transferred to a third party. Deed registry fees amounting to 0.683% of the total lease amount would accrue together with a fixed contribution amount (approximately TRY2,055).

6.21 Forced Eviction

A tenant may be evicted prior to the originally agreed date if the grounds for termination discussed in **6.19 Right to Terminate a Lease** arise. In such an event, eviction proceedings typically take one to one-and-a-half years.

In the event of eviction for failure to pay rent, a landlord may also seek to have the tenant evicted by way of execution proceedings. The execution office would serve a payment order on the tenant in such a case, and, upon failure to pay within 30 days, begin the process to evict. This procedure is notably faster than eviction by court order.

Both eviction processes may be subject to appeal and the eviction order can be suspended while the appeal is pending.

6.22 Termination by a Third Party

A government agency may be able to terminate a lease only in exceptional circumstances. One such instance may be when the leased real estate is subject to condemnation. In the event of condemnation, the lessee does not receive compensation from the government. Another such instance is if the leased property is going to be subject to demolition under the scope of the Urban Regeneration Law. In such an event, the lessee would be given a total of 90 days to vacate the premises and would be evicted by the government upon failure to voluntarily surrender the property.

6.23 Remedies/Damages for Breach

If a tenant breaches the lease agreement, the landlord will be able to claim damages. For certain breaches (like using the property against the purpose of the lease and failure to timely pay the rent), the landlord may terminate the lease agreement and evict the tenant. For eviction, the tenant has no remedy other than initiating a lawsuit or enforcement proceedings.

In workplace and residential leases, security deposits cannot exceed three months' rent. If the parties agreed on cash or negotiable instruments as a security, the tenant must deposit the money in a time deposit account and deposit the negotiable instruments in a bank – not to be withdrawn without the consent of the landlord. The bank may return the security only (i) with the consent of both parties, (ii) upon finalisation of the enforcement proceedings, or (iii) on the basis of a finalised court decision.

If the landlord has not informed the bank in writing that they filed a lawsuit against the tenant in relation to the lease agreement or that they have initiated debt enforcement proceedings within three months of terminating the lease agreement, the bank is obliged to return the security upon the request of the tenant. In practice, parties breach the law and usually decide to pay cash or deliver a bank letter of guarantee to the landlord instead of following the above procedure.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Structures used in the global market (turnkey and cost-plus-profit) are also used in the Turkish market. Turnkey structures are commonly used in public tenders. For private deals, turnkey or cost-plus-profit structures may be used depending on the commercial agreement of the parties.

Moreover, a unique method that is commonly used that was created for construction to be made over private party land is known as "construction in return for flat". Under this structure, the contractor constructs the building without receiving any cash payment. The owner makes the payment to the contractor in the form of a flat or flats; accordingly, the owner and contractor share the flats in the constructed building in line with a ratio determined under the agreement (eg, 55% for the owner and 45% for the contractor). The owner does not make any other payment for the construction.

Revenue sharing, which is a structure that resembles ordinary partnership, has been gaining traction in the market recently. Revenue sharing involves the contractor taking on the construction and sale activities, and the landowner and the contractor sharing the collected revenues in previously agreed ratios.

7.2 Assigning Responsibility for the Design and Construction of a Project

Contractors assume the responsibility and construction of a project through construction agreements. However, as per the Turkish Code of Obligations, owners are responsible vis-à-vis third parties. In the event that owners are required to pay compensation to third parties, they are entitled to have recourse to their contractor. At the contractor level, design and construction work is outsourced through subcontractors that are hired by contractors.

7.3 Management of Construction Risk

Contractors generally assume the construction risk of a project; thus, limitation of the contrac-

tors' liability is not very common. Moreover, clauses containing waivers, indemnifications and limitations of liability in favour of contractors are not generally accepted by courts.

7.4 Management of Schedule-Related Risk

Provisions on schedule-related risks are subject to freedom of contract; therefore, parties may agree on certain milestones and penalties. This is commonly used in practice. As per the law, an owner is entitled to compensation if the contractor does not comply with the milestones and deadlines specified under the agreement.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Provisions on schedule-related risks are subject to freedom of contract; therefore, parties may agree on certain milestones and penalties. This is commonly used in practice. As per the law, an owner is entitled to compensation if the contractor does not comply with the milestones and deadlines specified under the agreement.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors are entitled to request the registration of a mortgage over the land to guarantee their receivables. Owners may request removal of the mortgage upon fulfilling their obligations under the construction agreement.

7.7 Requirements Before Use or Inhabitation

An occupancy permit certifying that the construction has been completed in accordance with the official designs (projects) should be obtained before a project is inhabited or used for its intended purpose.

8. Tax

8.1 VAT and Sales Tax

Sale of lands within the scope of a commercial enterprise and land owned by limited liability companies and corporations are subject to VAT. The generally applicable VAT rate for land sales is 10%.

However, the VAT rate applicable for flats generated from urban regeneration that are up to a net area of 150 square metres is 1% and from 150 square metres and higher is 20%.

The VAT rate applied to sales of flats can be 10% or 20%, depending on the tax value of the flat concerned. VAT is paid by the purchaser.

The sale of lands held by limited liability companies and corporations for more than two years is exempt from VAT. However, this exemption does not apply to limited liability companies and corporations that conduct real estate business.

8.2 Mitigation of Tax Liability

Methods such as division, mergers, share transfers, etc, are used to benefit from mutual tax agreements and exemptions. Moreover, REIFs and REICs are exempt from corporate income tax. These structures can also be used to mitigate tax liability.

8.3 Municipal Taxes

There is no periodic tax applicable for the occupation of business premises. However, a fee determined by municipalities is paid to obtain and renew operation permits. There is no specific exemption for operation permit fees.

Moreover, real property tax is paid to municipalities. The municipalities determine this tax according to the value of the respective lands.

There are no significant exemptions for businesses with respect to real property tax.

8.4 Income Tax Withholding for Foreign Investors

Income generated by foreign investors who are not resident in Türkiye is subject to withholding tax (eg, 20% for rental income). Rental income is subject to income tax for real persons and corporate tax for companies. The income tax applicable for real persons varies between 15% and 40% depending on the rental amount and TRY33,000 (applicable for year 2024) of the rental income from residences is exempt from income tax. Corporate tax is paid on the rental income generated by limited liability companies and corporations. General corporate income tax is currently 25%.

There is no general tax exemption for income tax and corporate tax accrued on rental income. However, if rental income is generated by a REIF or REIC, the relevant income is exempt from corporate tax.

8.5 Tax Benefits

Depreciation deductions may be made over buildings, facilities, etc, as per the method and rates determined under the legislation (eg, 2% of the building's annual value). Moreover, expenses incurred for the respective real estate may also be deducted from the income subject to tax. Additionally, real persons can deduct a flat 15% of the income generated from the lease of real property.

TURKS & CAICOS



Law and Practice

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Griffiths and Partners offers more than 20 years' experience dealing with real estate in the Turks and Caicos Islands, and overseas. The real estate team assists with the sale and purchase of residential and commercial property on the Islands, from individual parcels of land to multimillion-dollar villas, as well as advising on large-scale commercial developments, mortgages and financing, leasing and share transfers, and joint venture agreements. The firm regularly advises on development agreements with the government and acts for local, institutional and overseas lenders in relation to secured lending in the Islands. There are no restrictions on foreign ownership of property on the Islands and the firm is able to lead its overseas clients through all the stages of identifying, financing and acquiring property. The firm provides guidance and close support throughout the development process, from site acquisition and planning, through the construction stage to completion, and thereafter the management and onward disposal or letting of the property.

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1. General

1.1 Main Sources of Law

The main sources of real estate law in the Turks and Caicos Islands (the "Islands") are local legislation, local case law and case law from Commonwealth jurisdictions.

1.2 Main Market Trends and Deals

In recent years, the real estate market in the Islands has seen huge growth in the development of managed villa properties, such as Beach Enclave, Wymara Villas, Blue Cay Estate, H20 Lifestyle Resort, the Residences by Grace Bay Resorts and others, along with individual ultra high-end luxury bespoke villas. The Ritz-Carlton Hotel (which includes two resident towers) also opened in 2021.

There are a number of large-scale mixed condo/villa developments which have already completed phases and have opened to residents, such as Grace Bay Resort's, Rock House and South Bank residential resort and marina, and others in the pipeline or under construction, including The Strand, the Bight Hotel, Vista/Hyatt ANDAZ, the Loren and the St. Regis. The real estate market continues to grow rapidly, producing strong sales and increasing land prices.

We are now also starting to see increased activity over on North and Middle Caicos, with plans to revolutionise Sandy Point into a resort and marina, together with some other hotel and villa community projects, which will further boost the real estate market in the Islands.

Luxury condos along the famous Grace Bay Beach, and in Leeward as well as on private islands such as Parrot Cay and Ambergris Cay, continue to be in high demand at increasing prices.

The Islands have recovered quickly following the COVID-19 pandemic, with tourist numbers significantly higher than pre-pandemic levels, and expected to keep rising. We are also continuing to see a number of purchasers who are seeking a safe-haven second home should we experience a comparable pandemic in the future.

The real estate market continues to see considerable activity and property prices are continuing to rise year on year. In 2023, USD768 million of sales were made in the Islands, which has set a new record. 2024 has also got off to a very strong start.

1.3 Proposals for Reform
There are currently no proposals for reform.

2. Sale and Purchase

2.1 Categories of Property Rights
Real estate can be held as freehold title absolute or leasehold.

The Strata Titles Ordinance allows for the registration of a strata plan against a land parcel to create individual strata lots, each of which is registered with its own derivative title, with the remainder held as common property by a strata corporation. Strata titles are used as the preferred structure for condominium developments.

2.2 Laws Applicable to Transfer of Title
All transfers of title of real estate are primarily governed by the Registered Land Ordinance.

2.3 Effecting Lawful and Proper Transfer of Title
Transfers of real estate must be registered at the Turks and Caicos Islands Land Registry. Title is acquired, and only perfected, upon registration.

The land register is conclusive as to ownership, appurtenant rights and matters encumbering the title (with the exception of certain overriding interests) and it is state guaranteed (although it can be rectified to deal with matters such as error and fraud). Title insurance is not necessary, nor is it available in the domestic market.

Due to the COVID-19 pandemic, there were some limitations in the functionality of government offices and in-person availability for real estate transactions. This resulted in new procedures for the completion of transactions, such as payments being moved to online payments and some transactions being completed virtually. However, due to these limitations, the turnaround time for completion of registration increased slightly.

2.4 Real Estate Due Diligence
The purchaser's attorney will typically:

- review the title documents and advise on any adverse matters that would affect the intended use and enjoyment of the property;
- review any leases, if the property is subject to leases;
- raise any relevant enquiries with the seller (ie, about the state and condition of the property, any disputes, compliance with laws, overriding interests, and services);
- consider whether any additional enquiries should be raised with public or other bodies (depending on the nature of the transaction); and
- consider recommending a physical inspection or survey of the property by the purchaser and a professional.

During the COVID-19 pandemic, with international borders being closed, clients were purchasing property on the basis of remote viewings. Now that travel has opened up again, most clients are able to visit Turks and Caicos to view properties in person and instruct any inspections and surveys as necessary.

2.5 Typical Representations and Warranties
Typically, a property sale and purchase agreement will contain a basic set of warranties as to good title and the absence of knowledge of any claims or disputes, but generally the position is that purchasers must satisfy themselves as to the state and condition of the property, its suitability for the intended purpose and that the

necessary consents for development or existing structures are available and/or in hand. This position has not changed since the COVID-19 pandemic.

Common purchaser remedies for misrepresentation or breach of warranty would include an action for damages, misrepresentation and/or rescission of the agreement, and a refund of any deposit paid. We do not typically see time limits or liability caps in respect of representations and warranties given by a seller in a contract. Representation and warranty insurance is not available in the domestic market.

2.6 Important Areas of Law for Investors

Any investor should consider the primary sources of law, including the Registered Land Ordinance, the Planning Ordinance and the Stamp Duty Ordinance. Other laws may apply, depending on the nature of the transaction and how it is structured.

While actual title to land must be held by an individual or a Turks and Caicos limited liability company, there are generally no restrictions on foreign ownership of real estate in the Islands.

2.7 Soil Pollution or Environmental Contamination

Given the nature of the Islands, soil pollution and environmental contamination are not currently commonly encountered issues. Although uncommon, environmental liabilities can be dealt with contractually between the parties by way of warranty and representation.

The Planning Ordinance gives powers to the Planning Department to serve stop/enforcement notices where it considers that the amenity of an area is adversely affected by reason of, inter alia, the condition of any structure or the condition of the land. Notice can be served on the owner or occupier of the land or building, or the person responsible for causing the condition of the land or building.

There is currently no material environmental legislation and therefore sale contracts are typically silent in this regard.

The National Parks Ordinance establishes whether land forms part of a national park or is a site of historical interest. If so, the ordinance sets out certain limitations on the development of such land.

On application for planning permission, the director of planning may require an environmental impact report/survey to be carried out.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

There is a zoning plan for the Islands that is maintained and can be referred to in order to ascertain the applicable zoning. Any development of land requires a grant of planning permission. Development includes not only the undertaking of physical development but also change in the use of any building or other land, or the subdivision of land.

Development Agreements

It is common for larger developments to seek and enter into development agreements with the Crown and government to assist with a development project. The level of concessions and assistance afforded in such agreements will be determined by reference to general development guidelines, and an assessment of the benefits of a development to the Islands. The first port of call for parties wishing to secure development concessions or assistance would be the Islands' investment agency, Invest TCI.

2.9 Condemnation, Expropriation or Compulsory Purchase

The government may compulsorily acquire any land, but this is not common. Compensation is payable typically at the property's market value.

2.10 Taxes Applicable to a Transaction

Stamp duty is payable on:

- the transfer of land, which as a matter of contract is usually paid by the buyer, although the law makes both the seller and buyer liable;
- the grant of a new lease, which as a matter of contract is usually paid by the tenant;
- a debenture or a charge (mortgage) over land, which is usually paid by the borrower; and
- the transfer of shares in a landholding company (share transfer duty, rather than stamp duty), in which duty as a matter of contract is usually paid by the buyer, although the law imposes the liability on the company whose shares are being transferred.

Stamp duty on land is paid on the consideration stated in the instrument, or the market value of the property conveyed or transferred, whichever is higher.

The current rates of stamp duty on a purchase of land or property in the Islands' commercial and tourism hub, Providenciales (the rates vary for land or property on other islands in the Turks and Caicos Islands), are:

- USD25,000 to USD250,000 – 6.5%;
- USD250,001 to USD500,000 – 8%; and
- USD500,001 and above – 10%.

Stamp duty payable on a land charge is 1% of the secured sum up to a maximum of USD50,000.

The current rate of stamp duty payable on leases is as follows.

- If the term is not defined or is uncertain, or where the term is for seven years or less:
  - (a) USD50 where the annual rent exceeds USD2,000 but does not exceed USD5,000; and
  - (b) 1% where the annual rent exceeds USD5,000.
- If the term exceeds seven years but does not exceed 35 years:
  - (a) USD2 if the annual rent does not exceed USD100;
  - (b) USD10 for annual rent over USD100 but less than USD500;
  - (c) USD40 where the annual rent exceeds USD500 but does not exceed USD2,000;
  - (d) USD100 where the annual rent exceeds USD2,000 but does not exceed USD5,000; and
  - (e) 2% where the annual rent exceeds USD5,000.
- If the term exceeds 35 years:
  - (a) USD8 if the annual rent does not exceed USD100;
  - (b) USD40 for annual rent over USD100 but less than USD500;
  - (c) USD160 where the annual rent exceeds USD500 but does not exceed USD2,000;
  - (d) USD400 where the annual rent exceeds USD2,000 but does not exceed USD5,000; and
  - (e) 8% where the annual rent exceeds USD5,000.

Transfer duty on the transfer of shares in a landholding company is calculated as A/B x C x 8%, where A = the total number of shares being transferred, B = the total number of issued shares in the landholding company concerned

and C = the fair market value of the land owned by the company in the Islands.

Limited exemptions include:

- a transfer by way of gift to, or in trust for, the spouse, parent or child of the person conveying the land;
- where the permanent secretary of finance certifies that the lease or transfer is not made for valuable consideration to a sibling or grandparent or grandchild;
- transfers to a group company; and
- transfers between trustees where no change in beneficial ownership occurs.

2.11 Legal Restrictions on Foreign Investors

There are generally no restrictions on foreign ownership of real estate in the Islands, although certain formalities may apply to different types of purchasers.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The most typical forms of security for the financing of real estate are:

- legal charge;
- debenture (corporates only);
- legal or equitable mortgage/charge over shares in a company that holds the real property;
- assignment of any rental income;
- assignment of any sale contracts and/or any development contracts (usually for developments);
- assignment of insurance proceeds; and
- guarantees from directors, shareholders, related companies or individuals.

All legal charges over real property must be registered at the Land Registry and all security interests granted should be recorded in the company's register of mortgages and charges, and recorded with the Deeds Registry.

Assignments by way of security are usually created by deed and notice must be given to the counterparty to perfect the security.

Due to the relatively small size of the Turks and Caicos Islands' real estate market, it is generally not common to see large portfolios of real estate held by funds or investment trusts.

3.2 Typical Security Created by Commercial Investors

For the most typical forms of security for the financing of real estate, see **3.1 Financing Acquisitions of Commercial Real Estate**.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions on granting security over real estate to foreign lenders.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Stamp duty is payable at 1% of the secured amount (with a current cap on stamp duty on security instruments of USD50,000) on debentures and legal or equitable mortgages, or charges for immovable or movable property.

Where the amount of money to be advanced on the security of any property by way of mortgage is unlimited, the security is to be available for such an amount as the ad valorem duty paid thereon extends to cover. If any advance is made

in excess of the amount covered by that duty, the original instrument may be stamped up with the additional ad valorem duty required to cover the total amount then to be secured.

A mechanism exists to avoid double duty on separate security instruments that secure the same debt. In such cases, the ad valorem duty may be paid on the primary security instrument and the other security instruments can be described as "collateral", "auxiliary", "additional" or "substituted", and attract a fixed rate of duty of USD10.

Most other instruments and documents are subject to a fixed rate of stamp duty in comparatively nominal amounts. Registrable instruments (such as legal charges over real estate) are also subject to relatively immaterial registration fees.

It is customary for stamp duty and registration fees to be paid by the borrower.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no legal rules or requirements that must be complied with before an entity can give valid security. They must, however, be empowered to do so or not restricted from doing so by their constitutional documents. Often only board approval is necessary although the entity's constitutional documents should be checked for any further requirements or approvals. It would be prudent to obtain shareholder approval in any case where an entity is guaranteeing or pledging assets as security for another party's liabilities.

3.6 Formalities When a Borrower Is in Default

In terms of charges registered against Turks and Caicos real estate, the security is enforceable pursuant to its terms in conjunction with the provisions of the Registered Land Ordinance.

The Registered Land Ordinance provides a statutory power of sale by public auction, power to lease and power to appoint receivers. Commonly, a legal charge will vary and extend the statutory provisions to give the lender wider powers. To the extent that the powers contained in the legal charge vary or are in addition to those created by the Registered Land Ordinance, they may not be acted on without the order of the court, and a court order is required to exercise a power of sale by private treaty. If a court order is required, this can typically take up to three months to obtain.

Where a lender has entered into a facility with a company, as opposed to an individual borrower, a separate fixed and floating charge, known as a debenture, is taken over all assets of the borrower company and contains wide-ranging powers including the appointment of a receiver. This provides a lender with a quicker route to gaining control in the event of default. We typically also see a share pledge agreement entered into between the parties so that if the borrower defaults, the lender can enforce the provisions of the share pledge agreement and have the shares in the borrower company transferred to it. The lender then becomes the legal holder of the shares in the company that owns the property and circumvents the need to obtain a court-ordered power of sale if they wish to sell the property by private treaty. This route is seldom used as a transfer duty of 8% of the market value of the underlying real estate assets would be payable on the transfer of the shares.

Priority of legal land charges is determined by registration at the Land Registry.

The lender's ability to foreclose or realise on collateral on real estate lending is not recognised under local law. A foreclosure can be achieved

in effect where the debt equals or exceeds the market value of the underlying assets, but as with a share transfer, the transfer of real estate attracts a duty (of 10%) and is rarely used as it is not an efficient route to enforcement.

3.7 Subordinating Existing Debt to Newly Created Debt

Generally, a debt secured by a legal charge properly stamped and registered at the Land Registry will, in respect of the proceeds of realising such asset, rank in priority to any subsequently registered legal charge, any floating charge or any unsecured debt. It is possible for lenders to subordinate debt contractually, although this is not common.

3.8 Lenders' Liability Under Environmental Laws

There are no statutory provisions in relation to environmental liability in the Islands. However, once the lender has taken possession of the premises, a civil action for environmental harm can be brought. A lender can also seek an environmental indemnity from the borrower. Because of the Islands' lack of heavy industry, however, environmental issues have not, thus far, been a major legal concern in real estate transactions.

3.9 Effects of a Borrower Becoming Insolvent

Security interests created by a borrower in favour of a lender will not be rendered void if the borrower becomes insolvent. Security may, however, be set aside; eg, where it constitutes a preference or a transaction at an undervalue.

3.10 Taxes on Loans

Interest rates on most domestic lending transactions are calculated by reference to a domestic bank's prime lending rate. To the extent that facilities reference the London Interbank Offered Rate, lenders and borrowers would be advised to review their terms to ensure that an alternative method for calculating interest has been included.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The main legislation is the Physical Planning Ordinance and there is a development plan in effect for the Islands that is reviewed and updated periodically. Land in the Islands is also subject to zoning restrictions.

Definition of "Developments"

Any development of land requires a grant of planning permission. "Development" encompasses the carrying out of building, engineering, or other operations in, on, over or under any land, the making of any material change in the use of any building or other land, or the subdivision of land, but is subject to a number of exclusions, including any works for maintenance, improvement or other alteration that only affect the interior of a building or do not materially affect the external appearance of the building.

Planning Permission

Planning permission may be refused, granted unconditionally or can be subject to such conditions as the relevant authority deems fit.

The Planning Department is responsible for reviewing and considering applications to obtain planning permission. The director of planning is empowered to take enforcement action where necessary.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Planning permission is required for any proposed development or material change in use of any building or land. However, planning permission will not be necessary if certain exclusions apply; eg, if the works are carried out for maintenance, improvement or other alteration, and affect only the interior of the building or do not materially affect the external appearance of the building.

A permit is also required under the Building Code Regulations before the construction or change to a building or structure or any work that requires planning permission is carried out. All such works must be carried out in the manner authorised by the permit.

On completion of any development, a certificate of occupancy is issued which confirms that the works have been carried out in accordance with the planning permission and Building Code Regulations and that the property can be legally occupied.

4.3 Regulatory Authorities

Responsibility for the regulation of development and designated use of individual parcels of real estate lies with the Planning Department.

4.4 Obtaining Entitlements to Develop a New Project

An application for planning permission may need to be advertised in the newspaper and the Turks and Caicos Islands Government Gazette, and notices may need to be posted on the land as well as sent to adjoining owners within 200 feet. Generally, this notification regime does not apply to routine applications to build a house, but rather to larger-scale commercial and residential developments, changes of density, changes of use and so on.

Third parties have the right to object and objections will be taken into account by the planning director when considering applications.

4.5 Right of Appeal Against an Authority's Decision

An applicant can appeal a planning board decision. Such appeals are heard by the Planning Appeal Tribunal.

4.6 Agreements With Local or Governmental Authorities

Planning permission may be granted subject to such conditions as the relevant authority sees fit. A prudent developer would engage with utility suppliers at the outset of a project to incorporate their input into their plans. Planning permission runs with the land, although any agreements will be personal to the parties.

4.7 Enforcement of Restrictions on Development and Designated Use

Where any development of land (other than material changes in use) has been carried out without the applicable planning permission or not in compliance with any conditions attached to a grant of planning permission, the director of planning may, within six years of the alleged breach, serve an enforcement notice on the owner or occupier of the land.

Non-compliance with an enforcement notice is an offence and attracts a fine.

If the steps required to be taken by the enforcement notice are not carried out within the allotted period, the director of planning may enter the property and take those steps, and may recover the costs as a debt from the owner of the land.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Title to real estate must be held by a Turks and Caicos limited liability company or by a natural person, although the upstream ownership structure is not regulated.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

A Turks and Caicos Islands company's constitutional documents will set out its governance framework, including the powers of its board of directors, who ordinarily manage the day-to-day operation of the business. In relation to a company incorporated as a company limited by shares, the liability of its shareholders is limited to the amount (if any) unpaid on their shares.

5.3 REITs

Due to the relatively small size of the Turks and Caicos Islands' real estate market, it is generally not common to see large portfolios of real estate held by REITs. Real estate can be held by a trustee or multiple trustees on behalf of the underlying trust, and foreign investors would be able to participate in such arrangements.

5.4 Minimum Capital Requirement

There are no minimum capital requirements for a company.

5.5 Applicable Governance Requirements

The company will typically have one or more directors who manage the day-to-day business of the company. The constitutional documents set out the governance framework, along with the Companies Ordinance (as revised).

5.6 Annual Entity Maintenance and Accounting Compliance

Turks and Caicos Islands companies are obliged to pay annual fees, which typically amount to USD1,500 to USD2,000, inclusive of the company agent and government fees.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A person or company wishing to occupy another party's real estate for a limited period may do so by contractual licence with the owner or, more commonly, by entering into a lease.

6.2 Types of Commercial Leases

Given the size of the jurisdiction, there are no specific different types of leases.

6.3 Regulation of Rents or Lease Terms

Rents and lease terms are freely negotiable. Certain landlord and tenant covenants are implied in a lease by Sections 52 and 53 of the Registered Land Ordinance, unless otherwise expressly provided for in the lease.

In the wake of the COVID-19 pandemic, no legislation was enacted that affected the terms of lease agreements in regard to rent relief, late-payment assessments or eviction moratoriums. However, some landlords, both residential and commercial, gave their tenants rent reductions or abatements as an incentive to continue occupying the property while the pandemic was at its height.

The Turks and Caicos government did assist persons in the hospitality sector affected by the

closure of the airport and hotels by granting a stimulus cash grant.

6.4 Typical Terms of a Lease

The tenant is typically responsible for repairing the demised premises and the landlord is usually under obligation to insure and maintain the building and the common parts, and will usually recover these costs from the tenant in addition to the rent.

Rent is commonly paid monthly, in advance or arrears.

6.5 Rent Variation

It is typical for commercial leases to make provision for rent to be reviewed.

6.6 Determination of New Rent

Typically, rent is reviewed in relation to the market rent at the time of the review, based on a set of assumptions and disregards.

6.7 Payment of VAT

No value added tax (VAT) is payable in the Turks and Caicos Islands.

6.8 Costs Payable by a Tenant at the Start of a Lease

Stamp duty (see **2.10 Taxes Applicable to a Transaction**), any registration fees (nominal) and a security deposit are typically paid by the tenant at the start of the lease. Landlords also often request payment of rent for the final month of the term when the lease is entered into.

6.9 Payment of Maintenance and Repair

The landlord typically recovers their costs from the tenant through rent or communal service charges.

6.10 Payment of Utilities and Telecommunications

Where tenants have not purchased their electricity, water, gas and telecommunications services directly from suppliers, they will typically pay a share of these services provided by the landlord by reference to the size of their demised premises, or the landlord will separately meter each premises.

6.11 Insurance Issues

Typically, the landlord will be responsible for insuring the building and common parts (passing costs on to tenants through rent or common area charges) and the tenant will insure the contents. Typical insured risks would include fire, earthquake, hurricane, flood and civil commotion.

Business interruption insurance policies are not available in the domestic market in order for tenants to recover rent payments or other costs as a result of office closures and clean-up costs during the COVID-19 pandemic.

6.12 Restrictions on the Use of Real Estate

It is usual for a landlord to restrict the use of the demised premises and common areas. Planning permission and zoning constraints would also apply.

6.13 Tenant's Ability to Alter and Improve Real Estate

A lease will ordinarily prohibit the tenant from making alterations or improvements to the real estate without the prior consent of the landlord.

6.14 Specific Regulations

There are no specific regulations and/or laws that apply to leases of particular categories of real estate. Parties generally have the freedom to contract as they wish, although the Registered

Land Ordinance does imply certain covenants on the landlord and tenant, unless modified in the lease.

6.15 Effect of the Tenant's Insolvency

The terms of the lease usually allow a landlord to terminate the lease if the tenant becomes insolvent. At the time of writing, specific insolvency legislation is in the course of being implemented.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

It is common for a landlord to take a security deposit at the outset of a lease and the landlord may require guarantees from directors, shareholders or related companies.

Security deposits are freely negotiable but would likely include at least one rental payment. Security deposits are not regulated and so the terms of the lease would govern.

6.17 Right to Occupy After Termination or Expiry of a Lease

Unless expressly provided for in the lease, tenants do not have security of occupation or a right to renew at the end of the term. However, where a tenant continues to occupy the premises with the consent of the landlord after the termination of the lease, the tenant will be deemed to be a tenant holding the premises on a periodic tenancy on the same conditions as those of the expired lease, in so far as those conditions are appropriate to a periodic tenancy.

6.18 Right to Assign a Leasehold Interest

There is an implied term in the Registered Land Ordinance CAP 9.01 that tenants are only permitted to assign their leasehold interest with the written consent of the landlord which should not be unreasonably withheld. However, it is up to the landlord and the tenant to agree the position; eg, some leases may include an absolute prohibition on assignment.

To the extent assignment is permitted, the landlord may be able to impose certain conditions; eg, the assignee giving a direct covenant to the landlord to comply with the tenant covenants in the lease or obtaining a suitable guarantee.

The landlord may be able to withhold consent in certain circumstances; eg, if there is a material breach of the lease or, in the landlord's reasonable opinion, the assignee will not be able to comply with the tenant covenants in the lease.

6.19 Right to Terminate a Lease

Typically, a lease would provide the option for the landlord to terminate the lease in the event of a material breach by the tenant (subject to any negotiated cure periods) or the insolvency of the tenant. The landlord or tenant would ordinarily be given the right to terminate the lease if the leased premises are substantially destroyed or damaged and not repaired within a specified period. Tenant break options are generally uncommon, but could be negotiated.

6.20 Registration Requirements

Leases are presented for registration in the prescribed form or any form approved by the registrar. They are accompanied by a statement of truth for the value of the purchase price or other consideration and an acknowledgement of receipt of consideration. Leases are only deemed to have been properly executed if signed by a natural person (for an individual) or, in the case of a corporation, if the common seal is affixed on the lease in the presence of an officer/member of the corporation or, if the corporation does not

have a common seal, it is signed by an authorised person.

Leases are recorded on the register of title if they are for:

- a specific period of two years or more;
- for the life of the lessor or lessee; or
- if a lease is for a term of less than two years but contains an option whereby a further term is granted, which would result in a total term exceeding two years.

Leases that are for a period of less than two years or that are not compulsorily registrable but which are capable of being registered, can be registered if they are in a prescribed form, and stamp duty must still be paid even when the lease is not being registered. If the lease is a sublease, every lease superior to that sublease should be in the prescribed form and registered in priority to the sublease.

For the registration of the lease on the register of title, there is a fee of USD25 and it is usually paid by the tenant.

6.21 Forced Eviction

It is common for a lease to contain forfeiture clauses that allow the landlord to evict the tenant. However, the tenant has a statutory right to apply to the court for relief against forfeiture and so the timeframe for the forfeiture process can vary.

6.22 Termination by a Third Party

The Turks and Caicos Islands government can compulsorily acquire any land, but this rarely occurs.

Compensation is payable, typically at the market value of the interest acquired.

6.23 Remedies/Damages for Breach

There are no such statutory or customary limitations on damages, and the usual principles will apply. Security deposits are common and are typically paid in cash at the start of the lease term.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There is no commonly accepted market standard of contract and so parties are free to agree terms as they see fit, with the format and complexity of the contract often being driven by the sophistication of the parties and the type of project.

Most larger construction contracts will, however, typically follow a US style (such as the American Institute of Architects), a UK style (such as the Join contracts tribunal), a combination of the two, or even the contractor's (or developer's) own standard terms.

7.2 Assigning Responsibility for the Design and Construction of a Project

See **7.1 Common Structures Used to Price Construction Projects**.

7.3 Management of Construction Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.4 Management of Schedule-Related Risk

See **7.1 Common Structures Used to Price Construction Projects**.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

See **7.1 Common Structures Used to Price Construction Projects**.

7.6 Liens or Encumbrances in the Event of Non-payment

See **7.1 Common Structures Used to Price Construction Projects**.

7.7 Requirements Before Use or Inhabitation

Certificates of occupancy must be obtained from the Planning Department before any new buildings are occupied.

8. Tax

8.1 VAT and Sales Tax

VAT is not applicable in the Islands.

8.2 Mitigation of Tax Liability

There are no commonly used methods employed to mitigate stamp duty on large real estate portfolio purchases.

8.3 Municipal Taxes

No municipal taxes are paid on the occupation of business premises.

8.4 Income Tax Withholding for Foreign Investors

Income and capital gains are not directly taxed in the Islands.

8.5 Tax Benefits

As mentioned in **8.4 Income Tax Withholding for Foreign Investors**, income and capital gains are not directly taxed in the Islands.

Trends and Developments

Contributed by:
Oliver Chapman and Chris Smith
Griffiths and Partners

Griffiths and Partners offers more than 20 years' experience dealing with real estate in the Turks and Caicos Islands, and overseas. The real estate team assists with the sale and purchase of residential and commercial property on the Islands, from individual parcels of land to multimillion-dollar villas, as well as advising on large-scale commercial developments, mortgages and financing, leasing and share transfers, and joint venture agreements. The firm regularly advises on development agreements with the government and acts for local, institutional and overseas lenders in relation to secured lending in the Islands. There are no restrictions on foreign ownership of property on the Islands and the firm is able to lead its overseas clients through all the stages of identifying, financing and acquiring property. The firm provides guidance and close support throughout the development process, from site acquisition and planning, through the construction stage to completion, and thereafter the management and onward disposal or letting of the property.

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The Turks and Caicos Islands have emerged as a thriving hub for real estate investors worldwide, appealing to a diverse range of investors. Since the pandemic, there has been a noticeable surge in real estate investment, driven by a shift in traditional investment priorities. Historically, the foreign real estate investor demographic consisted of retirees and high net worth individuals seeking a peaceful retreat. However, recent years have witnessed a significant evolution, with a growing number of solo remote workers and multinational corporations turning their attention to the Turks and Caicos Islands. The islands' business-friendly climate, cultural resonance with Western nations, and strategic location make them an attractive destination for investment.

Hotel and Short-Term Let Boom

The allure of pristine beaches and vibrant culture continues to draw tourists, leading to a surge in demand for hotel accommodation and short-term rentals. Occupancy rates surpassed 80% in 2023, and groundbreaking has commenced on several developments. The Andaz, a luxury resort in Grace Bay, will offer 54 hotel rooms and 74 flats for sale. Similarly, in Provo, the Loren at Turtle Cove will showcase six beachfront villas and 25 condominium units with diverse layouts. Additionally, South Caicos will welcome Salterra, a new Marriott Luxury Collection property in 2025, boasting 100 guest rooms, including 52 suites and two penthouses.

Supply Chain Disruptions and Building Material Costs

As the impact of climate change and war continues to reverberate across the global supply chain, delays and disruptions in the procurement of building materials essential for construction and renovation projects continue. Skyrocketing costs and limited availability of materials further exacerbate challenges faced by developers and homeowners alike, impacting project timelines and bottom lines.

Inflation and Interest Rates

Moreover, inflationary pressures and fluctuating interest rates on the global stage add another layer of complexity to the local economy. Rising prices for goods and services diminish purchasing power, while fluctuations in interest rates influence borrowing costs and mortgage affordability. The Turks and Caicos Islands have diversified their investor base, mitigating reliance solely on individual homeowners and ensuring stability in the face of economic fluctuations. As

a result, while potential homeowners may face hurdles in securing financing for property acquisitions, the islands' real estate market maintains its liquidity and retains significant growth potential.

Mortgage Lending Dynamics

In Turks and Caicos, mortgage lending dynamics have evolved, and with the introduction of G&P Capital Limited, a private mortgage fund, a new era of possibilities is unfolding for investors and homeowners alike. Whilst once there may have been concerns about stringent lending criteria and limited financing options, the landscape is evolving, offering more accessible avenues for purchasing property. Furthermore, local regulations and economic conditions are aligning to foster a conducive environment for credit accessibility, empowering both residents and foreign investors to participate in the vibrant real estate market.

Unpredictable weather patterns

The ongoing unpredictability of weather patterns underscores the importance of reviewing building insurance policies in Turks and Caicos, ensuring the policy covers potential risks such as fire, flooding, and subsidence. Given the growing frequency of hurricanes in Florida and across the Caribbean, hurricane insurance is an important consideration and premiums have risen in recent years given the heightened risk in this region.

Sustainability

Sustainability plays a crucial role in development in Turks and Caicos, evident in the growing adoption of solar panels among property owners, leveraging year-round sunshine to reduce carbon footprints and achieve economic efficiency. Solar panels align with the islands' commitment to environmental conservation and support for sustainable development policies and international treaties.

In Conclusion

In conclusion, despite the challenges faced by the real estate industry, the Turks and Caicos Islands offer both opportunity and resilience. Developers are embracing creativity in sourcing building materials, while investors are tapping into innovative financing solutions like the GPC private mortgage fund to fuel growth. Government support for sustainable development and infrastructure enhances market resilience and fosters long-term prosperity.

By fostering collaboration between public and private sectors, Turks and Caicos continues to address systemic issues and capitalise on emerging opportunities.

Through a commitment to investment-friendly policies, regulatory clarity, and ongoing innovation, Turks and Caicos is poised to navigate the challenges of the global economy and emerge stronger, more resilient, and more prosperous than before.

UAE



Law and Practice

Contributed by:
Duncan Pickering, Nicola de Sylva and Sean Cope
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DLA Piper Middle East LLP has a market-leading real estate offering, with an international multidisciplinary team of lawyers that can serve client needs globally across the real estate sector. The firm has more than 750 real estate lawyers operating in more than 40 countries around the world, serving clients in key real estate markets, with strongly established teams in the Americas, Europe, the Middle East, Africa and Asia Pacific. DLA Piper works with clients through all stages of the real estate life cycle, including planning, acquiring, finding, developing, leasing, completing, trading and divesting. Working through this cycle, it offers the following services: financing, acquisitions and disposals, asset management, construction, cross-border investment, development, fund formation, joint ventures, leasing, litigation, planning, zoning and environmental issues, public-private partnerships, REITs, restructuring and tax. The team works alongside investors, lenders, developers and managers on every aspect of their real estate activities.

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1. General

1.1 Main Sources of Law

The United Arab Emirates (UAE) Civil Code (Law No (5) of 1985, as amended) and the UAE Constitution provide regulation of property and property transactions at a federal level. Laws relating to real estate ownership are enacted by each of the seven Emirates within the UAE.

Also within the Emirates are "free zones", which are authorised to issue their own laws and regulations. For example, the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC) have real estate laws that differ to the remainder of Abu Dhabi and Dubai.

This guide focuses on Abu Dhabi and Dubai, which are the main commercial hubs and attract the most foreign investment into real estate in the UAE.

1.2 Main Market Trends and Deals

The Dubai real estate market continues to attract record foreign direct investment (FDI) inflows, with the UAE ranking second globally in the number of greenfield FDI projects in 2023. The authors have noticed a trend of regional developers partnering with international developers on large-scale development projects as an alternative means of sourcing international investment.

A particular growth area is branded residential projects, with Dubai having the largest number of completed and of pipeline schemes in the EMEA region. A noteworthy trend is the increase in standalone branded residential projects (without a hotel component).

The UAE has been resilient to rising inflation and increases in interest rates. The regulatory framework for real estate investment and development is more sophisticated than in 2008 during the nascent years of the UAE market, when it opened to foreign ownership. This has helped the market to respond to the challenges and opportunities brought about by economic and geopolitical events.

The UAE is also taking positive steps towards regulating and embracing digital finance. Tokenisation, underpinned by blockchain technology, is attracting interest among major developers, given its potential for increased capital access. The UAE Security and Commodities Authority and its ADGM and DIFC counterparts are each focused on putting regulatory environments in place to encourage crypto-fundraising and develop markets for trading within the UAE.

1.3 Proposals for Reform

There is no formal requirement in the UAE to make public any proposals for reform.

2. Sale and Purchase

2.1 Categories of Property Rights

In the UAE, five main types of property interests can be held:

- absolute ownership (freehold);
- usufruct interest;
- musataha interest;
- leasehold interest; and
- granted land.

Absolute Ownership (Freehold)

In Abu Dhabi, the following may have absolute ownership of real estate:

- UAE nationals and UAE-incorporated companies wholly owned by them;

- UAE-listed public joint stock companies in which non-UAE national shareholding does not exceed 49%; and
- any person or company specifically authorised to hold real estate by decision of the Crown Prince or Executive Council.

All other nationalities are only permitted to own real estate in areas for foreign ownership – ie, the designated "investment areas".

In Dubai, nationals of the GCC, UAE-incorporated companies wholly owned by them and UAE-listed and public joint stock companies may have absolute ownership of real estate. All other nationalities are only permitted to own real estate in areas designated for foreign ownership.

Usufruct and Musataha Interests

A usufruct interest is a right in rem in favour of the grantee to use and exploit the property of another, provided the property remains in its original condition. A musataha interest is a type of usufruct that confers upon the grantee the right to build upon the land of another.

In Abu Dhabi, both usufruct and musataha rights can be held by UAE nationals and UAE-incorporated companies wholly owned by them (without restriction) and by non-UAE nationals in designated investment areas only.

In Dubai, both usufructs and musatahas can be held by GCC nationals and UAE-incorporated companies wholly owned by them, but by non-GCC nationals in designated areas only.

In all cases, usufructs are restricted to a maximum term of 99 years and musatahas to a maximum term of 50 years (renewable once in Abu Dhabi).

Leasehold Interests

Generally, leasehold interests in the UAE are treated as personal rights between two parties and not as real rights. An exception to this is leases of 25 years or more in Abu Dhabi and leases of ten years or more in Dubai, which are each considered as (and can be registered as) real rights.

Granted Land

Land may also be "granted" by the rulers of each Emirate to Emirati citizens or companies owned by Emiratis. The grant of such land can be revoked by the ruler at any time, and is subject to obligations to develop and to restrictions on its use and disposal.

2.2 Laws Applicable to Transfer of Title

The following federal laws are relevant:

- the Civil Code; and
- Federal Law No (18) of 1993 on commercial transactions, as amended (the "UAE Commercial Code").

Each Emirate has its own laws and regulations governing the transfer of title.

In Abu Dhabi, the relevant laws relating to the transfer of title include:

- Law No (3) of 2005 (as amended) concerning the regulation of property registration in the Emirate of Abu Dhabi;
- Abu Dhabi Administrative Decision 51/1/2008 on the issuance of the Implementing Regulation of Abu Dhabi Law No 3 of 2005 concerning the regulation of real estate registration in the Emirate of Abu Dhabi;
- Law No (19) of 2005 re-organising real property in Abu Dhabi (as amended by Law No (10) of 2013);

- Law No (3) of 2015 concerning the regulation of the real estate sector in the Emirate of Abu Dhabi;
- Law No (13) of 2019) concerning the amendment of some provisions of Abu Dhabi Law No (19) of 2005 concerning real estate ownership; and
- various Abu Dhabi Executive Council Decisions on designation of investment zones.

In Dubai, the relevant laws relating to the transfer of title include:

- Dubai Law No (7) of 2013 concerning the Land Department;
- Dubai Executive Council Decision No (30) of 2013 approving fees of the Land Department;
- Dubai Decree No (4) of 2010 regulating the granting of title to allotted industrial and commercial land in the Emirate of Dubai;
- Dubai Law No (13) of 2008 regulating the Interim Property Register in the Emirate of Dubai, as amended by Dubai Law No (9) of 2009, Law No (19) of 2017 and Law No (19) of 2020;
- Dubai Law No (6) of 2019 regulating the joint ownership of real estate in the Emirate of Dubai; and
- Dubai Law No (7) of 2006 concerning real property registration in the Emirate of Dubai, as amended by Dubai Law No (7) of 2019.

The laws apply to all asset classes.

2.3 Effecting Lawful and Proper Transfer of Title

Registration of Transfers

All transfers of land in Abu Dhabi and Dubai must be registered.

In Dubai, this may be done remotely through the Dubai Land Department (DLD) portal, or it may be done in person at one of the trustee offices of the DLD; while in Abu Dhabi it is done at the Abu Dhabi Department of Municipalities and Transport (DMT).

The DIFC and ADGM have their own system of land registration and maintain their own registers. Certain other free zones maintain their own register of real estate interests, but this does not negate the requirement to register land transactions at the onshore land register.

Off-Plan Sales Contracts

In Abu Dhabi and Dubai, contracts for the sale of real estate that is being developed (ie, off-plan) must be registered on an interim register. Interim registration does not, however, create any legal ownership. Upon completion of the unit, the interim registration is cancelled, and full registration occurs.

Title Insurance

It is not common for title insurance to be obtained.

2.4 Real Estate Due Diligence

In the UAE, the due diligence process can often be difficult due to the lack of information made publicly available. The land registers are not publicly searchable.

Most information relating to the ownership or particulars of a property (ie, title certificates, affection plans, zoning information, etc) can only be obtained from the relevant governmental departments upon application from (or with authorisation of) the owner of the property. Some information relating to utility arrangements, community charges, leases or other contracts affecting the land can only be obtained from the owner of the land.

As a result, any due diligence carried out will typically be reliant upon materials provided by the seller's lawyer (which includes title certificates and searches) and the seller's response to follow-up enquiries made by the buyer.

2.5 Typical Representations and Warranties

Representations and warranties in a sale and purchase agreement are subject to agreement by the parties, and vary from contract to contract.

Abu Dhabi and Dubai laws remain largely silent on the representations and warranties that are implied in the sale of property, except for the sale of off-plan units. A developer selling a unit off-plan is required to repair any structural defects in a unit for ten years from the date of issuance of the completion certificate, and is liable for latent defects for one year from the issuance date of the completion certificate.

2.6 Important Areas of Law for Investors

An investor should pay particular attention to the planning, zoning, construction, environmental, and health and safety laws that may apply to the property, and should obtain assurances that all requisite approvals were obtained prior to the building having been constructed.

Non-UAE nationals should carefully consider whether the property is in an area in which the buyer is legally permitted to hold the interest that they plan to buy.

2.7 Soil Pollution or Environmental Contamination

Environmental laws in the UAE are comprised of federal- and Emirate-level laws. The federal laws primarily aim to control all forms of major pollution, and will apply to the principal polluter (developer, industrial organisation, etc). There is a possibility that environmental liabilities can pass with land, particularly if the breach of environmental laws continues after the purchase by the buyer.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

The DMT and the Dubai Municipality (DM) are responsible for the zoning of land in their respective Emirates. The DMT and the DM each issue affection plans in respect of plots of land, which state the zoning for such land and details regarding the size of the building permitted to be built on such land.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation of land is possible in both Abu Dhabi and Dubai. The UAE Constitution and Civil Code, however, restrict the right of a public authority to expropriate land, unless such expropriation is for a public benefit and compensation will be paid to the party being disadvantaged by such expropriation.

There is no formal statutory process, although typically for large-scale expropriations a committee will be formed to co-ordinate dealings with affected parties and to determine compensation.

2.10 Taxes Applicable to a Transaction

Asset Deals

In Abu Dhabi, the seller and buyer are required to pay registration fees of between 1% and 4% of the purchase price. It is common for the buyer to pay the transfer fee.

In Dubai, the seller and buyer are required to pay registration fees of 4% of the purchase price, which is split equally between the parties unless

otherwise agreed. In practice, it is common for the buyer to pay the full 4% transfer fee.

Mortgage

Where a mortgage is taken over the property, the mortgage must also be registered. The current applicable mortgage registration fees are (for Abu Dhabi) 0.1% of the mortgaged amount and (for Dubai) 0.25% of the mortgaged amount (up to a maximum of AED1.5 million).

Share Deals

In Dubai, the DLD requires notification of any changes in shareholding of real estate-owning companies, and a proportionate transfer fee will be applied. Failure to inform the DLD can result in a fine. If the seller is a taxpayer for corporate income tax (CIT) purposes, any gain derived from the sale or divestment of shares will in principle be subject to tax at a rate of 9%, unless the conditions for the participation exemption regime are met, or unless the seller is eligible for the 0% tax rate under the free zone tax regime. The transfer of shares is typically exempt from VAT.

VAT

VAT is applied to the sale of real estate assets (discussed in more detail below).

CIT

Both buyers and sellers should evaluate the tax implications of transactions involving real estate from a CIT perspective. Generally, any income derived from the sale or divestment of real estate assets by juridical persons will be subject to tax at the standard tax rate of 9%. However, under certain circumstances, income from the sale of commercial property could benefit from a 0% CIT rate under the free zone tax regime (subject to meeting the relevant conditions). The UAE CIT regime offers various forms of relief for intra-group transfers or business restructurings involving real estate, whereby assets can be transferred at book value and no gain is realised by the seller.

Individuals who conduct a business or business activity in the UAE will also be subject to CIT if their turnover exceeds AED1 million within a calendar year. However, income that individuals earn from real estate investments, including profits from selling, leasing, subleasing or renting out land or property, is exempt from CIT. This exemption applies provided these activities do not require a licence or are not conducted through a licence. Additionally, this type of real estate income does not count towards the AED1 million threshold that determines CIT liability for individuals.

2.11 Legal Restrictions on Foreign Investors

There are legal restrictions on foreign investors acquiring real estate, as set out in this guide.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

It is common for the acquisition (or development) of real estate in the UAE to be financed by obtaining a loan (often with a mortgage as security for repayment). A loan can be provided either on a bilateral basis (single lender providing the entire facility) or on a syndicated or club basis (multiple lenders, each providing parts of the overall facility). Only banks licensed by the UAE Central Bank are eligible to be mortgagees of record for real estate in the UAE.

Another popular financing structure in the UAE is through Islamic financing, which has developed

in accordance with Sharia principles. One of the key principles is that the payment and receipt of interest (riba) is prohibited and any obligation to pay interest is considered to be void. However, Islamic principles do not prohibit a financier in an Islamic finance transaction from making a profit, rental or other return on its asset or investment.

Existing real estate may be financed through sale and leaseback arrangements (ijara), where the borrower sells the property to the Islamic financier and subsequently leases it back in exchange for paying rentals. However, this kind of arrangement may attract registration and other costs, which can make a leasing or ijara structure economically unviable.

Commodity murabaha (tawaruq) financing structures rely on underlying commodities trades in order to create debt-based obligations (like a conventional loan). This structure does not involve additional transfers and can also be structured on a bilateral or syndicated basis in the same way as for a conventional loan. A commodity murabaha structure can also be secured using a mortgage over the underlying real estate.

Other Financing Structures

There is a general trend towards the establishment of real estate funds/real estate investment trusts (REITs) whereby stakeholders inject capital into a fund, where the principal objective is to invest in strategic real estate in the UAE (and/or the wider GCC area) and to grow a real estate portfolio for the fund's investors.

Another alternative is to access the debt capital markets, through either bonds or sukuk (also known as Islamic bonds).

3.2 Typical Security Created by Commercial Investors

Security over real estate and real estate interests (such as usufruct or musataha) can be taken by way of a mortgage that is registered at the relevant land department. Some of the Emirates (and free zones) have specific laws dealing with mortgages, but, in the absence of legislation, mortgages are generally governed by the Civil Code. Generally speaking, mortgages over real estate may only be granted in favour of a bank that is licensed by the UAE Central Bank.

Movable Property

In 2020 the UAE issued a new Federal Law No 4 of 2020 (the "Movable Assets Mortgage Law") as a regulatory regime which provides that a wide variety of assets (such as accounts, trade payables or receivables, equipment including future property) can be secured without demonstrating possession – provided that the security is registered on the applicable security register.

The Movable Assets Mortgage Law provides a greater level of certainty in the context of real estate financing transactions, and also enables security to be taken over movable property that is similar in effect to a debenture or "floating charge". In terms of registration, the current applicable security register where such security over movable property is to be registered is the Emirates Integrated Collateral Registry Company.

Security Over Shares

Where a special purpose company (SPC) has been established for the purposes of a real estate investment or development, it may be possible for the financiers to take security over the shares of that SPC. As a general rule, it is possible to take security over the shares in a company, including onshore LLCs. There are restrictions

on which entities can own real estate, and the process for share pledges can differ depending on where a company is registered. Generally, if the SPC is incorporated in onshore UAE or in certain free zones, the share pledge would be subject to notarisation and can only be granted to locally licensed banks. For cross-border financing, a foreign lender would be required to appoint a locally licensed bank that will act as a local security agent.

Guarantees

Guarantees are common in the UAE, including corporate and/or personal guarantees given in relation to a real estate financing. These kinds of guarantees are specifically codified in the Civil Code and the UAE Commercial Code.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

The UAE Central Bank's rules and regulations provide that a party wishing to hold security over real estate must be a bank, company or financial institution that is licensed by the UAE Central Bank to provide property finance. Foreign (unlicensed) lenders will often appoint a locally licensed security agent to act on their behalf in relation to security over real estate assets.

The only restrictions on repayments being made to a foreign lender under a security document or loan agreement include:

- restrictions or measures designed to counteract money laundering and/or the funding of terrorist activities; and
- transactions involving certain sanctioned countries or blacklisted entities.

The UAE Central Bank may impose additional restrictions.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

There are no specific taxes that would apply in the UAE; however, the following fees are payable in relation to granting and enforcing security over real estate:

- a bank property valuation fee;
- notarial fees;
- a mortgage registration fee;
- notarial fees to give notice of default (Dubai);
- a publication fee and a public auction fee if a secured asset is sold by public auction; and
- court fees for enforcement of a security interest.

3.5 Legal Requirements Before an Entity Can Give Valid Security

It is not possible for a joint stock company (JSC) target, or any of its subsidiaries, to provide any financial aid (such as loans, security and guarantees) that will assist a buyer in acquiring its shares. However, limited liability companies are exempt from such restrictions under a Ministerial Resolution of 2016. In any event, as a matter of good practice, all companies would be advised to demonstrate that there is a corporate benefit to the company granting any security.

3.6 Formalities When a Borrower Is in Default

A lender is entitled to satisfy the debt from the mortgaged property when the debt falls due, provided that the mortgage has been properly registered.

Upon a default in payment by the borrower, and provided that the mortgage has been registered, the lender must give 30 days' notice to the debtor by registered mail (Abu Dhabi) or through a notary public (Dubai) before commencing execution proceedings. If the payment is not made

within such 30-day period, the magistrate of summary justice (in Abu Dhabi) or the execution judge (Dubai) shall, at the request of the lender, order an attachment against the mortgaged property, and shall, at the request of the lender, issue a decision enabling the mortgaged property at public auction.

The court may postpone the sale of the property by public auction for a period of up to 60 days if it is of the opinion that the mortgagor may be able to settle the debt within this period, or if the sale of the property would cause "serious damage" (Abu Dhabi) or "substantial damage" (Dubai) to the mortgagor.

If the real estate is insufficient to satisfy the debt, the mortgagee may have recourse against the mortgagor's other assets as an ordinary creditor. The mortgagee must follow the statutory procedure, and provisions in the mortgage document attempting to circumvent this procedure would be held to be void.

3.7 Subordinating Existing Debt to Newly Created Debt

If a security interest is required to be registered, the date of registration determines its ranking. If it is not registrable, it will rank in order of the date of creation (noting, however, that the laws relating to priority are largely untested in the UAE). If two or more applications to register a mortgage against the same property are made at the same time, the mortgages are registered together and rank equally in the distribution of auction proceeds.

A lender may assign the ranking of its mortgage to another creditor that has a security interest in the same property.

3.8 Lenders' Liability Under Environmental Laws

Environmental laws in the UAE are not particularly detailed, but the relevant authorities are likely to pursue the party responsible for causing the environmental harm, which may or may not be the mortgagor. If there are any remedial costs associated with rectifying the damage, the law provides that the lender may "take whatever legal action is necessary to protect its rights and recover the costs from the mortgagor". In addition, the mortgage will typically contain indemnities in favour of the lender in the case of pollution or other acts caused by the mortgagor that are harmful to the environment.

3.9 Effects of a Borrower Becoming Insolvent

There remains a degree of uncertainty as to the correct application of Federal Decree Law No 9 of 2016, as amended (the "UAE Bankruptcy Law"). A declaration of insolvency will not result in the dissolution of contracts that are binding on both parties unless the services are "personal" in nature.

If a borrower declares insolvency, the lender's security interests will not be extinguished to the extent that such security is not challengeable on an antecedent transaction. The obligations of a UAE company are subject to limitations arising from bankruptcy, liquidation, composition, and all other laws and general principles affecting the rights of creditors generally.

The UAE Bankruptcy Law provides for a short-term cramdown process for debtors entering bankruptcy during (and as a result of) an emergency financial crisis, and the amendment also suspends creditor applications during an emergency financial crisis. An "emergency financial crisis" requires a Cabinet Decision to declare it.

3.10 Taxes on Loans

No federal taxes are directly applicable.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Abu Dhabi

Planning powers are vested in the DMT. Major developments are subject to a review process, in line with the longer-term strategy for Abu Dhabi's urban development. The review process includes four key steps, as follows.

Step 1: the information meeting

This is held by the DMT with the owner/developer on the acquisition of a development site, to enable the DMT to provide the applicant with relevant information (eg, plans, policies, processes, etc).

Step 2: preliminary development options

The applicant is required to prepare preliminary development options. General land use and site layout must be provided. The DMT and the applicant will review the options and then select an option to develop through to the concept-plan stage.

Step 3: the concept plan

The applicant is required to submit a concept plan for evaluation and approval by the DMT and other government authorities. The concept plan will be reviewed for compliance with the Emirate's urban and development plans and policies.

Step 4: the detailed plan

For small and medium-sized projects, applicants can then prepare and submit detailed site and building plans for review. This step also confirms that any conditions of approval have been met. The planning review process ends once all these steps have been satisfactorily carried out, and the applicant is then ready to apply for municipal building permits.

For large projects, this stage of the process is aimed at helping applicants translate concept masterplans into detailed regulations and guidelines. Additional developer and DMT/municipal review are required for large projects, to ensure compliance with DMT-approved regulations and guidelines before the applicant can apply for building permits.

Dubai

Dubai Law No (16) of 2023 on urban planning (the "Planning Law") establishes a system of primary and subsidiary statutory plans. The Dubai Urban Plan 2040 is the basis of the primary structure plan, which sets out planning policy at a strategic level. The subsidiary framework plans are to be prepared by DM or other relevant authorities to implement the principles of the structure plan.

Under the Planning Law, development work in the Emirate may only be carried out following the granting of a master plan permit, planning permit or general planning permit. It is an offence under the Planning Law for any "development work" to be undertaken in the absence of a permit.

The affection plan system remains, where an owner or developer obtains an "affection plan" from the DM. The affection plan is a high-level general site plan that is issued with basic information containing the plot number, the land use classification and any other particular zoning requirements that are required by the DM. The plan will state the height allowance, the usage, any setback requirements and whether parking must be included.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Abu Dhabi

To assist in regulating the design, appearance and method of construction of new buildings, the DMT has adopted the International Codes of the International Code Council (such as the Building, Fire, and Plumbing Codes, etc) and the Abu Dhabi Environmental Health and Safety Management System. Any development must also comply with the statutory requirements of other government agencies, such as the DMT and Abu Dhabi Waste Management Control, among others.

Dubai

In addition to the three types of permits listed above, the Planning Law confirms that additional requirements may be imposed on permits by the DM, which could take the form of conditions, and that environmental impact assessments (EIAs) will apply in accordance with existing legislation, with the DM as the relevant authority.

The Planning Law envisages that decisions in respect of "major urban projects" may be issued by the Supreme Committee for Urban Planning. Further details are awaited as to the threshold for development being considered a major urban project.

Numerous technical guidelines and circulars issued by the DM and other relevant authorities also regulate detailed designs. These need to be examined on a case-by-case basis to ensure that the detailed design is compliant with the relevant regulations for the area where the building is being constructed.

4.3 Regulatory Authorities

In Abu Dhabi, the main authority responsible for regulating the development and designated use of land is the DMT.

In Dubai, the main authority responsible for regulating the development and designated use of land is the DM, subject to the oversight of the Supreme Committee for Urban Planning. Within the free zones, the relevant authorities have planning powers, subject to a degree of oversight by the DM.

4.4 Obtaining Entitlements to Develop a New Project

An application is required to be made to the DMT (Abu Dhabi), the DM (Dubai) or the relevant free zone authority for approval of proposed developments or change of use. Generally, there are no formal consultation processes involving third parties, although the Planning Law suggests that in the future a certain degree of consultation may be provided for in Dubai.

4.5 Right of Appeal Against an Authority's Decision

In Abu Dhabi, the decision of a governmental authority may be reviewed by the Ruler of the Crown Prince's Office by direct application; and in Dubai it is possible to apply to the Ruler's Court. In both cases, the power to intervene in such decisions is entirely discretionary.

In Dubai, the Planning Law states that the Supreme Committee for Urban Planning will be responsible for dispute resolution. While further details can be expected in secondary legislation and guidance, the implication is that dispute resolution may be available for applicants.

4.6 Agreements With Local or Governmental Authorities

Non-binding memoranda of understanding are common between master developers and statutory utility suppliers. Binding agreements are common with providers of district cooling services, which are sometimes project-financed. Formal agreements with local authorities are rare.

4.7 Enforcement of Restrictions on Development and Designated Use

The DMT (Abu Dhabi) or the DM (Dubai) can order a contractor to stop work and, in extreme cases, to demolish unapproved structures. This is likely to be established during an inspection prior to the granting of a completion certificate.

A building completion certificate will not be issued if the building permit has not been complied with. The building completion certificate is required in order for occupation of the building to be allowed.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Various types of corporate vehicles are capable of holding real estate assets in the UAE. If the holding company of a real estate asset has foreign shareholders, the company may only hold the real estate asset within a designated investment area.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Company (LLC)

Onshore LLCs established in the UAE (outside the free zones) have historically been subject to foreign investment laws which required at least 51% equity participation by a UAE national. The UAE's new Commercial Companies Law, which came into force on 2 January 2022, contains no general requirement for equity participation by a UAE national; however, certain activities have been designated as having strategic impact (for example, in the security and defence sector) and continue to require prescribed levels of local ownership.

JAFZA Offshore Companies

An offshore/free zone company can be 100% foreign-owned. If the asset is to be wholly owned by foreigners (and therefore in a designated area), a DLD Direction in 2011 confirmed that the shareholders are permitted by the law to use a JAFZA offshore company only to purchase and register the land interest (regulated by the Jebel Ali Free Zone Authority in Dubai and "accepted" by the DLD), and foreign companies in other jurisdictions are no longer permitted to register land ownership interests. The issue becomes more complicated if the intention is for the company to develop the land and sell units, villas, etc. Specific advice must be sought in such circumstances.

Public Joint Stock Company (PJSC)

Share capital is divided into negotiable shares of equal value. The nominal value of each share cannot be less than AED1 nor more than AED100. Shareholders have limited liability to the value of their shares. A PJSC must have at least five founder members.

Subject to implementation of the recent amendments to the Companies Law, UAE nationals must own at least 51% of the shares in the PJSC, and the founding members must subscribe for between 30% and 70% of the issued share capital.

Private Joint Stock Company (Private JSC)

A private JSC is similar to a PJSC but with certain differences, including:

- the minimum share capital is AED5 million;
- the shares cannot be offered publicly; and
- only two founder members are required.

The Companies Law provides that, unless specifically stated, all requirements that apply to a PJSC apply to a private JSC as well.

Tax Implications

Under the new CIT regime, income from immovable property derived by a legal entity, whether derived from sale or through leasing, will typically be subject to a 9% tax rate for "regular taxpayers" who are subject to the standard tax regime (taxable income up to AED375,000 is taxed at 0%).

Under the free zone tax regime, entities that are considered qualifying free zone persons (QFZPs) are eligible for a 0% CIT rate on certain types of income (ie, qualifying income), provided specific criteria are met. The regulations with respect to the free zone tax regime are relatively complex, but in essence, in a real estate context, only income from commercial properties located in the free zone may qualify for the 0% rate, provided the transaction is conducted with an entity registered within a free zone (ie, a free zone person).

Conversely, revenue from residential properties does not qualify for the 0% rate. It is important to note that properties such as hotels, motels, bed and breakfasts, serviced apartments, and similar establishments are not categorised as commercial properties for the purposes of the free zone tax regime.

5.3 REITs

While the UAE is not traditionally recognised as a funds jurisdiction, the development of offshore jurisdictions such as the DIFC and ADGM, with evolving legislation aimed towards the development of a funds market, has made these financial free zones a more attractive jurisdiction for the establishment of such real estate funds. UAE REITs can apply for corporate tax exemption if they meet certain specified criteria.

5.4 Minimum Capital Requirement

LLC

There is no prescribed minimum capital amount for an LLC, but share capital must be adequate. This can be decided by the shareholders, and there is no published guidance in this regard. In practice, a notary public currently accepts a minimum share capital of AED100,000 to AED150,000, divided into equal shares with a minimum value of AED1,000.

JAFZA Offshore Companies

AED1,000 applies for such companies, and shares must have a minimum value of AED1 each.

PJSC

AED30,000,000 applies for a general company, and this amount increases in the case of banks and insurance companies. Given the substantial capital requirement and the fairly restrictive rules of establishment and management, it is often not a suitable corporate vehicle for overseas investors wishing to establish a vehicle for investment purposes.

Private JSC

AED5 million applies for such companies.

5.5 Applicable Governance Requirements

LLC

An LLC must appoint a general manager to manage the company. The general manager can be of any nationality, but, in practice, rejection of a proposed general manager does occur without reason from time to time. An LLC must also appoint a UAE-certified financial auditor before the end of its first year of business.

JAFZA Offshore Companies

A JAFZA offshore company must appoint a registered agent, to whom notices are served. It must also have at least two directors, a general manager and a company secretary at all times.

PJSC

Since a PJSC is required to be listed, it has to comply with the governance requirements of the relevant stock exchange, which include various disclosure requirements to be met, the publication of accounts and other statements, as well as mandatory compliance with the Emirates Securities and Commodities Authority's corporate governance code.

Private JSC

A private JSC must have a board of directors consisting of between three and 11 directors, and each director's term must be no more than three years (subject to re-election). There must be a chairman from among the directors, and such chairman must usually be a UAE national.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual compliance costs for an entity investing in real estate vary in line with the needs of each individual company.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

In Abu Dhabi, the law does not provide a clear distinction between a lease (a personal right) and a usufruct (a right in rem). The law states that long leases (ie, those with a term of 25 years or more) are property rights, but it does not clearly define the characteristics of leases with terms shorter than this. In practice, the DMT has deemed leases for a term of more than four years granted in favour of a non-UAE national (or a company owned in whole or in part by a non-UAE national) in relation to land outside an investment zone, and which contain rights to sublet, to be usufructuary rights (and therefore not capable of being granted to a non-UAE national outside an investment zone).

In Dubai, a long lease is one with a term of ten years or more, and these require registration at the DLD. For leases of less than ten years, registration is required but at a nominal cost on the "Ejari" system.

6.2 Types of Commercial Leases

In Abu Dhabi, for leases of less than four years, the DMT requires parties to use a mandatory form of lease that records key provisions (eg, parties, premises, rent and term, etc). It is common for parties to attach supplemental terms to this mandatory form. For leases of over four years, the form of lease is not mandated.

In Dubai, for leases of less than ten years, the DLD requires parties to use a mandatory form of lease that records key provisions (eg, parties, premises, rent and term, etc). It is common for parties to attach supplemental terms to this mandatory form.

6.3 Regulation of Rents or Lease Terms

Rent in the UAE may be freely negotiated between the parties to the lease.

In Abu Dhabi, Executive Council Resolution No 14 of 2016 on the leasing of premises agreements prohibits rental increases of greater than 5% per annum.

In Dubai (excluding the DIFC), Decree No 43 of 2013 provides for the average market rent to be set according to the Rent Index for the Emirate of Dubai, as approved by the Real Estate Regulatory Agency (RERA). The percentage of the maximum increase in the real estate rents is determined on renewal according to the current annual rent amount compared with the average rent for a similar property. While these restrictions apply to both residential and commercial property, in practice, for commercial property, agreed-upon alternative terms (such as fixed increases) are likely to be respected.

6.4 Typical Terms of a Lease

The terms of a lease may be freely negotiated between the parties, provided that the contents of the lease agreement do not contravene law.

Both the Abu Dhabi and Dubai landlord and tenant laws include provisions in relation to the repair and maintenance, termination, eviction and term of leases where the lease agreement remains silent on such topics, and are mandatory in application; although in practice most contracts will contain express terms on those matters and on which provisions must not contravene the applicable law.

6.5 Rent Variation

The rent payable under a lease must be specified in the lease agreement, and is generally subject to fixed or index-linked increases at regular intervals. In addition to a base rent, turnover rents are common in retail lettings.

Market rent review provisions are also included in some leases, but these clauses are not used as frequently as they are used in more developed real estate markets, since reliable comparable transactions can be difficult to establish due to the lack of publicly available market data.

6.6 Determination of New Rent

Revised rents may be determined by applying a fixed or index-linked percentage increase, or by determining the open market rent.

6.7 Payment of VAT

VAT applies to rent payable for a commercial property.

6.8 Costs Payable by a Tenant at the Start of a Lease

A tenant's liability for upfront costs should be set out in the lease agreement. The parties to a lease commonly agree that the tenant will be responsible for paying the registration fees associated with registration of the lease at the relevant registration department. Tenants are also generally responsible for the cost of opening an account for utilities and telecommunications, and for paying for meters and connections in new properties. A tenant may also be liable for the fees of any agent (such as real estate brokers) involved in the transaction.

6.9 Payment of Maintenance and Repair

A commercial lease agreement may impose an obligation on the tenant to pay a service charge to the landlord, to be used for the maintenance and repair of the common property.

6.10 Payment of Utilities and Telecommunications

Premises will usually be individually metered. In such cases, the tenant will usually purchase services such as electricity or water directly from suppliers. Where premises are not individually metered, leases may be inclusive of utilities and telecommunications, and the landlord may recover such costs through the service or separate utility charge.

6.11 Insurance Issues

A landlord will typically pay for building insurance in a multi-let property, and a tenant will pay for its own contents insurance. A landlord operating a service charge will then recover the costs of the building insurance through the service charge. Under UAE federal law, there is automatic rent cesser following damage or destruction of the property.

6.12 Restrictions on the Use of Real Estate

Leases normally specify the permitted use. If the lease is silent on this matter, the use should be consistent with zoning authorised for such property and the licensed activities of the tenant company.

6.13 Tenant's Ability to Alter and Improve Real Estate

Abu Dhabi and Dubai laws both require the tenant to obtain the consent of the landlord to all proposed works. The terms of a lease may also set out:

- what kinds of alteration or improvement works the tenant is permitted to carry out;
- when the landlord's consent should be sought for such works; and
- whether any types of works (eg, structural) are absolutely prohibited.

Certain works require the consent of government authorities. In order to obtain such consent, these government authorities will require evidence of the landlord's consent to such works.

6.14 Specific Regulations

Abu Dhabi

Residential

There is a maximum number of tenants who are permitted to occupy a single dwelling, which varies depending on the type of and number of rooms in the dwelling. Two months' notice for renewal or termination is required for residential leases.

Commercial

Commercial leases have similar rules to those applicable to residential leases, with minor exceptions.

Three months' notice for renewal or termination is required for commercial leases.

Hotels/serviced apartments

There are no specific provisions that apply to hotel leases. Leases of serviced apartments do not fall within the ambit of landlord and tenant legislation.

Dubai

The same laws currently apply to residential, industrial, office and retail leases. The exception to this is accommodation provided by an employer to an employee. The DIFC Leasing Law 2020 draws a distinction between leases of commercial and of residential premises, with enhanced protections afforded to tenants of residential premises.

6.15 Effect of the Tenant's Insolvency

Insolvency law applies only to commercial companies. If a tenant (not a commercial company)

is insolvent, the regular landlord and tenant laws would apply, which would comprise the remedies for failure to pay rent. There are no provisions specific to insolvency in the landlord and tenant laws.

Under insolvency law, the debtor must first apply to the court for:

- a preventative composition, in which case it is the debtor's duty to inform the court, within 30 days of doing so, of all and any creditors' rights against the debtor; or
- bankruptcy, in which case any ordinary creditor of ordinary debt under AED100,000 can apply to the court to open proceedings, as long as the creditor has warned the debtor to settle in writing and this has not been done within 30 days of the written notice to settle.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Parties are free to negotiate the form of security to be provided. Typically, a landlord may ask for a security deposit, bank guarantee and/or parent company guarantee.

Although it is common for a landlord to take a security deposit from a tenant, there is no statutory guidance on how such deposits must be held, when they can be utilised and when they must be returned. It is important, therefore, to ensure that a lease contains detailed provisions on dealing with the security deposit.

6.17 Right to Occupy After Termination or Expiry of a Lease

If a lease term expires and the tenant remains in the property with the landlord's knowledge and without any objection by the landlord, the lease shall (in Abu Dhabi) be renewed for a similar term and on the same conditions, or (in Dubai) renewed for a similar term or a period of one year (whichever is less) on the same terms.

If the lease agreement does not specify the terms of renewal, the Abu Dhabi and Dubai landlord and tenant laws set out a standard position to be implied into the contract; and if a party does not wish to renew or wishes to re-negotiate the terms of the lease, notice must be given in accordance with the landlord and tenant laws.

6.18 Right to Assign a Leasehold Interest

In Abu Dhabi and Dubai, a tenant may only assign the lease or sublease all or part of the leased premises with the written consent of the landlord. Unless otherwise agreed, the landlord may withhold or grant its consent at its sole discretion.

6.19 Right to Terminate a Lease

In Abu Dhabi, tenants have a statutory right to request the Rent Dispute Settlement Committee to terminate a lease where the landlord hands over the property in such a poor condition that it cannot be used for its intended purpose.

The Civil Code also allows parties to an agreement to agree to an early termination.

Break rights in longer-term leases are common, to allow tenants greater flexibility. Landlord break rights are less common and may not be effective in Abu Dhabi, unless the landlord can also establish a ground for termination.

6.20 Registration Requirements

Abu Dhabi

Leases of less than four years are required to be registered by the landlord (or property management company) in the Tawtheeq system. Leases

of between four and 25 years attract a registration fee equal to 1% of the rent "on a one-year lease basis". The authors understand that the DMT's current practice is to apply the 1% fee against the year-one rent value, multiplied by the total length of the term. Leases for over 25 years attract a registration fee equal to 4% of the value of consideration.

Dubai

Leases of less than ten years are required to be registered on the Ejari system, using the DLD mandatory form of lease. A nominal registration fee is payable. Leases with a term of ten years or more require registration on the full register at the DLD. A registration fee equal to 4% of the total rental value of the lease is payable in equal proportion by the landlord and tenant, unless agreed otherwise.

6.21 Forced Eviction

Abu Dhabi

Article 23 of Law No (20) of 2006 (as amended) sets out grounds that permit a landlord to seek early termination of a lease and to re-enter the premises:

- failure to pay rent;
- assignment or subletting the premises without consent;
- high occupancy levels;
- use of the premises other than for the purpose let or for a detrimental purpose;
- where the landlord wishes to demolish and redevelop the premises;
- where the landlord wishes to occupy the premises for their own purpose;
- condemnation of the premises;
- breach of the tenant's obligations; or
- demolition notice from authorities.

Dubai

Article 25 of Law No (26) of 2007 (as amended) sets out grounds that permit a landlord to seek early termination of a lease and to re-enter premises:

- failure to pay rent, after notice;
- subletting the premises, without consent;
- illegal or immoral use of the premises;
- failure to keep the premises occupied for specified periods of time;
- any change to the premises which renders them unsafe, or which causes damage;
- unauthorised use of the premises;
- condemnation of the premises;
- breach of the tenant's obligations; or
- demolition notices from authorities.

In both Abu Dhabi and Dubai, where a landlord wishes to terminate a lease prior to its expiry pursuant to an event of default, 30 days' prior written notice of default should be served on the tenant through the notary public or by registered mail. If the tenant disputes the grounds for early termination of the lease, a case can be lodged at the relevant Rent Disputes Settlement Centre. There are no guidelines as to how long the process would take.

6.22 Termination by a Third Party

Under the Civil Code, property can be appropriated by the government for the public benefit. In such circumstances, "just compensation" must be paid. Whether and to what extent the compensation would cover any tenant's interests in the property is dealt with on a case-by-case basis.

6.23 Remedies/Damages for Breach

The usual remedies for landlords include the following.

Compensatory Remedies

These are any damages that the landlord may be entitled to as a result of the breach and/or termination, including accrued rights (such as unpaid rent, service charges, or other payments under the terms of the lease) and other damages (such as damages caused to the property over and above what may be covered by any security deposit).

Eviction

There may be specific notice requirements that apply for specific types of eviction (see **6.21 Forced Eviction**).

7. Construction

7.1 Common Structures Used to Price Construction Projects

Pricing structures will vary according to the nature of the works. The most common pricing structures are:

- lump sum – a pre-agreed sum that the contractor will be paid to perform the works under the construction contract;
- measurement or unit price – whereby the work is measured and valued on the basis of a bill of quantities;
- prime cost – payment is made for the costs of labour and materials used; and
- cost plus – payment is made for the prime cost, plus an added percentage for profit.

Payment is usually made against the certification of completed works by an engineer appointed by the employer.

7.2 Assigning Responsibility for the Design and Construction of a Project

While there is no local standard suite for construction contracts in the UAE, many construction contracts for major projects in the UAE are based on the industry standard form of contracts published by the International Federation of Consulting Engineers (FIDIC) (with appropriate project specific amendments), and such responsibility for design and construction is allocated contractually in accordance with standard international practice, depending on the specific requirements of the project.

7.3 Management of Construction Risk

The contractual devices included in the FIDIC standard forms of contract are typically used to manage risk allocation in the context of a construction project (however, the standard FIDIC conditions of contract are often amended by employers to transfer additional risk to the contractor). While the majority of the standard FIDIC provisions are generally viewed as being enforceable under UAE law, the Civil Code provides that an agreement or a contractual provision will be unenforceable if:

- it conflicts with a mandatory provision of the law;
- it is contrary to public order or morals;
- it is performed in bad faith; or
- a right is exercised in an unlawful manner (including where the benefit realised is disproportionate to the harm suffered by others, or where the interests sought to be realised conflict with Sharia).

Any parts of an agreement that conflict with or are inconsistent with such mandatory provisions will either be rendered automatically void or will provide the courts with the power to adjust the

agreement to ensure consistency with mandatory provisions.

7.4 Management of Schedule-Related Risk

Virtually all construction contracts in the UAE require the works to be completed by a specified date.

Instead of the employer demonstrating the damage it would suffer for late completion of the works by the contractor (which may be difficult to quantify), it is standard practice to require the contractors to agree to "liquidated damages" (LDs) (eg, a pre-agreed fixed amount) for delay.

Pursuant to Article 390 of the Civil Code, parties can pre-agree to damages that become due on the occurrence of certain conditions (eg, a breach of contract, or delay). In a formal dispute, the effect of Article 390 is to reverse the burden of proof: it is for the party seeking to avoid, or otherwise amend, any pre-agreed damages to demonstrate that the other party has not suffered (in full or part) because of them. In all cases, the court (or tribunal in the case of an arbitration) retains the discretion to amend any pre-agreed damages, whether of its own volition and/or at the application of a party.

Importantly, pre-agreed damages are to be distinguished from "penalty" clauses under English law.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Construction contracts in the UAE typically provide for:

- an "on demand" performance bond for 10% of the contract price;
- an "on demand" advance payment guarantee securing the employer's advance payments under the contract; and
- retention of 10% from each interim payment as security for the contractor's obligations to remedy defects during the defects notification period (or occasionally a bond in lieu of such retention).

Company guarantees from a contractor's parent or group company in favour of the employer are also fairly common, especially where the contracting entity is a special purpose vehicle.

7.6 Liens or Encumbrances in the Event of Non-payment

The Civil Code provides a contractor or consultant with the potential remedy of a statutory lien over property, in circumstances where the contractor or consultant's work has produced a beneficial effect on the property, but the employer has failed to pay for such work. This entitles the contractor or consultant to retain (and not hand over) the property they have improved pending payment for such work by the employer. However, this mechanism remains relatively untested, and contractors and consultants typically rely on contractual remedies for non-payment.

7.7 Requirements Before Use or Inhabitation

There are no express requirements to be satisfied under UAE law before a building may be inhabited or used, other than the issue of the "completion certificate". However, the law is unclear as to whether this requirement relates to the completion certificate from the relevant authority confirming that construction is complete, or to the completion certificate issued by the engineer under the construction contract.

In practice, a building completion certificate from the relevant municipality (following inspections of the works by the relevant authorities and civil defence) is usually stipulated as a contractual requirement before construction works can be used and occupied.

8. Tax

8.1 VAT and Sales Tax

Since 1 January 2018, VAT at the standard rate (5%) applies to the sale of commercial property (whether such property is newly constructed or not). If the transaction can be treated as a "transfer of a going concern", the transfer shall not be considered a supply for VAT purposes (hence no VAT will arise). The conditions for obtaining this treatment could be complex and require appropriate legal analysis.

8.2 Mitigation of Tax Liability

No methods are currently used to mitigate transfer, recordation, stamp or other similar tax liability on acquisitions of large real estate portfolios.

For CIT, various forms of business restructuring relief are available. These types of relief can significantly reduce the tax impact of intra-group transfers or transfers of a business (or an independent part thereof).

8.3 Municipal Taxes

In Abu Dhabi, a municipality fee applies to anyone leasing property, except UAE nationals. Fees are calculated at 5% of the rent (with a minimum of AED450), which is paid to the Abu Dhabi Distribution Company (ADDC) or Al Ain Distribution Company (AADC) on behalf of the DMT, in addition to water and electricity bills. Registration for the fees occurs automatically when the lease is registered with Tawtheeq.

In Dubai, a municipality fee applies on the occupation of property, and this is calculated as 5% of the annual rent or 0.05% of the value of the property (in the case of ownership). Value is generally treated as the amount for which the current occupier bought the property.

8.4 Income Tax Withholding for Foreign Investors

Income earned from immovable property in the UAE by foreign individual investors, who are considered UAE taxpayers based on the criteria provided in **2.10 Taxes Applicable to a Transaction**, is currently not subject to any withholding tax in the UAE, as the rate is set at 0%. However, it is important to note that this rate might change in the future.

Foreign legal entities that derive income from immovable property in the UAE will be considered to have a nexus in the UAE. Non-resident persons that have a nexus in the UAE are required to register for corporate income purposes.

8.5 Tax Benefits

Under the new UAE CIT regime, no specific rules have been introduced to date regarding depreciation deductions for real estate. However, in the absence of specific rules governing the depreciation of real estate assets, for tax purposes depreciation rules will default to the guidelines set out under applicable accounting standards (ie, the International Financial Reporting Standards).

UK



Law and Practice

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Hawkins Hatton Corporate Lawyers Ltd is a niche corporate law firm established in December 2005 and based in London and Dudley, dealing primarily with corporate and commercial work, commercial property and litigation. Its client base includes European and Anglo-US companies, national and regional clients, as well as individuals. The firm's real estate department is best known for secured lending work on behalf of HSBC Bank PLC, NatWest Bank PLC and RBS, as well as for all aspects of commercial property work on behalf of its SME client base, spanning a number of key industry sectors, including pharmaceuticals and healthcare, manufacturing, engineering, IT, hospitality and leisure. It advises on a wide range of property-related matters, including commercial acquisitions and disposals, commercial leases, secured lending and corporate support, and on a broad range of specialist areas, such as property investment and finance, development schemes, compulsory purchase issues and construction.

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1. General

1.1 Main Sources of Law

UK real estate law is derived from common law and statutory legislation. In relation to the latter, the primary legislation comprises:

- the Law of Property Act 1925, which reduced the number of legal estates to two and streamlined the transfer of interests in land for purchasers;
- the Land Charges Act 1972, which updated the process for registering charges against unregistered land; and
- the Land Registration Act 2002, which updated the law of land registration and stipulated the registration of shorter leases.

Reference will be made throughout this guide regarding the extent to which real estate law has been reformed since the primary legislation and new statutory legislation or regulations were introduced.

1.2 Main Market Trends and Deals

With UK interest rates at a 15-year high and inflation out of control, 2023 was a challenging time for the real estate sector, as the cost of borrowing increased and property values fell. This, coupled with a sharp decline in consumer spending due to the cost-of-living crisis, resulted in a very subdued UK economy.

With any distressed property market, there are always investors with capital waiting in the wings to take advantage of new opportunities. It is predicted that the real estate sector will see a wave of increased activity in 2024 as inflationary pressures ease, and interest rates are forecasted to not only stabilise at a reduced rate but possibly decrease further.

2024 will see unprecedented change, whether in the form of domestic legislative reforms, global politics, global stability or a change of UK government. These vast changes will directly impact on the UK economy, consumer spending and investor appetite for risk. As regards which real estate sectors will see the most activity, these will likely include the industrial and residential

sectors, as there is potential for rental growth, while the office and retail sectors continue to decline. CBRE Group reported that office investment in 2023 was at its lowest level in 20 years, with only GBP6.5 billion invested in the first three quarters of 2023. With the emphasis on environmentally sustainable buildings, office space in good locations with outdoor space is likely to see rental growth due to its scarcity. It is also predicted that technology companies will seek new office space, as (for example) artificial intelligence is likely to see its largest growth in 2024 due to increased private equity investment.

1.3 Proposals for Reform

The Building Safety Act 2022

This Act is now in force, imposing far-reaching legal responsibilities on those who:

- commission building work;
- are involved in design and construction; and
- manage structural/fire safety in relation to high-risk buildings.

The reforms came into force in stages, including in April 2023 and October 2023. Current high-risk buildings capable of occupation had to be registered with the Building Safety Regulator (BSR) by 30 September 2023. New high-risk buildings completed after 1 October 2023 must be declared as safe by the BSR prior to occupation.

The real issue continues to be costs or remedial works. The government issued a second consultation in January 2024 on a new building safety levy to raise revenue for dealing with defective cladding, which closed on 7 February 2024. There is no indication of when the levy will be launched, but the expectation is to raise GBP3 billion over ten years.

The Economic Crime (Transparency and Enforcement) Act 2022

This Act has been rushed through parliament due to the Ukraine conflict. The objective is transparency with regards to ownership of land in the UK by overseas entities (a legal entity governed by the law of a country outside the UK). The overseas entity must register its beneficial owner details on the Register of Overseas Entities to enable it to register any proprietorship at HM Land Registry. Where an overseas entity owned land in the UK when the Act came into force, it had six months to register its beneficial owner details in the Register of Overseas Entities. The deadline was 31 January 2023. After this date, any application to register a disposal at the Land Registry is caught by a restriction preventing registration of any disposal in the Register of Overseas Entities, unless the overseas entity is registered.

There has since been a further round of legislation, namely the Economic Crime and Corporate Transparency Act, which became law on 26 October 2023. The Act makes two principal changes to the Register of Overseas Entities, which will come into effect in 2024 – namely, it expands the scope of registrable beneficial interest for the purpose of the ROE and expands the information that must be delivered to Companies House. The changes are aimed at addressing the criticism that the true beneficial owners of a foreign entity were not being identified.

The Act will also deliver significant reforms to Companies House to improve transparency over UK companies and other legal entities to enhance national security.

The Act will reform the role of Companies House and improve transparency for UK companies and other legal entities, in order to enhance

national security and to combat economic crime, by ensuring the UK operates a more reliable companies' register.

The Act has brought in new powers for Companies House to improve its role in combating financial crime. New provisions in March 2024 include:

- identity verification checks for directors and people of significant control, and challenging of filings where the information is suspicious, false or misleading;
- a new requirement to obtain a registered email address and seek confirmation that the company has been formed for a lawful purpose; and
- Companies House having wider information-sharing powers to volunteer data with law enforcement agencies, regulators and public authorities, as well as wider powers to remove information from its register.

The Economic Crime and Corporate Transparency Act 2023 (Financial Penalty) Regulations 2024 were placed before Parliament in February 2024. These are expected to be passed in May 2024 and will permit the Registrar of Companies to impose a penalty on a person if it is satisfied beyond reasonable doubt that they have committed an offence pursuant to the Companies Act 2006.

Real Estate Investment Trusts

The real estate investment trust (REIT) regime has continued to evolve during 2023–2024 (see **5.3 REITs**).

Minimum Energy Efficiency Standards

The Minimum Energy Efficiency Standards (MEES) have applied to all new leases and renewals since April 2018. However, from April 2023, a landlord will be considered in breach if they let commercial property that has an EPC rating below E. It was expected that the minimum standard would be raised to a rating of B by 2030, but this may now occur at a slower rate than announced as consultations continue, with further legislation in 2024 to implement government policy.

The Charities Act 2022

Some of the provisions in this Act relating to the disposal of land by charities came into force in June 2023, and on 7 March 2024 the final phase of provisions came into force. This will mean that requirements under Section 23 of the 2022 Act (amending Section 122 of the Charities Act 2011 relating to the statements to be included within a disposition instrument) must be implemented. There will be no need for a trustee to certify compliance with the Charites Act 2011.

HM Land Registry

There is a new form for prescribed clauses in a lease for a term longer than seven years, and, unless these are adopted, from November 2023 HM Land Registry will have rejected the lease. The new prescribed clauses also make it clear whether a party is an overseas entity.

The Levelling-up and Regeneration Act 2023

This Act received Royal Assent on 26 October 2023, though a lot of the measures will not come into effect until further guidance and secondary legislation is passed. This Act, however, marks the beginning of wide-ranging planning reforms, with the expectation that these extensive reforms will make the planning system (which dates back to the Town and Country Planning Act 1947) a much easier, simpler, fairer and quicker system. The reforms clearly target meeting the demand for housing, with an inevitable impact on other sectors, such as the office, commercial and

energy sectors. Sweeping changes of this nature will require the government to commit resources and skills.

The Act also include proposals for the Secretary of State to obtain disclosure of the ownership of land. In December 2023, the government published a consultation (which closed on 21 February 2024) on transparency of land ownership involving trusts, in order to seek comments and to widen access to information held in the Register of Overseas Entities as well as ownership of land in the UK. This area will be subject to further reform.

The Act grants powers to local authorities to implement rental auctions for vacant high-street properties. How the regime will work remains to be seen.

The Act also sets out a framework for reform of the Community Infrastructure Levy and for replacing this with a new regime – the Infrastructure Levy – based on gross development value rather than floor space. These changes will be published at some point in 2024.

The Landlord and Tenant Act 1954

The Law Commission has announced a review of the commercial leasing rules, including (most importantly) the Landlord and Tenant Act 1954. The Commission is due to publish a consultation paper on the review by the autumn of 2024.

The Renters' Reform Bill

This was recently introduced to reform the private rental sector, including the abolition of Section 21 "no fault" evictions and measures to deal with rental increases. It will likely be passed in the autumn of 2024.

Biodiversity Net Gain

From 12 February 2024, all developers must understand the requirements of biodiversity net gain (BNG). The objective is to create and improve natural habitats by measuring the impact of development on biodiversity, and developers will have to deliver a net gain of at least 10% more than there was before the development.

The Leasehold and Freehold Reform Bill

The objective here is to reform home ownership in the UK, which includes making it easier for existing leaseholders to extend their leases or buy the freehold, as well as greater transparency in relation to costs (such as service charges).

The Leasehold Reform (Ground Rent) Act 2022

This Act limited ground rents on new long leases to a peppercorn, and the government has been consulting on broadening this to a retrospective cap on ground rents for existing leases. The consultation ended on 17 January 2024.

Law Society

The Law Society is consulting on a new draft code for the signing and exchanging of property contracts, with the objective being to allow the use of new technologies. It is likely that the new code will be mandatory for Conveyancing Quality Scheme residential transactions, but will likely not be mandatory for commercial agreements.

2. Sale and Purchase

2.1 Categories of Property Rights

The Law of Property Act 1925 creates two categories of property rights within England and Wales:

- freehold rights, where a proprietor has absolute control of a property and any dealings with it, as they own it in its entirety; and
- leasehold rights, where a proprietor does not own the property but is granted exclusive use of it subject to terms (including the period of occupation) agreed to in the lease.

2.2 Laws Applicable to Transfer of Title

Title to real estate is transferred by a sale contract and transfer. No special laws apply to the transfer of any specific types of real estate.

2.3 Effecting Lawful and Proper Transfer of Title

A lawful and proper transfer of title is effected by submitting a duly executed transfer deed to HM Land Registry under cover of an AP1 form. This transfers the legal interest in the property from the seller to the purchaser. On receipt of the deed, the Land Registry will register the legal interest of the new proprietor and generate an electronic register of the property showing the purchaser as the new owner of the property. This registration process is stipulated by the Land Registration Act 2002. Since November 2022, AP1 applications to change the register have been electronic through the Digital Registration Service, and the process of manually competing an AP1 and uploading it to the portal has been withdrawn.

It is possible to obtain title insurance. However, this is not common, as the expectation is that a purchaser will fully interrogate and investigate the title.

2.4 Real Estate Due Diligence

Real estate due diligence is carried out at all stages of a transaction. This is usually undertaken as follows.

The purchaser's conveyancer will interrogate the title to the property being purchased, and will raise enquiries of the seller to:

- understand what rights the property has the benefit of and is subject to;
- identify any covenants or restrictive covenants to which the property is subject that may affect the use of the property (eg, it would not be advisable to complete the sale of a property that has a total restriction on the property being used as an office if it is the client's intention to use the property for this purpose); and
- highlight any security registered against the property, which will need to be discharged prior to completion of the transaction.

The purchaser's conveyancer also undertakes searches against the property, namely:

- a contaminated land search to identify any contamination issues;
- a drainage and water search to identify whether the property is connected to the mains water and drainage system;
- a coal and mining search to identify whether the property is located on or close to a mining area;
- a chancel repair search to identify any chancel repair liability; and
- a local authority search to identify any planning permissions or building regulation approvals/issues.

The purchaser's conveyancer also raises standard enquiries in respect of the property for the seller to reply to (see **2.5 Typical Representations and Warranties**).

2.5 Typical Representations and Warranties

In commercial property transactions, the seller is asked to provide replies to commercial property standard enquiries (CPSEs). These raise questions regarding, for example:

- boundary disputes and maintenance;
- compliance with statutory obligations and planning permissions;
- environmental issues;
- VAT position; and
- capital allowances.

The answers provided in the replies to CPSEs constitute warranties provided by the seller to the buyer.

The buyer's remedies for misrepresentation are rescission and/or damages, depending on whether the misrepresentation was fraudulent, negligent or innocent.

2.6 Important Areas of Law for Investors

An investor must consider proposed changes in legislation (including tax) that may impact on the financial viability of the transaction, given that an investor's objective is to derive capital growth and/or secure income.

From April 2020, new legislation has meant that a landlord will only be allowed a 20% tax credit for mortgage interest paid. This has two main implications for landlords:

- if the landlord is a higher-rate taxpayer, only a 20% tax refund will be given (not the higher rate of tax paid); and
- it may force landlords into a higher tax bracket, as they will have to declare the monies paid on the tax return.

This change is affecting investment by landlords in buy-to-let properties.

In April 2023, the rate of UK corporation tax on income and gains increased from 19% to 25% for companies with profits in excess of GBP250,000. This increase will affect UK and non-UK corporate investors. This may encourage investors to consider the UK REIT as a means of holding UK real estate. In December 2022, the UK government removed the requirement for a REIT to own a minimum of three properties, provided the portfolio contains a single property valued at GBP20 million.

Further changes to REITs were proposed in 2023 to improve the tax rules, and these reforms will take effect in 2024 with the passing of the Finance Act 2024, which attained Royal Assent on 22 February 2024. One of the changes is that investors will not be treated as being "holders of excessive rights" (which can give rise to tax liabilities for the REIT) if such holders are taxed at a double tax agreement at a set rate.

The annual tax-free allowance for capital gains tax (CGT) dropped from GBP12,300 to GBP6,000 in April 2023. This means that, when a property is sold, one will only pay tax on gains over this amount. This was expected to drop further in April 2024, to GBP3,000. This will discourage investors in property.

Stamp duty land tax (SDLT) is also a consideration for property investors (see **2.10 Taxes Applicable to a Transaction**). A 3% penal rate of SDLT applies on top of the standard rate for each subsequent purchase by a purchaser who owns one or more dwellings. SDLT is also payable where non-residential or mixed-use land is purchased for more than GBP150,000.

2.7 Soil Pollution or Environmental Contamination

Land is considered contaminated where substances either are causing or could cause:

- significant harm to people, property or protected species;
- significant pollution of surface waters or groundwater; or
- harm to people as a result of radioactivity.

Generally, the person who caused or allowed the contamination to occur is liable for it unless they cannot be identified or the local council/environmental agency considers them exempt. The council may decide that the landowner or the person who occupies the land is liable for the contamination. Owners or occupiers who cause contamination remain liable after the disposition of the land, whereas an owner/occupier who is not a polluter has no liability when their ownership or occupation of the property ceases.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A local authority search will identify the permitted use of a parcel of land and whether this use has planning permission.

Where the property does not have planning permission for the permitted use, the seller/occupier of a commercial property can obtain a lawful development certificate for existing use or development, provided it can show that the property has been used for that purpose for a continuous period of ten years or more. A local authority can take no enforcement action once ten years have elapsed from the date of the breach (ie, the date on which the unlawful use of the property started).

An indemnity policy is usually readily available for providing cover to protect against the risk of any enforcement action.

In relation to a building completed more than four years ago, where the building has been used as a dwelling for more than four years, a lawful development certificate can be obtained.

It is possible to obtain authorisation from the local authority in respect of change of use, and it is always recommended that, prior to any development work, clients obtain the relevant planning permission from the local authority. This planning permission will include the permission required to undertake the planned works and to use the property following completion.

The Town and Country Planning (Use Classes) (Amendment) (England) Regulations 2020 introduced substantial changes to the Town and Country Planning (Use Classes) Order 1987. These changes came into force from 1 September 2020. The key changes are:

- Classes A, B1 and D1, applicable to retail, office and non-residential institutions, and to assembly and leisure, have been removed and replaced with a new Class E;
- there is also a new Class F1 and F2 relevant to education, learning and non-residential local community institutions; and
- some uses (for example, as a public house, cinema and bingo hall), which used to have their own class, have now moved into the sui generis category.

The above changes are subject to transitional arrangements.

2.9 Condemnation, Expropriation or Compulsory Purchase

A compulsory purchase order (CPO) of property enables councils, central government, utility companies, etc, to purchase land if it is in the public interest to do so. "Public interest" could include:

- town-centre regeneration;
- housing developments;
- road-building projects;
- rail-building projects; and
- airport expansions.

If a CPO is granted, the landowner is paid compensation for the loss of the property.

Notice is served on the landowner of a proposed CPO, and approval from the government/parliament is then obtained. This notice will set a time limit for the landowner to lodge any objections. These are considered by the relevant authority, which then decides whether the CPO should be granted.

If a CPO is granted, the purchase will proceed, and the landowner will be compensated. The compensation is usually equivalent to the market value of the property together with reasonable moving costs, SDLT for buying an equivalent home, and reasonable legal and lender's fees.

2.10 Taxes Applicable to a Transaction

SDLT is payable by the buyer on all property transactions in the UK. The rates of SDLT are determined by the price of the property and the designated use of the property (ie, whether it is commercial or residential).

Multiple dwellings relief (MDR), where purchasers of residential property acquire more than one dwelling in a single transaction or linked transactions, is abolished for transactions with an effective date on or after 1 June 2024. For contracts which exchanged on or before 6 March 2024, MDR will continue to apply, even where completion of the purchase takes place on or after 1 June 2024. This is subject to there being no variation of the contract after 6 March 2024.

MDR will continue to apply to contracts that are substantially performed before 1 June 2024.

For linked transactions which include the purchase of dwellings both before and after the change, those pre- and post-change transactions will be treated as unlinked for the purposes of MDR.

Residential Property Rates

SDLT is usually payable on property prices above GBP250,000. From September 2022, the SDLT rates are:

- GBP0 to GBP250,000 – 0%;
- GBP250,001 to GBP925,000 – 5%;
- GBP925,001 to GBP1.5 million – 10%; and
- more than GBP1.5 million – 12%.

Relief for First-Time Buyers

First-time buyers pay no SDLT on properties worth up to GBP425,000; thereafter, the usual rates apply.

Residential Leasehold Sales and Transfers

If a new residential leasehold property is purchased, SDLT is payable on the purchase price (premium) of the lease as if it was the sale price of a freehold property. The level of rent due under the lease is not taken into account.

Higher Rates of SDLT

A 3% penal rate of SDLT applies on top of the standard rate for each subsequent purchase by a purchaser who owns one or more dwellings.

SDLT is also payable where non-residential or mixed-use land is purchased for more than GBP150,000. For between GBP150,000 and GBP250,000, the rate is 2%, and thereafter 5%.

Non-residential property includes:

- commercial property (eg, shops or offices);
- agricultural land;
- forests;
- any other land or property not used as a residence; and
- six or more residential properties bought in a single transaction.

A "mixed-use" property is one that has both a residential and non-residential element (such as a flat above a shop).

SDLT rates on non-residential and mixed-use land are:

- GBP0 to GBP150,000 – 0%;
- GBP150,001 to GBP250,000 – 2%; and
- more than GBP250,001 – 5%.

Non-residential Leasehold Sales and Transfers

If a new non-residential leasehold property is purchased, in the event that the total rent of the lease over the duration of the lease is GBP150,000, SDLT at a rate of 1% is payable above GBP150,000.

- GBP0 to GBP150,000 – 0%;
- GBP150,001 to GBP5 million – 1%; and
- more than GBP5 million – 2%.

SDLT Reliefs and Exemptions

Reliefs

The following reliefs can be applied for:

- first-time buyer;
- multiple dwellings;
- a building company buying an individual's home;
- employers buying an employee's house;
- local authorities making compulsory purchases;
- property developers providing amenities to communities;
- companies transferring property to another company;
- charities;
- right-to-buy properties; and
- registered social landlords.

Exemptions

SDLT is not payable and no SDLT return needs to be filed if:

- no money or other payment changes hands for a land or property transfer;
- property is left in a will;
- property is transferred because of divorce or dissolution of a civil partnership;
- freehold property is purchased for less than GBP40,000;
- a new lease of more than seven years is purchased or assigned, provided that the premium is less than GBP40,000 and the annual rent is less than GBP1,000;
- a new lease of less than seven years is bought or assigned, provided that the amount paid is less than the residential or non-residential SDLT threshold; and/or
- an alternative property financial arrangement is used.

SDLT on Residential Property Owned by a Corporate Vehicle

SDLT is charged at 15% on residential properties costing more than GBP500,000 that are bought by certain corporate entities. However, the 15% rate does not apply to property bought by a company acting as a trustee of a settlement or property bought by a company to be used for:

- a property rental business;
- property developers and traders;
- property made available to the public;
- financial institutions acquiring property in the course of lending;
- property occupied by employees;
- farmhouses; and
- a qualifying housing co-operative.

In addition, there is a 3% surcharge on residential properties bought by companies.

SDLT on Shares in a Company

SDLT is payable at a rate of 0.5% of the entire transaction. SDLT will be payable on transactions, including a change of control of a company if shares are sold.

Value-Added Tax (VAT)

The sale of real estate is exempt from VAT unless the seller has opted to tax the land and buildings. Most new-build commercial properties will attract standard-rate VAT at 20%. If, however, a property is acquired with a sitting tenant, the "transfer as a going concern" exemption will apply, provided that both parties are VAT-registered, and hence no VAT will be payable on the purchase price. This exemption only applies where the buyer opts to tax the property before transfer.

HMRC has made some changes to the process for opting a property for tax – namely, HMRC will no longer issue an acknowledgement of the option for tax application. The requirement for a person to notify HMRC of the exercise of an option to tax will remain, and can be charged within 30 days of that VAT.

Capital Gains Tax (CGT)

CGT is payable by an individual on the disposal of residential real estate in the UK (other than the individual's main residence) in respect of the gain (profit) made, at a rate of 28% for a higher-rate taxpayer and at a lower rate for a basic-rate taxpayer. A 20% CGT rate applies for commercial property.

A UK-based company will pay corporation tax at a rate of 25% on the investment gain (subject to any indexation allowance, which now only accrues up to 31 December 2017) on the disposal of a commercial or residential property.

Since April 2023, the tax-free allowance dropped from GBP12,300 to GBP6,000, dropping further to GBP3,000 in April 2024.

The CGT exemption for non-resident investors in respect of non-residential property was removed from April 2019, albeit with exemptions.

"Non-resident" CGT (NRCGT) is payable at 28% on any post-April 2015 gains made on UK residential property by individuals who are non-resident for tax purposes.

From 6 April 2019, NRCGT was extended to post-April 2019 gains in respect of commercial property, albeit with certain exemptions.

2.11 Legal Restrictions on Foreign Investors

There are currently no restrictions on foreign investors acquiring property in the UK.

See under **The Economic Crime (Transparency and Enforcement) Act 2022** in **1.3 Proposals for Reform**.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial property are generally financed by borrowing from institutional banks/lenders. However, many companies also purchase property using their available resources, without the need for any finance.

There are also a number of private companies that offer finance to developers to assist with projects and development opportunities.

3.2 Typical Security Created by Commercial Investors

A lender will require a first legal charge to be registered against the property as security for the advanced loan.

If the purchaser of a property is a company, the lender will usually require a debenture over the company's assets. If a holding company (ie, a company that does not trade) purchases a property, the lender will usually require a lease between the holding company and its trading company so that the monthly repayments under the mortgage can be secured.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

There are no restrictions other than compliance with the anti-money laundering legislation.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

A modest fee is payable for registering security over property or a company. This fee is payable to either the Land Registry in respect of a legal charge/mortgage or to Companies House in relation to a debenture or charge over shares. In addition, enforcement of security would attract court fees and legal fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Before an entity can give valid security over its real estate assets, a private company director will need to ascertain their director's duties and whether the transaction is for the company's benefit. They also need to confirm that the company is solvent in accordance with the Companies Act 2006. If the corporate benefit of giving security cannot be established, a director could be in breach of their duties to the company. Directors are encouraged to record the basis of their decisions in board minutes and identify the corporate benefit. It is also advisable to ask the company's auditor to confirm the company's solvency.

3.6 Formalities When a Borrower Is in Default

Provided the lender has secured its mortgage through registration of a legal charge against the property asset with the Land Registry, there are usually no obstacles to enforcing its security in the case of a default. A lender will usually enforce the security by the appointment of a Law of Property Act (LPA) receiver, who will manage the disposal of the property asset and repayment of the debt (together with the cost of realisation) from the sale proceeds.

At the point of enforcement, no further steps can be taken to give priority to the lender's security

above that of other creditors. Priority of security is a matter to be addressed by a deed of priority when making the loan.

3.7 Subordinating Existing Debt to Newly Created Debt

The rules governing the priority between two different security interests over the same asset vary for different types of assets.

In order for a particular security interest to take priority over an earlier security interest, one or a combination of the following circumstances must usually apply:

- the later security is a "better" type of security (legal rather than equitable, fixed rather than floating);
- the holder of the later security was not aware or is deemed to have been unaware of the earlier security; and/or
- the later security has been better perfected or was perfected first.

Secured creditors will usually agree on the priority of their respective secured interests contractually by virtue of a deed of priority, which will rank the priority of the secured interests on enforcement.

3.8 Lenders' Liability Under Environmental Laws

A lender cannot generally be liable for environmental damage unless it is responsible for the cause or knowingly permits the damage. A lender does, however, need to be mindful that, if it takes possession of the property at enforcement of its security, it may then have a liability relating to any environmental issues as an owner of contaminated land or as a knowing permitter.

3.9 Effects of a Borrower Becoming Insolvent

The secured interests of a lender are not affected by the insolvency of a borrower. However, during an administration, a lender may not start or continue legal proceedings against the company and/or enforce security without leave of the court.

3.10 Taxes on Loans

From April 2020, new legislation has meant that a landlord will only be allowed a 20% tax credit for mortgage interest paid. This has two main implications for landlords:

- if the landlord is a higher-rate taxpayer, only a 20% tax refund will be given (not the higher rate of tax paid); and
- it may force landlords into a higher tax bracket, as they will have to declare the monies paid on the tax return.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Government plans and development aspirations are contained in policy statements, including the National Planning Policy Framework (NPPF), which applies only to England. This provides the programme for generating local plans for housing and other developments. It is against the background of these local plans that applications for planning permission are determined.

The local planning authorities (LPAs) are also motivated to prepare a local plan which sets planning policies in a local authority area. If there is no local plan, LPAs will be deemed to adopt a "presumption in favour of sustainable devel-

opment". The NPPF was revised in light of the Levelling-up and Regeneration Act 2023. See **1.4 Proposals for Reform**.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The LPA will decide whether a proposed development of a property should be permitted.

The developer seeking to obtain planning permission will submit plans and specifications of the intended work to be undertaken to the relevant LPA.

Planning permission is required for most new buildings, major alterations to existing buildings, and significant changes to the use of a building or piece of land. When planning permission is granted, it is usually subject to strict conditions with which a developer must comply.

Building Regulations Approval

Building regulations are minimum standards for design, construction and alterations to almost every building. A landowner applies to its local authority building control department for building regulations approval. Examples of where building regulations approval will likely be required include:

- when erecting a new building;
- when extending or altering an existing building; and
- when providing services and/or fittings in a building (such as washing and sanitary facilities, hot water cylinders, foul water and rainwater drainage, replacement windows and fuel-burning appliances of any type).

When the work is carried out, it must meet the relevant technical requirements in the building regulations. In addition, the work must not make other fabric, services and fittings less compliant or more dangerous than they were before.

4.3 Regulatory Authorities

The local authorities for regional areas regulate the use of individual parcels of real estate, subject to prevailing primary and secondary legislation.

4.4 Obtaining Entitlements to Develop a New Project

It is usual for LPAs to notify any neighbouring properties of a new development project or major refurbishment. Notices are displayed, and the parish, town or community council is usually notified. This enables third parties to provide their comments on the proposed planning permission.

The LPA will then consider any minor changes to the planning permission in light of these comments. Third parties have the right to apply for a judicial review of an LPA decision if they have reason to believe that a decision has been reached unlawfully.

4.5 Right of Appeal Against an Authority's Decision

If the LPA refuses permission or imposes conditions, it must provide written reasons. Appeals must be submitted within six months of the date of the application decision letter.

4.6 Agreements With Local or Governmental Authorities

It may be necessary to enter into agreements with local or governmental authorities or agencies, or with utility suppliers, to facilitate a development project. These agreements can include (for instance) the developer committing to payments towards local infrastructure improvement

projects, or the provision of new highways or drainage systems. The objective of such agreements is to mitigate the effects of development.

4.7 Enforcement of Restrictions on Development and Designated Use

If the LPA considers that planning has been carried out in breach of the terms of the planning permission, an enforcement notice will be issued. This notice will identify the breach and stipulate what steps the LPA intends to take. Failure to comply with an enforcement notice could result in a fine. Alternatively, a breach-of-condition notice can be given as an alternative to an enforcement notice, in which case the developer is required to remedy the breach of condition.

During the development, the LPA will undertake site visits to inspect compliance with building regulations. Failure to comply can result in enforcement action in the form of prosecution and/or an enforcement notice requiring the alteration or removal of work that contravenes the regulations. If the owner does not comply with the notice, the local authority has the power to undertake the work itself and recover the costs from the owner.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Entities available to investors to hold real estate assets include:

- limited liability partnerships (LLPs);
- private limited companies; and
- public limited companies.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

LLPs

LLPs are comprised of members in partnership with limited liability. The relationship between the members is usually governed by a members' agreement. An LLP is taxed in the same way as a partnership.

Private Limited Companies

Private limited companies are comprised of shareholders who own share capital of the company proportionate to their individual levels of capital investment. Directors (who may or may not include shareholders) are appointed to run the company. The shareholders have personal liability protection, and their relationship is governed by a shareholders' agreement. This entity is liable for corporation tax, and shareholders only pay tax on dividends.

Public Limited Companies

A public limited company is a limited liability company, the shares of which may be sold and traded to the public and listed on a stock exchange. It can, therefore, raise money by selling shares to the general public.

5.3 REITs

REITs are a popular means for UK property investment as they benefit from tax exemptions on income and capital gains, especially given the UK corporation tax increase from 19% to 25%. Foreign investors are encouraged to consider REITs as a means of holding UK real estate. In December 2022, the UK government removed the requirement for a REIT to own a minimum of three properties, provided that the portfolio contains a single property valued at GBP20 million.

Further changes to REITs were proposed in 2023 to improve the tax rules, and these reforms

will take effect in 2024 on the passing of the Finance Act 2024, which attained Royal Assent on 22 February 2024. One of the changes is that investors will not be treated as being "holders of excessive rights" (which can give rise to tax liabilities for the REIT) if such holders are taxed at a double tax agreement at a set rate.

5.4 Minimum Capital Requirement

No minimum capital requirement applies in the case of LLPs and private limited companies. A public limited company must have a minimum issued share capital of GBP50,000, with at least 25% (GBP12,500) of this being paid up in full.

5.5 Applicable Governance Requirements

LLPs are governed by UK company law, but differ from limited companies in that members of an LLP can manage their own interests without forming a board.

Private limited companies are governed by the Companies Act 2006, and have a constitution (articles of association) to assist the shareholders and directors in regulating their relationship with the company and each other.

Unlike private limited companies, public limited companies require at least two directors and a company secretary. They are otherwise governed by UK company law. If a public limited company is trading on a stock exchange, it will be subject to the regulations of that exchange.

5.6 Annual Entity Maintenance and Accounting Compliance

The costs of annual entity maintenance and accounting compliance vary, subject to the extent of the portfolio of properties owned by each entity.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The law recognises the following arrangements that allow a person, company or other organisation to occupy and use real estate for a limited period of time without buying it outright:

- a lease, which grants exclusive occupation of the property for an agreed period; and
- a licence, which grants occupation of a property without exclusive possession.

6.2 Types of Commercial Leases

There are no specific different types of commercial leases. The nature of any lease, in terms of its duration, rental, break clause, etc, is a matter of negotiation and agreement between the parties.

The Code for Leasing Business Premises came into force in September 2020, with the aim of assisting negotiations in producing comprehensive heads of terms to make the legal drafting process more effective.

6.3 Regulation of Rents or Lease Terms

The Code for Leasing Business Premises provides a code of practice governing the negotiation of leases between landlords and tenants. On 23 March 2020, the UK government announced that commercial landlords could not pursue forfeiture of a commercial lease for non-payment of rent pursuant to Section 82 of the Coronavirus Act 2020. This prohibition remained in force until restrictions were lifted in March 2022, except for restrictions on rent arrears during the pandemic which had to be decided by arbitration. On 23 September 2022, all restrictions were lifted and

the lease forfeiture procedure is now governed by the contractual lease.

6.4 Typical Terms of a Lease

There is no typical length of a lease.

A tenant will generally covenant to maintain and repair the property in a long lease. A tenant will limit its liability by recording the state of repair of the property at the commencement of the lease with a schedule of condition.

It is usual for lease rents to be paid quarterly, namely on March 25th, June 24th, September 29th and December 25th.

Following the COVID-19 pandemic, the parties to a commercial lease will give consideration to more flexible arrangements, such as rent-free periods, break clauses and/or rental based on turnover or performance criteria.

6.5 Rent Variation

The rent payable under a lease will remain the same for the duration of the lease term, unless there is a rent review clause.

6.6 Determination of New Rent

New rent under an existing lease will be determined in accordance with the rent review clause, if such a clause exists. It is usual for the rent review clause to be "upwards only". The revised rent will be the greater of the rent payable at the time of the rent review and the market rent determined by a surveyor.

Less common rent review clauses provide that the rent will be reviewed in line with inflation.

6.7 Payment of VAT

VAT is only payable on rent at the current rate of 20% if the landlord has opted to tax the property.

6.8 Costs Payable by a Tenant at the Start of a Lease

A deposit may be payable under a rent deposit deed at the start of a lease. In addition, a tenant will be responsible for the registration of the lease (if it is for more than seven years), as well as for payment of the modest registration fee. SDLT is also payable for a commercial lease, as detailed in **2.10 Taxes Applicable to a Transaction**. Subject to negotiation, insurance rent and service charges may also be payable at the outset.

6.9 Payment of Maintenance and Repair

The landlord is responsible for the maintenance and repair of the common areas used by tenants. The landlord will usually undertake to provide these services on the estate and recoup the cost from tenants via a service charge.

6.10 Payment of Utilities and Telecommunications

A tenant will be responsible for the utilities it consumes, and these will be apportioned according to the space occupied by the tenant, unless the supply is segregated.

6.11 Insurance Issues

The landlord usually insures the property and passes this cost on to the tenant.

The typical risks insured against include:

- fire;
- explosion;
- lightning;
- earthquake;
- storm;
- flood;
- bursting and overflowing of water tanks, apparatus or pipes;

- impact by aircraft and articles dropped from them;
- impact by vehicles;
- subsidence;
- ground slip;
- heave;
- riot; and
- civil commotion.

6.12 Restrictions on the Use of Real Estate

The tenant is under obligation to use the property in accordance with the legal permitted use. See **2.8 Permitted Uses of Real Estate Under Zoning or Planning Law** on the new classes of use. In addition, a lease will usually specify that a tenant cannot use the property for any illegal or immoral purpose.

Further restrictions on use can be agreed upon as part of the lease negotiations. A landlord can restrict the use of the property by agreement with the tenant. For example, if one tenant on an estate has entered into an exclusivity agreement for a specific type of use of a property (eg, an Indian restaurant), the landlord can restrict the use of other properties on the estate within this area in order to comply with the exclusivity agreement.

6.13 Tenant's Ability to Alter and Improve Real Estate

A lease will prohibit the tenant from undertaking any external or internal structural work to the property without the landlord's consent. Even internal, non-structural alterations to the property usually require the landlord's consent in the form of a licence to alter.

6.14 Specific Regulations

One of the key statutory regulations which applies to commercial leases is the Landlord and Tenant Act 1954. This legislation provides business tenants with security of tenure unless the statutory provisions are formally contracted out.

An abundance of statutory regulation applies for residential leases and agricultural tenancies, on which specific advice should always be sought.

6.15 Effect of the Tenant's Insolvency

A lease usually provides that the landlord can end the lease (forfeit) and regain the property if the tenant becomes insolvent.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

If a landlord is concerned about a tenant's ability to meet its obligations under a lease, it can require a rent deposit for particular rental payments. This usually comprises the payment of up to three months' rent upfront, which can be used in the event of default. The landlord can also insist on a personal guarantor.

6.17 Right to Occupy After Termination or Expiry of a Lease

A business tenant is able to remain in occupation after the expiry of the term of a lease if the lease is not contracted out of the security-of-tenure provisions of the Landlord and Tenant Act 1954.

If the lease is protected, the landlord can only bring the lease to an end on the expiry date by providing the tenant with formal notice (of not less than six months and not more than 12 months) that one of the following is applicable to the property:

- the tenant has breached a repairing covenant;
- the tenant has persistently delayed paying the rent;
- the tenant has breached other obligations;

- the landlord has offered the tenant the availability of alternative accommodation;
- a subtenant is in place at the property and possession is required for letting or disposing of the whole property;
- the landlord intends to demolish or reconstruct the property; and/or
- the landlord intends that its own business should occupy the building.

6.18 Right to Assign a Leasehold Interest

Most commercial leases include the right for a tenant to assign its interest or to sublease. This is subject to obtaining the landlord's consent by virtue of a licence to assign/sublease. A landlord will permit an assignment subject to conditions, including:

- the new tenant ("assignee") providing a rent deposit to the landlord (pursuant to a rent deposit deed) as security for performance of the obligations under the lease; and
- an authorised guarantee agreement (AGA) whereby the original tenant ("assignor") will guarantee the performance by the assignee of the obligations under the lease.

Regarding a sublease, this is a contract between the original tenant and the new tenant (subtenant) whereby the subtenant takes over the rented premises and pays rental directly to the original tenant, and the original tenant remains directly liable to the landlord. The landlord's consent to the sublease should be obtained with the usual condition for consent being that the subtenant can only use the property for the purposes that the landlord has approved in the lease, and subject to the sublease terms mirroring those of the head lease.

6.19 Right to Terminate a Lease

The landlord is typically able to forfeit the lease if one of the following events occurs:

- any rent is unpaid 14 days after becoming payable, whether it has been formally demanded or not;
- any breach of any condition or tenant covenant in the lease; and/or
- the tenant becomes insolvent.

Additionally, both parties may have a contractual right to break the lease or negotiate a surrender of the lease.

6.20 Registration Requirements

Commercial leases granted for a period of more than seven years are required to be registered at the Land Registry, and registration needs to be completed within two months of the completion of the lease. The responsibility for registration lies with the tenant, as it protects the tenant should the property change ownership.

A lease for seven years or less can be noted on the landlord's title. Any Land Registry fees are to be paid by the tenant and, prior to registration, any SDLT which is payable (see **2.10 Taxes Applicable to a Transaction**) will need to be paid and a certificate obtained for filing at the Land Registry.

6.21 Forced Eviction

A landlord can commence forfeiture proceedings to end the lease prior to the expiry date on the grounds of the tenant's default. How long the process takes is dependent on various factors, including whether the tenant seeks relief from forfeiture.

6.22 Termination by a Third Party

A lease could be terminated by a third party (eg, the government) if the public interest so required. For such a process to take place, the requisite public law requirements/criteria would need to be met and, where relevant, compensation would be payable.

6.23 Remedies/Damages for Breach

On termination of a lease, a landlord is entitled to pursue a tenant for damages to be compensated for the loss arising out of the tenant's breach of the lease terms, whether that be non-payment of rent or failure to maintain/repair the premises or wider damage to the property.

The issue faced by the landlord is demonstrating the diminution in value of its property due to the damage or disrepair, coupled with the landlord's general duty to seek to mitigate its losses. The landlord would have the rent deposit at its disposal, to seek to recover some of the losses sustained. The landlord also has to be mindful of the extent to which any property damage is covered by property insurance.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Lump-sum or fixed-price contracts comprise a total fixed price for all construction work. They are the most commonly used form of contract.

Cost-plus contracts comprise payment of the actual costs, consumptions or other expenses relating directly to the construction work.

Measured contracts define the buildings that will be covered by the work, the period over which work may be required and an estimate of the likely total value of the work.

7.2 Assigning Responsibility for the Design and Construction of a Project

The "traditional" procurement method, often referred to as "design bid build", is the most commonly used method of procuring construction work. This is where design consultants are appointed to design the project in detail, and contractors are invited to tender for the construction of the designed project. The design consultants are responsible for the design and the contractor is responsible for the construction work.

The "design and build" procurement method, as its name suggests, is where the contractor is appointed to design and construct, as opposed to a traditional contract where the client appoints design consultants to design the development and a contractor is then appointed to construct the project.

7.3 Management of Construction Risk

A percentage (often 5%) of the amount certified as due to the contractor on an interim certificate is deducted from the amount due and retained by the client. The reason for the retention is to encourage the contractor to discharge its duties fully under the contract.

Limitations and Exclusion of Liability

The three most common methods of limiting liability are:

- caps on liability, where the amount payable in the event of a breach is capped;
- net contribution clauses, where a claimant must pursue a claim against all parties responsible for damage to seek full recovery of loss; and

- exclusion clauses, which, if agreed to and upheld, would negate any liability for loss or damage (liability for death or personal injury cannot be excluded).

Collateral Warranties

Collateral warranties are agreements that are related to another "primary" contract. They extend the duty of care by one of the contracting parties to a third party that is not a party to the primary contract. For example, an architect of a new development owes a duty of care to an occupier of the development despite there being no contractual relationship between the architect and the occupier.

7.4 Management of Schedule-Related Risk

Schedule-related risk is the risk that construction work may take longer than scheduled. Delay can lead to cost risk; hence this is usually managed by the contract, including a clause to pay liquidated and ascertained damages (LADs) to the client if the contract is delayed. LADs are not penalties; they are damages pre-determined at the outset of the contract based on a real calculation of the actual loss the client is likely to incur if the completion date is delayed.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Performance Bonds

A performance bond is used in relation to construction projects as a means of insuring a client against the risk of a contractor defaulting on the contract obligations. A performance bond is provided by a third party up to an agreed amount.

Parent Company Guarantees

A parent company guarantee (PCG) is also a form of protective security in the event of default on a contract by a contractor controlled by a parent company (or holding company). These are particularly helpful when a small contractor is retained who is part of a more financially viable parent company.

Escrow Accounts

Escrow accounts are also used as holding accounts for construction project funds. They are usually set up by a solicitor acting on behalf of one of the parties. The terms of the agreement will specify that the payments must be protected, so as to provide security should a party default on payment.

7.6 Liens or Encumbrances in the Event of Non-payment

No information is available on this topic.

7.7 Requirements Before Use or Inhabitation

Contractors and/or designers are permitted, subject to an express agreement, to exercise a lien or otherwise encumber a property in the event of non-payment, and this can only be removed upon payment of the outstanding fees.

8. Tax

8.1 VAT and Sales Tax

The sale of real estate is exempt from VAT unless the seller has opted to tax the land and buildings. Most new-build commercial properties will attract a standard-rate VAT of 20%.

If, however, a property is acquired with a sitting tenant, the "transfer as a going concern" exception will apply, provided that both parties are VAT-registered, and hence no VAT will be payable on the purchase price. However, this exemption only applies where the buyer opts to

tax the property before transfer. See **6.7 Payment of VAT**.

8.2 Mitigation of Tax Liability

Mitigation of tax liabilities (such as SDLT or CGT) arising from the transfer of property requires specialist tax input and is specific to circumstances. However, investors need to be mindful that the manner in which the legal title to the property is held, whether as an individual or as a corporate entity, will affect the applicable tax rates, available reliefs and options for mitigating any liability. For example:

- if a property is owned by a company, then rather than transfer the property, shares could be sold, which would attract no SDLT; or
- if property assets are transferred within a corporate group structure where SDLT relief is available or assets are held in a partnership between connected parties, and the partnership is then incorporated, SDLT can be avoided.

See **2.10 Taxes Applicable to a Transaction**.

8.3 Municipal Taxes

Business rates will be payable on the occupation of business premises, such as:

- shops;
- offices;
- pubs;
- warehouses;
- factories; and
- holiday rental homes or guesthouses.

The domestic rates will be payable to the local council in March of each year in respect of the amount required in the following tax year.

The following are examples of available reliefs from business rates:

- small business rate relief;
- rural rate relief;
- charitable rate relief;
- enterprise zone relief;
- hardship relief;
- exempted buildings and empty buildings relief; and
- transitional relief if one's rates change by more than a certain amount at revaluation.

8.4 Income Tax Withholding for Foreign Investors

The Non-resident Landlord Scheme

A landlord who resides abroad for more than six months of the year must pay tax on any rental income received from a property in the UK. If the landlord is a company or trustee, the rules relating to their usual place of abode apply. The tax is collected using the Non-resident Landlord (NRL) Scheme. The tax can be paid by either the letting agent or tenant.

8.5 Tax Benefits

There are tax benefits to owning real estate, but these require specialist tax advice/input.

Trends and Developments

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Hawkins Hatton Corporate Lawyers Ltd is a niche corporate law firm established in December 2005 and based in London and Dudley, dealing primarily with corporate and commercial work, commercial property and litigation. Its client base includes European and Anglo-US companies, national and regional clients, as well as individuals. The firm's real estate department is best known for secured lending work on behalf of HSBC Bank PLC, NatWest Bank PLC and RBS, as well as for all aspects of commercial property work on behalf of its SME client base, spanning a number of key industry sectors, including pharmaceuticals and healthcare, manufacturing, engineering, IT, hospitality and leisure. It advises on a wide range of property-related matters, including commercial acquisitions and disposals, commercial leases, secured lending and corporate support, and on a broad range of specialist areas, such as property investment and finance, development schemes, compulsory purchase issues and construction.

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With UK interest rates at a 15-year high and inflation out of control, it is no wonder that 2023 was a challenging time for the real estate sector, as the cost of borrowing increased and property values fell. This, coupled with a sharp decline in consumer spending due to the cost of living crisis, resulted in a very subdued UK economy.

The real estate sector in the UK and, indeed, further afield has been reshaped by COVID-19, and the trends which emerged during the pandemic continue to impact on property investors' appetite towards certain categories of property assets. In particular, office space remains empty and underutilised as remote working has become the norm. Hybrid working is a primary means of attracting talent in an ever-decreasing talent pool, with the result being a continuing decline in the need for office space. Very similarly to the decline in the need for retail space (especially high-street), which started some time before the pandemic but never recovered following the surge in online shopping, in 2023 PWC reported that sales of office buildings are down twice as much as other property types.

The challenge ahead is how to repurpose both empty retail units and (now) office buildings. The costs associated with repurposing these vast buildings is often far too expensive given the backdrop of the stringent sustainability regulation, to the point that consideration will need to be given to large-scale demolitions, with land being available for redevelopment.

With any distressed property market, there are always investors with capital waiting in the wings to take advantage of new opportunities. It is predicted that the real estate sector will see a wave of increased activity in 2024 as inflationary pressures ease, and interest rates are forecasted to not only stabilise at a reduced rate but possibly decrease further. The only flies in the ointment are the following.

Global Conflict

The world is in a precarious position owing initially to the Russia-Ukraine conflict and now the war in Gaza. The impact on supply chains in the construction sector has been a disproportionate increase in build costs, and this trend will continue, with no end in sight.

Global Elections

2024 is described as a global election year, with more than half the global population taking to the polls. Inevitably, investors across the world will postpone significant investment decisions pending the outcome of the elections. As we live in a widely interconnected world, domestic polices alone no longer influence our economy; hence the focus will be on the outcome of global elections and, closer to home, on a possible change in government, which could bring a different tax regime for investors.

Sustainability

Certain types of properties that are more costly or complicated to upgrade will see a fall in asset value. The Minimum Energy Efficiency Standards (MEES) have applied to all new leases and renewals since April 2018. However, from April 2023, a landlord will be considered in breach if they let commercial property that has an EPC rating below E. The minimum standard was expected to be raised to a rating of B by 2030, but this may now occur at a slower rate than announced as consultations continue, with further legislation in 2024 to implement government policy. Investors, lenders and business owners are setting their sights on energy-efficient properties to meet their own environmental, social and governance (ESG) strategies.

Legislation

While the Building Safety Act 2022 continues its far-reaching impact, the real estate sector faces further reform in 2024. Whether it be the Renters' Reform Bill (introduced to reform the private rental sector, including the abolition of Section 21 "no fault" evictions) or the Leasehold and Freehold Reform Bill (the objective of which is to reform home ownership in the UK, including making it easier for existing leaseholders to extend their leases or buy the freehold), it is clear that a whole array of legislation in 2024 will impact on the residential sector.

Additionally, development has been affected by biodiversity net gain (BNG) since 12 February 2024, whereby all developers must deliver a net gain of at least 10% more than there was before the development in terms of improving natural habitats. There is even reform on the horizon for commercial leases, with the Law Commission announcing a review of the commercial leasing rules, including (most importantly) the Landlord and Tenant Act 1954. Last but by no means least are the significant reforms proposed by the Levelling-up and Regeneration Act 2023, including powers to local authorities to implement rental auctions for vacant high-street properties.

Outlook

2024 will see unprecedented change, whether that be in domestic legislative reforms, global politics, global stability or a change of UK government. These vast changes will directly impact on the UK economy, consumer spending and investor appetite for risk. Despite this, 2024 is forecast to see the real estate sector start climbing back from the downturn in 2023, when the UK marginally escaped a recession.

All indications are that 2025 will then build on the growth in 2024, and will see the UK economy rebound. As regards which real estate sectors will see the most activity, these will likely include the industrial and residential sectors, as there is potential for rental growth, while the office and retail sectors continue to decline. CBRE Group reported that office investment in 2023 was at its lowest level in 20 years, with only GBP6.5 billion invested in the first three quarters of 2023. With the emphasis on environmentally sustainable buildings, office space in good locations with outdoor space is likely to see rental growth due

to its scarcity. It is also predicted that technology companies will seek new office space, as (for example) artificial intelligence is likely to see its largest growth in 2024 due to increased private equity investment.

Real estate investment and activity in the logistics sector and for big sheds saw a decline in 2023 compared to 2022. This was probably also reflective of the challenges facing consumers, and of a noticeable change in consumer spending on lifestyle as opposed to material items. This is consistent with casualties in the hospitality sector (among restaurants, pubs, nightclubs, etc) throughout 2023.

Meanwhile, there are new areas of growth for real estate investors in wellness-focused businesses. CBRE Group reported that the health and fitness club sector reached an all time high in 2023 of GBP3.52 billion. This is consistent with consumers focusing on health and well-being expenditure despite the increased cost of living.

Falling mortgage rates will give the residential sector the boost it needs to recover in 2024. The cost of construction will continue to affect new home completions; however, the fall in inflation should stabilise price costs. The senior living market is also rising above the parapet as investors see rental growth. The government has placed greater focus on seeking growth in this sector, though a new government may lead to a change of policy.

The one certain thing is that the year ahead is set to be a monumental year, both globally and in the UK, in terms of political and economic reform.

UKRAINE



Law and Practice

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Arzinger is a premium independent Ukrainian law firm that has been active in the market for more than 20 years. The team includes 14 partners and over 85 legal professionals, based in Kyiv and Lviv. A presence in the major cities of Ukraine allows Arzinger to combine top-tier legal advice with regional market expertise. The firm has a strong focus on German-speaking clients and has a dedicated German desk. Strategic areas of practice for the firm include real estate and construction, property finance, privatisation and PPP. The team has handled the most complex transactions and litigations involving residential, commercial and corporate real estate assets for many years. The firm's areas of service include due diligence, development and finance deals, acquisition and exit transactions, legal and tax structuring, regulatory approvals and property construction. Arzinger and members of the firm have been highly ranked for years by international legal directories.

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1. General

1.1 Main Sources of Law

The main and only source of real estate law in Ukraine are the relevant statutes.

1.2 Main Market Trends and Deals

In 2022, the real estate market suffered significant losses due to the full-scale invasion of Ukraine by Russia. Businesses were forced to abandon the implementation of new projects, given the constant threat of rocket attacks.

According to public information, in 2023 Ukrainians purchased 1.7 times more property than in 2022, though still less than in 2021.

However, despite the difficult situation, many Ukrainian developers have continued their activities.

The privatisation and leasing of State-owned properties showed successful results despite the situation in the country. In the first three quarters of 2023:

- more than 300 privatisation auctions were held, raising UAH2.7 billion for the State budget; and
- 1,229 lease contracts of State property were concluded, which involved UAH572.15 million for the State budget.

Of the significant transactions in the real estate sector, mention should be made of the privatisation of the "Ust-Danube" seaport, as this was the first case of privatisation of port assets in Ukraine.

Ukrainian authorities have actively worked with international financial organisations and foreign governments throughout the past year in order to contribute to post-war reconstruction.

COVID-19 has had no further real impact on the real estate market. Rising inflation and increases in interest rates have resulted from the escalation of the Russian invasion of Ukraine.

Also in the Ukrainian market, real estate sellers have, for several years now, discussed the possibility of structuring transactions using new tools such as blockchain and defi, though this is mostly just a marketing ploy and not a common practice.

1.3 Proposals for Reform

Construction Reform

An ongoing reform of the construction sector began in 2021, including replacement the licensing system with the certification of individuals performing construction works (ie, construction supervisors) to enable personal responsibility for construction.

A new construction authority, the State Inspection for Architecture and Urban Planning of Ukraine (instead of the State Architectural and Construction Inspection) has been established. The introduction of the new body was aimed at restarting State-business relations in the construction sphere, by adopting more transparent procedures and introducing an electronic construction system aimed at significantly reducing the level of corruption.

Past years have also seen an even greater introduction of digitalisation in the construction industry and a reduction in paperwork. In particular, almost all services in construction (the issuance of town planning conditions, permits on construction, commissioning, etc) are provided through the Unified State Electronic System

for the Construction Sector, launched in 2021. This system allows for automation of processes and the elimination of human influence on decision-making processes in the industry.

In December 2022, a new law introducing urban planning reform was adopted. It provides for the digitalisation of administrative and other services in the field of urban planning, and for the introduction of private urban planning control. However, the law still awaits being signed off by the President of Ukraine (as of March 2024), and many discussions regarding the changes proposed by this law are ongoing.

Urban Planning and Land Decentralisation Reform

Another important reform that was implemented in 2021 provides for:

- transferring previously government-owned land to local municipalities;
- simplification of changing the designated use of land plots and related procedures;
- approval of detailed plans of territories outside settlements by municipalities instead of local state administrations (which are central government bodies); and
- the introduction of a new type of urban planning document – a complex plan of spatial development of the community, and numerous other changes in urban planning.

Simplification of the Construction of Transport Infrastructure Facilities

Due to the full-scale invasion of Ukraine by Russia and the need for business relocation in 2022, a reform was introduced that provides for the simplification of the construction of transport infrastructure facilities. As a result, a number of facilities were built – in particular, river ports (terminals) on the Danube River, roads, multimodal terminals and complexes near the borders with the EU.

2. Sale and Purchase

2.1 Categories of Property Rights

Freehold and leasehold are the main titles. There are, however, some "exotic" title forms, inherited from Soviet times, which sometimes emerge in transactions. Among the new instruments are transactions with special property rights to construction in progress, which have recently appeared on the Ukrainian real estate market and have not yet gained significant popularity.

2.2 Laws Applicable to Transfer of Title

The main laws applicable to the transfer of title of real estate are:

- the Civil Code of Ukraine;
- the Commercial Code of Ukraine;
- the Law of Ukraine "On State Registration of Property Rights to Immovable Property and Their Encumbrances"; and
- the Law of Ukraine "On Privatisation of State and Municipal Property".

Special treatment of investment transactions involving residential properties is governed by the Law of Ukraine "On Investment Activity" and the Law of Ukraine "On Financial and Credit Mechanisms and Property Management During Residential Construction and Real Estate Transactions".

2.3 Effecting Lawful and Proper Transfer of Title

Transfers are most commonly effected by entering into sale and purchase agreements or via other bilateral documents (eg, acts of transfer and acceptance for contribution to share capi-

tal). The agreements providing for transfer of title to real estate are subject to notarisation. The notary also validates the agreement's provision for compliance with the law. The property rights are subject to registration with the Property Register, which can also be performed by a notary. Title insurance as a product is not very popular on the Ukrainian market.

Despite the difficulties with notarisation caused by COVID-19 and the Russian invasion of Ukraine, the procedure has not changed.

2.4 Real Estate Due Diligence

Due diligence (DD) usually includes:

- the verification of various public registers (including litigation and insolvency registers, and title register);
- review of title validity;
- encumbrances;
- title transfer history;
- effective urban planning documents;
- disputes; and
- leases.

The presence of sanctions imposed on the counterparty and related parties is also reviewed.

The full-scale invasion of Ukraine by Russia had a significant impact on the DD process. Due to limited access to registers, not all information can be found in the public domain.

2.5 Typical Representations and Warranties

Warranties were only introduced into Ukrainian law in July 2021, and this is why the majority of commercial property deals are structured as share deals outside Ukraine to allow the application of foreign law.

Typical representations and warranties in commercial real estate transactions are:

- clear title;
- absence of third-party rights and encumbrances;
- absence of disputes; and
- necessity for capital repair.

Others may depend on the industry or on the position of the parties. For instance, a purchaser with a strong negotiation position usually requires warranties and/or indemnities on the title history. There are no specific COVID-19-related warranties/representations.

Ukrainian law provides for very basic protection of the buyer against the seller's misrepresentation. There is a rule that an agreement concluded as a result of a lie (ie, where the agreement would not have been concluded if not for the lie) may be invalidated in court. However, buyers rarely rely on this rule, as in Ukraine it may be quite complicated to prove the forgoing circumstances. This is one of the main reasons why English law is chosen as the governing law in the majority of large real estate transactions.

Ukrainian insurance practice does not offer representation and warranty insurance.

2.6 Important Areas of Law for Investors

Civil law, land law, banking and tax are the most important areas of law for an investor to consider when purchasing real estate in Ukraine. Transactions involving major real estate assets and yielding properties may be subject to merger control approval.

FDI screening is not available in Ukraine. However, the Ukrainian Antimonopoly Committee is vested with the powers to block transactions

involving parties included in the Ukrainian sanctions list.

2.7 Soil Pollution or Environmental Contamination

Ukrainian law does not impose responsibility on a buyer if the buyer did not commit any violations in relation to soil pollution or environmental contamination. However, the controlling authorities usually record the fact that the soil is polluted (or that another such violation has been committed) and issue a fine to the owner of the relevant property. It is then the buyer's responsibility to challenge the fine in court or by administrative procedure.

However, it can be difficult to prove that the violation was committed by the seller, as the burden of proof is on the buyer. To this end, a comprehensive review of the purchased property is recommended, including conducting technical or ecological DD if necessary, and making a record of its condition in the agreement or transfer act.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In order to ascertain the applicable zoning regulations, the buyer may request the relevant information from the seller and the authorities. The zoning regulations are most commonly contained in the master plan of the city/village, the zoning plan and/or the detailed plan of the territory. There is no option to enter into a development agreement with public authorities to facilitate a private project.

2.9 Condemnation, Expropriation or Compulsory Purchase

There are several grounds for governmental taking of land or real estate, as set out below.

- When a person acquires land that they are not entitled to own (eg, if a foreigner acquires agricultural land) and does not dispose of it within one year.
- Where a compulsory purchase of land or real estate for public needs is possible (eg, the construction of roads of State significance, and of airports). In both cases, this is done through a court and compensation should be paid.
- The expropriation of land or real estate in connection with the introduction and implementation of martial law measures is also possible. In this case, expropriation is carried out by decision of the military command.
- Lastly, in 2022, in connection with the full-scale invasion of Ukraine by Russia, the institution of seizure of property into State ownership was introduced as a type of sanction.

2.10 Taxes Applicable to a Transaction

An asset deal is subject to 20% VAT. The sale of an undeveloped plot of land is VAT-exempt. If the buyer is an individual, a pension duty of 1% of the property value applies. Stamp duty is 1%.

For land and real estate, notarisation costs will apply, in particular for certifying the contract. There is also an administrative fee for registration of title to the purchased asset. In certain cases, it is necessary to pay a military levy at the rate of 1.5%.

A share deal (acquisition of shares of a property-holding company) is VAT-exempt, and no further transaction taxes and notary fees apply. However, withholding tax may be payable by the seller (see **8.4 Income Tax Withholding for Foreign Investors** for more detail).

The distribution of transaction costs between parties may vary. However, it is common for

each party to pay its own taxes and duties, with notary fees to be paid by both parties equally, and the registration fee is most commonly paid by the buyer.

2.11 Legal Restrictions on Foreign Investors

There are no restrictions on foreign investors acquiring bricks-and-mortar real estate (buildings, etc), but some restrictions apply with regard to land acquisition, which is legally seen and treated as a separate asset in the majority of cases.

Foreign investors are banned from acquiring agricultural land in Ukraine, either directly or indirectly. The acquisition of non-agricultural land is subject to certain restrictions, in particular:

- in settlements – the plot can only be purchased along with the real estate located on it, or the plot can be purchased for construction purposes; and
- outside settlements – the plot can only be purchased along with the real estate located on it.

However, in practice, certain legal structures do enable foreign investors to purchase non-agricultural land in some instances.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

There are no special regulations for the acquisition of commercial real estate; the usual means of financing (ie, equity and debt) are used. Funds legislation is not very advanced in Ukraine.

3.2 Typical Security Created by Commercial Investors

The most common type of security for the acquisition of existing real estate is a mortgage. Depending on the property's valuation, the bank may also require additional security. In this case, there are various options, including:

- pledge of shares;
- pledge of funds on deposit;
- mortgage of additional real estate (including a second tier in some cases);
- an ultimate beneficial owner (UBO) personal guarantee; and
- (third party's) surety.

For the financing of development, the above options are also applicable; however, there are certain peculiarities. In large transactions, the lender will likely be required to provide evidence of the construction in progress – as well as other collateral property in the mortgage, and shares of the developer in the pledge – and to conclude direct agreements with the designer, the general contractor, etc, to be able to intervene in the transaction instead of the developer in the case of enforcement. In this regard, it is important whether the land underlying the construction is leased or owned. The owned land plot will also be considered for the mortgage, while the pledge of lease right has certain restrictions and limitations.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Foreign lenders are not entitled to foreclose on agricultural land. That said, agricultural land is not considered as a security for international lenders. Domestic lenders can use agricultural land as a security, subject to certain restrictions.

Generally, there are no restrictions on the repayment of loans in favour of foreign lenders, though the loan agreement and all addenda thereto are subject to registration with the National Bank of Ukraine.

Due to martial law, some restrictions on the repayment of loans in foreign currency apply.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Notary fees for the notarisation of mortgages and stamp duties for the registration of mortgages and pledges apply.

There are no taxes (including VAT) or fees for granting a security.

Enforcement of security is treated as acquisition; therefore, taxes, duties and fees apply the same way as described in **2.10 Taxes Applicable to a Transaction**. In certain cases, the adjustment of tax differences may be applicable.

3.5 Legal Requirements Before an Entity Can Give Valid Security

There are no special requirements. However, general requirements, such as the obtainment of corporate approvals, shall apply.

3.6 Formalities When a Borrower Is in Default

The formalities may depend on the enforcement option provided in the mortgage agreement. However, the common and most important rule is to comply with the procedure of serving the borrower with the default notice. This notice will be served at least 30 days prior to enforcement, and this term is also a mandatory cure period, during which the borrower may perform the breached obligation. If the obligation is performed within the cure period, the lender may not enforce the mortgage.

The priority of the lender's security interest is procured by registering the mortgage upon its conclusion. The mortgage registered earlier has priority over the mortgage registered later.

No restrictions on foreclosure were implemented in response to the COVID-19 pandemic.

For the period of martial law (which has been in force in Ukraine since 24 February 2022), and for another 30 days after its termination, lenders are deprived of the right to compulsory foreclosure of real estate under mortgage agreements entered before the introduction of martial law.

3.7 Subordinating Existing Debt to Newly Created Debt

If the debt is secured, it will be considered senior to unsecured debt by operation of law, regardless of any agreements.

However, if the new debt is also secured, the lenders may agree to make the existing debt subordinate to the new one. To effectuate this, the existing lender will have to:

- deregister the mortgage;
- allow the new lender to register its mortgage; and
- re-register its mortgage as a second-tier security.

3.8 Lenders' Liability Under Environmental Laws

Ukrainian law does not impose any liability on lenders under environmental laws.

3.9 Effects of a Borrower Becoming Insolvent

A borrower's security interests do not become void in the event of its insolvency. However, a debt restructuring plan, which is approved by the court, may provide for the release of certain debts. Once the debt is released, all security instruments shall automatically terminate.

Furthermore, any agreements that the borrower entered into within three years prior to the commencement of the insolvency proceedings may be clawed back – ie, invalidated by a court at the request of the receiver or a lender if they damaged the borrower's solvency (eg, where the borrower prematurely performed its obligations or undertook excessive liability that led to insolvency).

3.10 Taxes on Loans

Due to the intensification of the government's housing programme, all costs of concluding a contract and registering real estate have been transferred to the borrower – the buyer of such property. As a rule, the bank charges a commission of 1%, and the new owner must also pay for mortgage insurance (0.25% of the value). Personal income tax of 5% may also be payable if the property has been owned for less than three years, and if it is the second sale in a calendar year.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The government and municipalities develop and approve various urban planning documents that regulate the zoning of territories. Businesses must comply with the regulations when allocating land and developing any real estate.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

State standards are approved by the Ministry for Communities, Territories and Infrastructure Development of Ukraine. These standards regulate requirements as to the design and method of construction of real estate. Certain parts of the appearance of real estate, such as facades, may be regulated by municipalities (eg, the appearance of advertisements and naming signs).

4.3 Regulatory Authorities

The development and designated use of a real estate object is performed by the designer at the developer's request. It should comply with the urban planning documents and designated use of the underlying plot of land. There may also be other restrictions, such as for protection zones, sanitary protection zones and cultural heritage areas. Some restrictions may prohibit the construction of residential real estate, while others may prohibit any construction whatsoever.

4.4 Obtaining Entitlements to Develop a New Project

Several stages of development may be involved, depending on the project. The developer may need to:

- prepare a detailed plan of the territory and obtain approval for it;
- conduct an environmental impact assessment;
- design the project;
- undergo expert valuation of the design; and
- obtain a construction permit.

Therefore, there may or may not be stages where third parties are involved and raise an objection. The greatest likelihood of third parties objecting is during the stages of developing the detailed plan of the territory and conducting an environmental impact assessment, as these procedures imply public hearings. However, there are also cases where the public objects at later stages of construction.

4.5 Right of Appeal Against an Authority's Decision

There is a right to appeal to a higher administrative body and to challenge the decision in court.

4.6 Agreements With Local or Governmental Authorities

There is no requirement to enter into facilitation agreements. However, the developer will likely need to conclude agreements with utilities suppliers to connect the property to the relevant networks.

4.7 Enforcement of Restrictions on Development and Designated Use

Firstly, when leasing or purchasing public land, relevant authorities will ensure compliance with urban planning documents, and will refuse to allocate the land if the intention of the construction contradicts the aforementioned documents.

Secondly, the controlling authority may refuse to issue the construction permit.

Lastly, depending on the restriction, a certain controlling authority may exist that can inspect the facility. For instance, an authority exists that inspects land, and may establish a violation of the designated use.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The most common and viable investment vehicles are the limited liability company (LLC) and the joint stock company (JSC).

However, various entities may of course be used by investors. Besides those already mentioned, there are also:

- additional liability companies;
- full liability companies and commandite companies (types of entities close to full and limited partnerships);
- private enterprises; and
- co-operates, etc.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

An LLC is a company in which the investor's liability is limited to its contribution to the company's share capital. It is a straightforward type of entity, which is easy to establish and operate. The membership in an LLC is registered in the Companies Registry.

A JSC is a business entity by shares of a certain nominal. This is a more advanced type of entity that is more suited to larger structures with elaborate corporate governance. The JSC may issue different types of shares; the shares of a JSC are securities and are stored by a depository institution. The procedures for convening the general shareholders' meeting, formulation of agenda, etc, are more complicated in a JSC. Furthermore, JSCs may conduct a public offering of shares.

There are no tax benefits under the general rules for these types of entities.

5.3 REITs

A real estate investment trust (REIT) in Ukraine is a publicly available mechanism for investing in real estate. However, it is not popular and is only beginning to attract investors. Only a few companies provide such services. The advantages of this investment mechanism include:

- a low entry threshold (it can go as low as USD150); and
- a reduced personal income tax rate for income received through REITs.

5.4 Minimum Capital Requirement

The minimum capital required to establish an LLC is UAH0.01; and is UAH1.34 million for a JSC.

5.5 Applicable Governance Requirements

The main governing body of an LLC and a JSC is the general shareholders' meeting. An LLC may be managed by a single director or a board, and may have a supervisory board, depending on the investor's choice. The LLC's charter may provide for limitations of the director's powers.

The management structure of a JSC is determined by its charter. Under the one-level structure of a JSC, it is managed by a single director (if the number of shareholders is up to ten people) or a board of directors. Under the two-level structure of a JSC, besides having a single director or board of directors, it is required to have a supervisory board. There are also corporate governance requirements for public JSCs, including the requirement to appoint independent directors to the supervisory board.

The Corporate Transparency Act does not apply in Ukraine.

5.6 Annual Entity Maintenance and Accounting Compliance

For an LLC, the annual entity maintenance and accounting compliance costs may vary greatly, depending on the volume of operations of the company. For instance, if there is a relatively small number of transactions per month (ie, up to 50 or 100 transactions), and a small number of employees, accounting can be outsourced for a reasonable fee. If the company is more active, hiring an accountant (or several) may be necessary.

As JSCs have more complicated accounting and reporting practices, the relevant costs are significantly higher for this type of entity.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The main types of agreements on the use of real estate are leasehold and easement.

6.2 Types of Commercial Leases

There is no special treatment of commercial leases; the lease is generally regulated by the Civil Code of Ukraine, while the leasing of public assets (State and communal properties) is regulated by a separate, dedicated law.

6.3 Regulation of Rents or Lease Terms

As stated at **6.2 Types of Commercial Leases**, the lease is regulated by the general provisions of the Civil Code of Ukraine, and there is a significant amount of discretion in practice.

There is currently no material ongoing regulation of rents or lease terms that resulted from the COVID-19 pandemic.

Due to the introduction of martial law and the need for business relocation, the Ukrainian government has established special conditions and discounts for the leasing of public assets (State and communal properties).

6.4 Typical Terms of a Lease

There is a high level of discretion regarding the length of a lease – ie, such length is not regulated and largely depends on the business cycle of the tenant. The usual length is:

- five years for an office lease;
- five to ten years for a retail lease; and
- one to three years for a residential lease.

For major retail, anchor tenants usually insist on 20 to 25 years. Also, the lessee will commonly want to have the option of prolongation.

The day-to-day maintenance of the leased property is usually performed by the lessee, while a capital repair is usually conducted by the lessor. However, the initial adaptation may include capital repair as well, if the premises are accepted in a shell – and core – condition. This is relevant for hypermarkets, cinemas and other lessees that have special requirements with regard to the premises and designated construction teams.

For lease contracts of public assets (State and communal properties), restrictions on the terms and other conditions of the lease are set. Lease contracts of such assets are generally concluded based on the results of auctions, except for some cases.

6.5 Rent Variation

The lease payments (ie, the rent, plus the operating expense (OpEx), utilities and marketing payments) are paid in local currency (Ukrainian hryvnia), while the actual rates of the principal/base rent and OpEx are nominated in foreign currency. Payments are made according to the actual foreign exchange (FX) rate. Domestic FX payments are prohibited.

Rent is usually subject to indexation for inflation.

For a lease of premises in a newly developed shopping centre, the lessee would normally expect a discounted rent until the moment the shopping centre is fully occupied.

The parties may further agree on the staged increase of the rent within the term of the lease.

The amount of rent for public assets (State and communal properties) is determined based on the results of the auction.

During the COVID-19 pandemic and following the introduction of martial law, the actual commercial terms of leases were often waived, with the parties agreeing ad hoc on suitable commercial terms based on the actual economic situation.

6.6 Determination of New Rent

There is usually a formula predetermining how the rent is changed – eg, a 5% increase per year, plus the rate of inflation and the currency exchange rate.

6.7 Payment of VAT

VAT (20%) applies to rent payments.

6.8 Costs Payable by a Tenant at the Start of a Lease

Costs at the start of a lease usually include an advance payment in the amount of one to three months' rent, which may also serve as a security deposit. This advance payment usually consists of all payments under the agreement, except for

the utilities and the turnover rent – ie, the base rent, OpEx, marketing fee.

6.9 Payment of Maintenance and Repair

Common area maintenance and repair costs are usually covered by the category of OpEx, which is charged on top of the principal rent.

6.10 Payment of Utilities and Telecommunications

Usually, the utilities used on the premises are paid for to the relevant utilities providers based on metering devices, while the utilities used in common areas are paid for by all tenants, pro rata, to the rented area.

6.11 Insurance Issues

The costs of insuring the real estate that is the subject of a lease, and of events causing damage, will depend on the negotiations of the parties. There have been cases where the lessors demanded that the lessee insure the leased premises, and vice versa. Most commonly, there are no requirements with regard to insured events in lease agreements.

The insurance culture is underdeveloped in Ukraine; therefore, the majority of businesses in Ukraine do not have business interruption insurance.

6.12 Restrictions on the Use of Real Estate

It is quite common for the lessor to stipulate the designated use of the real estate in the agreement. There are also certain legal restrictions for different types of real estate. For instance, there are strict restrictions for residential real estate. However, as regards commercial property, the law does not provide for many requirements, except for the general requirements on fire safety, sanitation, etc.

6.13 Tenant's Ability to Alter and Improve Real Estate

The most common approach is that the lessee is allowed to improve the real estate, subject to the lessor's written consent and pre-approval of design documents. Also, the lessees are often not compensated for inseparable improvements of the real estate unless there is a specific arrangement between the parties.

6.14 Specific Regulations

The leases of all types of privately owned real estate assets are treated equally. Special treatment applies for the leasing of public assets, which is tightly regulated.

There is also a special statute regulating land leases, according to which the land is considered and treated as a special real estate asset in comparison to bricks-and-mortar properties.

Coronavirus legislation did not establish any distinction between leases of different asset classes.

6.15 Effect of the Tenant's Insolvency

Insolvency proceedings against the tenant can trigger termination of the lease by the lessor.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The most common form(s) of security is/are an advance payment (ie, a security deposit) in the amount of one or two months' rent and/or a bank guarantee.

6.17 Right to Occupy After Termination or Expiry of a Lease

The law provides that, if the lessee continues using the real estate for a month after the termination of the lease without the lessor's objec-

tions, the lease is renewed for another term on the same conditions.

To avoid this, the lessors usually explicitly prohibit this in the lease agreements. Also, the law provides for a penalty in the amount of double daily rent for each day of delay in returning the real estate.

6.18 Right to Assign a Leasehold Interest

Ukrainian law only allows assignment subject to the other party's written consent. The lease agreements usually use the same provision or prohibit any assignment whatsoever. On a related note, the lease agreements may allow subleasing, but also subject to the lessor's explicit consent.

That said, the lenders usually insist on rent assignment covenants as a collateral, and commercial terms of leases are often subject to approval by the lenders.

6.19 Right to Terminate a Lease

The right to terminate a lease largely depends on the parties' negotiations. It is common for a strong lessee to seek a unilateral termination right without having to justify the decision.

The law provides that the lessor may terminate the lease if the lessee:

- uses the property against the designated use or in breach of the agreement;
- has subleased or assigned the lease to a third party without the lessor's consent;
- by their negligence poses a threat to the property; or
- did not conduct a capital repair if they were so obliged under the agreement.

The lessor may also sue the lessee for termination if the lessee systematically violates the payment obligations.

The lessee may terminate the agreement if the property does not correspond to the requirements set out in the agreement, or if the lessor does not perform its obligation regarding capital repair of the property.

6.20 Registration Requirements

A lease relating to a building, capital structure or a part thereof exceeding three years is subject to mandatory notarisation and to registration with the property register for its validity. The lease and other property rights are registered in the State Register of Property Rights to Immovable Property and their Encumbrances. The land lease is also registered in the State Land Cadastre.

The fees include a notarisation fee and a registration fee. It is common for the lessee to pay the fees; however, the notarisation fee can also be paid by the parties in equal parts or by the lessor, though this is quite rare.

6.21 Forced Eviction

The lessee may be evicted after termination of the agreement (either by the lessor unilaterally or by expiry of the term of the lease).

If done outside court, this is subject to the agreement's regulation. A common procedure established in the agreement is that the lessor collects the lessee's property from inside the leased real estate and stores it at the lessee's cost; if the lessee does not collect its property within the term stipulated by the agreement (usually around ten business days), the lessor may dispose of the property at its discretion.

However, there are cases where the lessee resists an out-of-court eviction. In this case, the lessor may file a suit on eviction. If the dispute is won, the lessor may evict the lessee, with the involvement of an enforcement officer and the national police.

6.22 Termination by a Third Party

Ukrainian law does not allow a third party to terminate an agreement. However, the agreement may be challenged by a third party if its interests were violated at some stage – for instance, if mandatory corporate approvals or spousal consents were not obtained.

The law also provides that an agreement may be invalidated if it contradicts the interests of the State and society or the moral principles of society. However, this is an exceptional measure, and the authors are not aware of respective case law.

6.23 Remedies/Damages for Breach

In the event of a breach of the lease (such as late payment of rent), the landlord may charge penalties, including annual interest on the amount owed. The landlord also has the right to keep the security deposit if the termination of the agreement is caused by the tenant's breach of its obligations. The security deposit may be in cash or in the form of a letter of credit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

In the majority of cases, the price for construction works will be fixed, though the price for materials may be flexible.

7.2 Assigning Responsibility for the Design and Construction of a Project

The designer and the contractor may be different companies or the same company; this varies from case to case. The major international companies often also involve an independent supervisory entity.

In addition, the developer must appoint a person responsible for technical supervision (for the construction to comply with the applicable regulations), who must not be the same person as the contractor.

7.3 Management of Construction Risk

From an organisational point of view, there is:

- technical supervision and author's supervision;
- expert valuation of design documents;
- certification of construction materials; and
- the developer's control over the process.

The suppliers of materials as well as the contractor shall give warranties on the quality of the goods and works, and shall undertake to compensate for any damages. A warranty of quality of works is also established by law for ten years after the commissioning of the facility. There may be a cap for damages compensation of 100% of the contract price; however, this should not cover the gravest defects/violations.

Indemnifications, waivers and elaborated limitations of liability are not common in Ukrainian practice.

7.4 Management of Schedule-Related Risk

There are penalties and fines in the majority of agreements, for delays in the delivery of milestones and construction completion dates.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

There may be retention of a portion of the contract price – eg, 5% – which is payable within one or several years if no defects are discovered. Alternatively, a bank guarantee or a holding-company guarantee may be acceptable if the contractor is a reputable party. Escrow accounts and third-party sureties are not quite as common.

7.6 Liens or Encumbrances in the Event of Non-payment

The contractor is permitted to lien the property in the event of non-payment. However, this is not often done in practice. After the payment is made, the contractor shall submit an application to deregister the lien, which is registered as an encumbrance under Ukrainian law, within five days from the date of the developer's request. If the contractor does not deregister the lien, it is liable for all damages resulting from it, and the developer may sue the contractor on the termination of the lien, after which the developer may itself deregister the lien.

7.7 Requirements Before Use or Inhabitation

There are no requirements to inhabit or use the constructed object, except for the general requirement to commission it.

8. Tax

8.1 VAT and Sales Tax

As a general rule, an asset deal is subject to a standard VAT rate of 20%.

However, an asset deal with an undeveloped land plot is VAT-exempt, and a transaction involving a residential building (premises) may also be VAT-exempt (depending on the reflection of the building and a land plot in the accounting system).

The amount of VAT is usually included in the purchase price and is paid by the buyer.

Share deals are also exempt from VAT.

8.2 Mitigation of Tax Liability

A share deal (the acquisition of shares of a property-holding company) may be considered in this regard, as the sale and purchase of the shares is not subject to VAT. There are also no strict requirements regarding expert valuation of the real estate property before making such a transaction; thus the contractual price depends only on parties' agreements and could be lower than the market price. This makes such transactions more attractive from a taxation perspective, even if it involves a higher volume of transactional work (legal and financial DD, merger control, sales and purchase agreement structure, etc).

It should also be borne in mind that profits derived from sales (alienation) of shares in Ukrainian property-rich companies may be subject to withholding tax in the territory of Ukraine. See **8.4 Income Tax Withholding for Foreign Investors** for details.

8.3 Municipal Taxes

All owners of business premises are payers of real estate tax, except for certain exemptions (ie, for State-owned premises, dormitories, orphanages, etc). This is a local tax applied on residential and non-residential premises (buildings, apartments, etc) and is calculated based on their area.

The rate is determined by local councils, and cannot exceed 1.5% of the minimum wage

established as of January 1st of the tax year per square metre.

Based on the decisions of the local councils, certain privileges/exemptions may be applicable for specific locations.

Land payment is a separate tax, paid in the form of a land lease (by tenants of leased public land plots) or as a land tax (paid by owners of land).

8.4 Income Tax Withholding for Foreign Investors

Generally, foreign private individuals are subject to personal income tax (including income from a lease, and the sale of real estate) at a rate of 18% and a military levy at the rate of 1.5%. Receipt of the rental income for foreign private individuals is only possible through an agent (a legal entity or a private entrepreneur) located in the territory of Ukraine. The agent shall be involved through an agency agreement to conduct rental activity on behalf of the foreign individual. Personal income tax and a military levy shall be withheld from the rental income and paid to the State budget by the agent. Failure to have an agent for a foreign individual could be considered tax evasion and be subject to prosecution.

Legal entities are subject to withholding tax on Ukraine-sourced income, which is levied at a rate of 15%, unless a relevant double tax treaty to which Ukraine is a party rules otherwise. This tax rate also applies to income from transactions (lease, sale and purchase) with real estate located in Ukraine. The amount of withholding tax is deducted by the buyer from the purchase price before payment to a non-resident.

Capital gains derived from the sale or other disposal of shares or corporate rights in a Ukrainian legal entity (as well as in a foreign legal entity that owns corporate rights of the legal entity in Ukraine), the value of which is 50% or more formed by real estate located in Ukraine, shall be taxed in Ukraine with withholding tax at the rate of 15%, unless a relevant double tax treaty rules otherwise. This rule also applies in the event that the sale or disposal transaction is carried out between two non-residents abroad.

If the seller is a non-resident with a representative office (RO) in Ukraine, the tax is paid by that RO. If there is no RO, the tax shall be paid by the purchaser (including a non-resident purchaser).

8.5 Tax Benefits

With the exception of land, the cost of fixed assets used in business activities is capitalised and depreciated for corporate income tax purposes. Each fixed asset is accounted for separately and is depreciated on a monthly basis.

Legal entities can determine the period of useful economic life of fixed assets in their internal accounting policies, provided that this period is not less than the minimum period prescribed by the Tax Code of Ukraine.

Land and shares are not depreciable.

Trends and Developments

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Arzinger is a premium independent Ukrainian law firm that has been active in the market for more than 20 years. The team includes 14 partners and over 85 legal professionals, based in Kyiv and Lviv. A presence in the major cities of Ukraine allows Arzinger to combine top-tier legal advice with regional market expertise. The firm has a strong focus on German-speaking clients and has a dedicated German desk. Strategic areas of practice for the firm include real estate and construction, property finance, privatisation and PPP. The team has handled the most complex transactions and litigations involving residential, commercial and corporate real estate assets for many years. The firm's areas of service include due diligence, development and finance deals, acquisition and exit transactions, legal and tax structuring, regulatory approvals and property construction. Arzinger and members of the firm have been highly ranked for years by international legal directories.

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ARZINGER 20 YEARS

Challenges for the Real Estate and Construction Market in 2023: Full-Scale Russian Invasion

The real estate market has suffered significant losses due to Russia's full-scale invasion of Ukraine. As well as a general drop in demand for all types of real estate, market operators have faced other challenges, such as regarding the safety of visitors and staff.

In addition, many assets have been damaged or destroyed, and significant investments are needed to restore them. According to the Kyiv School of Economics (KSE Institute), direct documented damages inflicted upon Ukraine's infrastructure due to the full-scale invasion by Russia, as of January 2024, stands at USD155 billion (at replacement cost).

The increase in the total amount of damage is due to a growth of damaged and destroyed infrastructure, housing, industry, energy, education and healthcare facilities. The number of damaged and destroyed residential buildings is increasing every day – as of January 2024, there were almost 250,000 damaged and destroyed buildings. Direct damage to these facilities is estimated at USD58.9 billion.

As of the beginning of 2024, the damage to infrastructure has reached USD36.8 billion, and the direct damages to industry and businesses have already reached USD13.1 billion. According to the latest data, 78 small, medium and large private enterprises, as well as 348 State-owned enterprises, have been destroyed or damaged.

Therefore, business and government representatives are faced with finding solutions that would help to stabilise the economy quickly during the invasion, and to ensure effective development in the post-war reconstruction period.

Market Trends

Residential property construction and price increases

As a result of the Russian invasion, the residential property market in Ukraine virtually came to a standstill in 2022. New developments were on hold, with only projects started before the war being completed. However, after the shocking year 2022, the main indicators began to level off, and a positive dynamic was outlined.

According to statistics, 7.38 million square metres of housing was built in Ukraine in 2023. Most of this comprises two-or-more dwelling buildings (3.88 million square metres). In terms of the total area of residential buildings put into operation in 2023, there were five leaders: Kyiv City, Kyiv, Lviv, Vinnytsia and the Ivano-Frankivsk regions.

In 2023, there was a new trend of perceiving shopping centres not only as a place to purchase goods but also as an opportunity to change the focus of attention, and to relax (cinemas, restaurants, concerts, etc). This gave impetus to the construction of new shopping centres, especially in the western regions. Among the new projects that were opened in 2023, the shopping centres in Kolomia, Lviv, Truskavets, Drohobych and the Ivano-Frankivsk and Kyiv regions are worth noting. All have a new community-centre format with many Ukrainian brands.

One new area of activity is the construction of temporary housing for displaced persons, especially in the western and Kyiv regions of the country. Procedures for such construction have been simplified. Usually, such projects are implemented with the funds of donors.

Another concern is the repair and restoration of housing that has been damaged and destroyed

as a result of the armed aggression of the Russian Federation. In May 2023, a special law and by-laws were adopted, which introduced a State mechanism that made it possible for citizens to receive compensation for damaged and destroyed housing without waiting for reparations. The "eRecovery" State programme entitles every citizen whose home was damaged to apply for State aid for ongoing repairs. Owners of destroyed housing can also submit an application for compensation for the purchase of a new apartment or house in the Diya application.

The Register of Damaged and Destroyed Property was also created. It contains all data on damaged and destroyed property and makes the compensation process simpler and more convenient. UAH4.1 billion of budget funds has already been allocated for repairs, and 45,000 Ukrainian families are already rebuilding their homes (the total number of applications is more than 79,000, mostly in the Kharkiv, Kyiv, Mykolaiv and Kherson regions). More than 11,000 applications were submitted for housing cost compensation. Some have already purchased new homes, with a total cost of more than UAH3 billion.

In October 2022, Ukraine also launched the government's "eOselya" affordable lending programme. Till 2023, the programme was available only to military, law enforcement, healthcare and education personnel, who could receive a preferential housing loan at a 3% interest rate for up to 20 years. However, since July 2023, the government has expanded this programme to include veterans (and their family members), internally displaced persons and, in general, all Ukrainians who do not have their own housing (or where this comprises a small area). For these categories of persons, a fixed annual loan rate of 7% applies. However, citizens can choose housing under construction only from those developers that are accredited by banks participating in the programme.

The war has triggered significant inflation and a depreciation of the national currency. These factors affected the cost of construction, as prices for construction materials increased significantly. Housing prices increased by 12.8% in 2023:

- one-room apartments rose in price by 14%;
- two-room apartments rose in price by 11.1%; and
- three-room apartments rose in price by 13.5%.

The price of housing in the secondary market rose by 15.6%, which is 3.5 percentage points higher than in 2022. Nevertheless, in 2023, Ukrainians bought 404,000 real estate properties, which is 1.7 times more than a year earlier. However, this is still 1.6 times less than before the start of the full-scale invasion (631,000).

Lease relations

2023 could be called the year of gradual recovery, with some residents returning to Ukraine. In many cities, curfews were reduced, and most markets that were closed at the beginning of the war reopened their doors to visitors. The concessions the landlords were forced to make at the start of the full-scale invasion were reviewed in 2023. Rental rates for commercial property began to return to market rates.

The number of housing rental ads in Ukraine decreased from December 2022 to December 2023, in almost all regions. According to statistics, the average rent price increased (for example, the cost of renting a one-room apartment in Kyiv increased by 48%).

Insurance of investments against war risks

The Ukrainian government considers the introduction of an insurance mechanism to be one of the basic conditions for attracting foreign investment during the post-war recovery of Ukraine's economy. In particular, the Ministry of Economy of Ukraine has agreed with the Multilateral Investment Guarantee Agency (MIGA) (a member of the World Bank Group) to launch a wartime investment insurance mechanism. Other insurance mechanisms are also being developed.

New approaches to procurement, engineering and contracting in projects implemented jointly with international financial institutions (IFIs)

In January 2024, the Ministry of Infrastructure of Ukraine signed a memorandum of co-operation with the International Federation of Consulting Engineers (FIDIC) to co-operate and introduce procurement, engineering and contracting practices implemented jointly with IFIs.

The projects to be worked on under the memorandum are aimed at emergency recovery programmes in various areas (such as infrastructure, energy, healthcare, education, agriculture, etc). This will help to:

- bring Ukrainian construction standards and procedures closer to European ones;
- spread the practice of using FIDIC pro forma contracts; and
- implement high-quality infrastructure projects.

At the same time, co-operation with IFIs requires improving Ukraine's institutional capacity and qualification of specialists and consultants, as these are relatively new tools and rules for Ukraine.

Intensifying development of industrial parks

In 2020–2023, the process of improving legislation aimed at creating and operating industrial parks was underway. A few benefits and advantages were introduced for participants and management companies of industrial parks. The government has also adopted several additional acts that allow for the introduction of these privileges, as well as other types of State incentives for industrial parks from the budget.

As of March 2024, 75 industrial parks have been registered, of which ten were registered in late 2023 and four in 2024. This shows that the interest of private companies and local governments in said tool is growing, which is not surprising. This mechanism proves to be most effective for relocating businesses from war zones to safer areas, creating logistics hubs near seaports or in areas near Ukraine's western border.

Unfortunately, most industrial parks currently only exist formally, are not functioning, and have no management companies or residents. In some cases, the necessary adjacent engineering infrastructure (roads, utilities, railways, etc) is lacking, which means significant costs both for investors and the State. However, given that this tool is gaining momentum, the Ministry of Economy of Ukraine plans to establish an Industrial Parks Development Office, and has allocated UAH1 billion (EUR25 million) from the budget funds for the development of industrial parks in 2024.

The development of industrial parks will also be facilitated by the possibility of obtaining insurance against war risks, which has already been granted to the M10 Lviv Industrial Park by the World Bank's MIGA.

Legislative Changes

PPP-based co-operation between the State and the private sector

Despite the ongoing hostilities in Ukraine, the reconstruction process is gaining momentum. Given the enormous extent of damage to various infrastructure facilities, the government, relevant expert organisations and foreign donors continue to work actively to find ways of attracting investment to Ukraine.

Public-private partnerships (PPPs) are regarded as among these instruments. Therefore, discussions have now intensified around amendments to PPP legislation (Draft Law No 7508), which were adopted in the first reading back in October 2022. Key changes include:

- expanded scope of application – new areas, including the restoration and construction of new housing;
- introduction of a conditional classification of PPP projects – "regular", "rehabilitation" and "small" projects (worth up to EUR5.382 million);
- expanded sources and mechanisms of financial support – attracting grants from donors (foreign States, organisations, municipalities, IFIs, etc) to co-finance capital expenditures;
- transition to the EU model of selecting a private partner by analogy with public procurement procedures through restricted bidding, competitive dialogue and open bidding; and
- digitalisation of PPPs – gradual transition to online procedures, introduction of a standard form of a European single procurement document (ESPD), etc.

In addition, the Law "On Amendments to the Budget Code of Ukraine" came into force at the end of August 2022, and the government adopted several additional acts in 2023, providing for the introduction of long-term obligations under a PPP agreement and State support for the private partner at the expense of the State budget.

Introduction of State support mechanisms for private investment

The amendments to the law adopted in August 2023 have considerably expanded the list of industries where projects can be implemented with the use of the State support mechanism, as well as the types of such support. The minimum investment amount (changed from EUR20 million to EUR12 million), as well as the requirements for the investor and the project, have also been reduced. The law provides for State support in the form of tax, customs and other benefits, as well as for various forms of compensation, up to 30% of the contributed investment amount.

The process of developing and adopting a set of amendments to the by-laws is currently being finalised, intended to implement the provisions of the law, reduce the timeframe and simplify procedures. All necessary acts were expected to be adopted by March 2024. This will allow potential investors to start preparing and submitting applications, and to conclude the first special investment agreements with the government of Ukraine as a party thereto.

The updated status of the land reform

At the first stage of the land reform, in July 2021, it was permissible to sell agricultural land plots. The second stage of the land reform successfully came into force on 1 January 2024, and means that:

- the purchase and sale, or other types of alienation, of agricultural land plots in favour of legal entities is allowed (this was previously prohibited); and

- the total area of agricultural land that can be owned by a citizen of Ukraine is increased from 100 hectares to 10,000 hectares.

However, the moratorium on the acquisition of agricultural land still applies to foreigners, Stateless persons and foreign legal entities, as well as to any legal entities with foreign founders and/or foreign beneficial owners.

Foreigners, Stateless persons and legal entities are prohibited from acquiring shares in the charter capital, stocks or membership of legal entities (except for the charter capital of banks) that own agricultural land. The decision to lift this moratorium and allow foreign participation in the agricultural land market may be made only at an all-Ukrainian referendum. However, such a referendum is not expected to be held soon.

New construction rules

A law introducing urban planning reform was adopted at the end of December 2022, but is still pending signature by the President of Ukraine (as of April 2023). It provides for:

- the digitalisation of administrative and other services in the field of urban development;
- the introduction of private urban planning control;
- the definition of new criteria and procedures for recognising construction as unauthorised; and
- the strengthening of criminal and administrative liability for illegal actions, etc.

Also, in the conditions of a full-scale invasion, Ukraine is forced to respond to new challenges and to make new rules and regulations. In 2023, the construction of buildings for temporary residence of internally displaced persons, small houses (up to 500 square metres), certain industrial facilities and transport infrastructure was simplified, and new State Building Regulations for civil protection structures came into effect.

Certain other drafts are also very important, especially in the seaport and construction sectors. For a long time, construction on land occupied by waterways (ie, at the bottom of lakes, rivers, seas) was very difficult or almost impossible, though there is a draft law regulating the procedure for construction on such land plots, which has been adopted as a basis. Moreover, a draft law has been introduced providing for a clear construction algorithm within the territory and water area of seaports. The adoption of this legislation will significantly expand the opportunities for private investment in port infrastructure.

USA - ALABAMA



Law and Practice

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Dentons is a global law firm with a team of over 1,000 real estate lawyers in more than 80 countries across the globe, including more than 180 real estate lawyers spread across 45 locations in the United States, and 19 real estate lawyers throughout the state of Alabama. Dentons' team of real estate lawyers is adept at handling the myriad of needs pertaining to real estate developers and investors, including assisting clients in procuring capital and credit, often combining construction, permanent, mezzanine and tax credit facilities with equity participations. The team is also well equipped to handle zoning and other land use matters, as well as litigation and controversies, including eminent domain, design and construction, environmental regulatory enforcement, ejectments, and dealing with insolvent counterparties.

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1. General

1.1 Main Sources of Law

Knowledge of federal, state and local law, of the changes to those laws, and of local forms and customs is essential in successfully and efficiently practicing real estate law. Alabama land records are handled on a county-by-county basis, and laws are interpreted accordingly.

Many probate offices have implemented technological improvements for better filing, record-keeping and access to recorded documents, though these developments can vary significantly between counties. Successful transactions often involve extensive negotiations. Closing commercial deals involves standard forms and requirements for both state law compliance and title insurance.

All Sections referenced herein are Sections of the Code of Alabama (1975).

1.2 Main Market Trends and Deals

Trends in 2023

In 2023, higher interest rates and continued high construction pricing caused a plateau in the resilient commercial real estate industry, reducing new developments and projects. Subsequently, commercial real estate became more limited to certain asset categories in specific markets, such as metropolitan areas and submarkets.

Higher rates and lower appraised values due to levelling rents and less occupancy have slowed permanent refinancing of both construction debt and existing permanent credit facilities. Multifamily experienced these higher interest rates yet maintained its place as a solid long-term asset in commercial real estate.

Meanwhile, returns to the office never rounded back to pre-COVID-19 pandemic numbers. Having suffered the largest rise in vacancy due to post-pandemic downsizing, office properties appear to be most concerning in commercial real estate, as waves of such properties arrive at loan maturity dates with reduced appraised values in a difficult capital market for credit. Together, these factors have combined to create a clogged commercial real estate market.

In Alabama, the state's residential housing markets followed the national decline. Nevertheless, the demand for vacation homes along the vari-

ous lakes and shorelines in Alabama remained, as these desirable areas represented more affordable vacation spots compared to pricier alternatives.

Significant Deals in 2023

Major companies with existing industrial and distribution hub facilities in Alabama (such as Mazda Toyota, Mercedes-Benz, Hyundai, and Amazon) have grown Alabama operations through increased development. Huntsville, Alabama's largest and fastest growing city, has been named a "real estate market to watch" by the National Association of Realtors, and continues to grow.

With the ongoing midtown developments, and with additional renovation, restoration, and development to the historic AG Gaston Motel, Southtown Court, Frank Nelson Building, Birmingham Building Trades Tower, and The Hardwick, there are many notable Birmingham projects. Luxury multifamily and commercial building opportunities are still ongoing, as downtown and metropolitan areas of Birmingham, Huntsville and other cities increasingly gain more attention. These types of projects and large, in-progress construction will likely generate additional real estate investment in 2024.

1.3 Proposals for Reform

Broker Legislation (National Association of Realtors)

In the residential real estate market, the National Association of Realtors came under fire in 2023, with multiple lawsuits being focused on the commission paid by the homeowner seller in residential transactions which is divided among brokers for both buyer and seller in such transactions. A settlement in early 2024 could result in eliminating such commissions, which commonly fall around 6% of the purchase price. At this point, it is unclear how this legislation and trend toward eliminating anti-competition of broker fees and commission will affect the commercial real estate industry specifically.

The Corporate Transparency Act (CTA)

The CTA became effective on 1 January 2024, requiring entities to report information, including specific beneficial ownership information, to FinCEN (the US Department of Treasury's Financial Crimes Enforcement Network). Community associations, such as homeowners or condominium associations, are likely required to provide such reporting despite operating as not-for-profit entities.

Applicability of the CTA and the specific reporting requirements should be reviewed to confirm that such community associations are in compliance. Challenges to the constitutionality of the CTA are currently ongoing in the first few months of 2024. In March 2024, the US District Court for the Northern District of Alabama declared the CTA unconstitutional, and this ruling is on appeal.

The Alabama Property Protection Act (APPA)

Effective on 1 August 2023, the APPA prohibits foreign principals (as defined in the APPA) from China (not including Taiwan), Iran, North Korea, and Russia from owning:

- agricultural and forest property; or
- property within ten miles of a military installation or critical infrastructure facility.

See Section 35-1-1.1. A list of what qualifies as a critical infrastructure facility is provided in Section 35-1-1.1(b)(2), and Section 35-1-1.1(d) provides an exception for existing owners.

2. Sale and Purchase

2.1 Categories of Property Rights

Unless the conveyance specifies otherwise, when real property is conveyed, granted, or demised, it is transferred as an absolute fee simple estate (Section 35-4-2). Alabama law also permits life estates, easements and servitudes. A fee simple owner may grant a leasehold estate or license to permit others to occupy and use the owner's real property. See **6. Commercial Leasing**.

2.2 Laws Applicable to Transfer of Title

A conveyance of real property must generally be written and signed by all parties, with witnesses to the signatures (Section 35-4-20), and must contain a valid property description. Conveyance instruments must:

- provide the instrument preparer's name and address (Section 35-4-110);
- list the grantor's marital status and conveyed property's homestead status (Section 35-4-73); and
- provide ad valorem tax notice, typically using Real Estate Sales Validation Form RT-1 (Section 40-22-1). See also **8.1 VAT and Sales Tax**.

Residential conveyances require special disclosures, but generally there are no special laws regarding the transfer of real property based on use. However, the parties to a transaction or locality rules may require additional provisions to be included in the deed or in a separate document recorded with the deed at closing.

Buyers should still take additional precautions to ensure that the property's proposed use complies with relevant local rules (see **2.8 Permitted Uses of Real Estate Under Zoning and Planning Law**).

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title is generally effectuated by a deed, usually taking the form of a general warranty deed, statutory warranty deed (Section 35-4-271), or a quitclaim deed. In commercial transactions, the most common form of deed is the statutory warranty deed. Other forms of conveyancing and/or transfer or occupancy instruments include:

- ground leases;
- leases;
- judicial decrees vesting title to real property;
- foreclosure deeds;
- tax deeds;
- sheriff's deeds; and
- deeds in lieu of foreclosure.

Conveyancing instruments must be recorded in the office of the judge of probate for the county in which the property resides (Section 35-4-50). Alabama uses a hybrid "race-notice" system where a purchaser takes priority over all prior purchasers of which they have no notice at the time they record their conveyance – eg, see Nelson v Barnett Recovery Corp, 652 So 2d 279, 281 (Alabama Court of Civil Appeal 1994) regarding Section 35-4-90.

2.4 Real Estate Due Diligence

In commercial transactions, due diligence typically involves:

- review of title and survey matters;
- physical property inspection;
- financial and other property records inspection; and

- review of relevant zoning, permitting, or platting requirements.

It may also include an examination of the property's environmental condition.

Lawyers are typically assigned review and/or cure of title and survey matters, and are often involved in addressing permitting and platting requirements as well as the resolution of environmental matters, if applicable. The allocation of attorney versus client responsibility continues to vary considerably based on the client's size and needs.

2.5 Typical Representations and Warranties

Purchase and sale agreements (PSAs) may vary from those providing for the sale of property in its "as is, where is" condition, with no representations to PSAs containing significant representations and warranties, such as the following:

- the seller's ownership of title;
- the seller's authority to sell the property;
- that no violations of law are present on the property;
- that the property has no tenants in possession (except as noted);
- the seller's warranty to satisfy mechanics' liens;
- environmental matters;
- zoning and permitting status; and
- the absence of pending litigation and condemnation.

Alabama law provides for an implied warranty of fitness and habitability for the sale of new residential property; however, the doctrine of caveat emptor generally applies – see Sims v Lewis, 374 So 2d 298, 303 (Alabama 1979).

A buyer's customary remedies for a seller's misrepresentation are based on the contract's terms. The seller's liability for such a breach can be negotiated and is often capped at a specific dollar amount, which varies.

2.6 Important Areas of Law for Investors

Foreign companies are not required to register with the state unless they are considered to be transacting business in Alabama (Section 10A-1-7.01). Foreign companies must, however, comply with all federal laws relating to the transfer of property to a foreign investor, including FIRPTA, etc. Additionally, foreign investors should consider the tax implications of such a transaction when purchasing real estate (see **8. Tax**). Recent changes to CFIUS regulations have had some impact in Alabama.

2.7 Soil Pollution or Environmental Contamination

Alabama's laws generally conform to federal environmental laws. Because environmental statutes often hold the current owner strictly liable for the costs of remediation, commercial real estate buyers and sellers may contractually allocate environmental liability. Buyers and sellers will negotiate the terms of any "as is" language, indemnification for environmental matters, and any release of environmental claims between the parties.

Negotiated terms vary between contracts, with sellers favoring caps on their liability and buyers preferring a complete indemnification from sellers. Additionally, many buyers wish to limit their liability by satisfying the requirements for the "innocent landowner defense" against CERCLA liability (discussed further in **3.8 Lender's Liability Under Environmental Laws**).

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

An interested buyer can request a zoning verification letter from the applicable jurisdiction's planning department. Some departments will include statements of compliance or non-compliance, but many counties in Alabama do not have the staff capacity to do so. In those cases, if a buyer or its lender requires a compliance certificate, there are consultants available who will provide such a compliance report or certificate for a fee. Local municipalities may enter into a development agreement to facilitate a specific project use, depending on the municipality and project type.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental taking of property by eminent domain and condemnation actions may occur if the property is taken for a "public use" and payment of "just compensation" is made (Alabama Constitution of 1901, Article XII, Section 235). In addition to state and federal constitutional limitations, Alabama has adopted the Alabama Eminent Domain Code, which sets procedures for eminent domain cases (Section 18-1A-1 to -311). If a landowner rejects an offer to purchase from the state, the state will file a complaint for condemnation with the probate court for the county where the relevant property is located.

2.10 Taxes Applicable to a Transaction

The deed tax is triggered by any real estate conveyance and is typically allocated to the purchaser, unless otherwise agreed by the parties. The purchase of an interest in a property-owning company is not considered a conveyance of real estate and, therefore, does not trigger the deed tax. The deed tax is USD0.50 for every USD500 (rounded up) of the conveyed property's value. If a mortgage is recorded simultaneously with the deed, a credit is provided by statute, such that the deed tax due is calculated on the value of the real property not securing the mortgage only (Section 40-22-1(c)).

For example, if a property is purchased and sold for USD2 million and the deed is recorded simultaneously with a mortgage of USD1.5 million secured by the property, the deed tax would be calculated only against the USD500,000 portion of the property's value not already subject to the mortgage tax.

Statutory deed tax exemptions exist for certain instruments made for agricultural purposes (Section 40-22-4), farm loans (Section 40-22-5), and certain conveyances by religious organizations (Section 40-22-5.1).

2.11 Legal Restrictions on Foreign Investors

See **1.3 Proposals for Reform** regarding the APPA and Section 35-1-1.1.

Under Alabama law (in addition to FIRPTA), upon the sale of any real property, the transferor must withhold 3% (if the buyer is an individual) or 4% (if the buyer is an entity) of the purchase price; or, if the gain recognized on the sale is less than the purchase price and the seller provides the buyer with an Affidavit of Seller's Gain (see Alabama Department of Revenue (ADOR) Form NR-AF2), the buyer may withhold 3% or 4% of the amount of the gain (Section 40-18-86). Transferors may be exempt from these withholding requirements under Section 40-18-86(d) (see **8. Tax**).

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The acquisition of commercial real estate is generally financed with indebtedness secured by a mortgage lien on acquired property. Depending on the type of real estate, financing may be available through bank debt, conduit loans, or government-sponsored enterprises.

3.2 Typical Security Created by Commercial Investors

A purchaser or developer of commercial real estate generally grants a mortgage to secure borrowed funds used to acquire and/or develop the real estate. Most commercial lenders also incorporate a security agreement into the mortgage (in addition to separate UCC filings made locally and in the borrower entity's domicile state) to cover personal property attached to or used in connection with the mortgaged real estate and proceeds. Lenders can also collateralize (with additional agreements and filings) the borrower's entity interests or stock and/or deposit accounts.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Financial institutions that are not domiciled in Alabama may be required to qualify to do business in Alabama and may be liable for filing tax returns and payment of annual privilege tax (under Sections 40-14A-21 to 40-14A-29) and excise tax (under Sections 40-16-1 to 40-16-8) if the financial institution is doing business in Alabama within the meaning of the laws.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Under Section 40-22-2, mortgage recording tax is generally USD0.15 per USD100 of the loan amount secured by the mortgage. Mortgages with open-end or revolving indebtedness have two options for paying the recording tax, as follows.

- Paying the recording tax based on the maximum principal indebtedness stated in the mortgage, regardless of the cumulative amount advanced.
- If the mortgage does not state the maximum principal indebtedness, the taxpayer must:
  - (a) pay a recording tax on the actual amount initially advanced;
  - (b) annually report the amount of indebtedness secured by the mortgage; and
  - (c) pay tax on additional advances made.

There are mechanisms, such as obtaining tax orders from ADOR, for allocating recording tax for mortgages covering property in multiple counties or states. Additionally, a nominal per-page recording fee will be collected upon recording.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Other than general contract law principles and granting a mortgage in proper form for recording, with the required information included in the document, there are no specific legal rules or requirements applicable solely to entities. For most transactions, it is recommended to obtain a lender's title insurance policy insuring the mortgage.

3.6 Formalities When a Borrower Is in Default

A mortgage must be recorded to maintain priority over subsequent liens granted on the property. Section 35-10-1 to -98 deals with state requirements for foreclosure. There is a homestead exemption pursuant to Section 6-10-2 and

a one-year statutory right of redemption under Section 6-5-248(b).

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debt can be subordinated to newly created debt if the parties execute and record a subordination agreement.

3.8 Lenders' Liability Under Environmental Laws

Unless the lender is deemed to be a partner in the transaction, it cannot be held liable under environmental laws for merely holding security (ie, a mortgage) unless it directly causes the pollution or contamination. Nonetheless, most Alabama lenders typically require an environmental indemnity agreement from the borrower and one or more beneficial owners.

If the lender forecloses and becomes the property owner, the only way to qualify for liability exemptions under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) for existing contamination is to conduct all appropriate inquiries (AAI), according to the ASTM E1527-13 standards, in a timely manner prior to the date the loan is made. AAI must be conducted no more than one year prior to the loan closing.

Any report more than one year old is of no value in establishing an innocent purchaser defense under CERCLA. Certain portions of the AAI are only good for 180 days. If AAI is not performed or completed in a timely manner, a lender can be liable once it takes possession of the property for contamination it did not cause.

In addition to AAI, most mortgage lenders in Alabama require the borrower (and other indemnitors) to agree to indemnify the lender against potential environmental liability.

3.9 Effects of a Borrower Becoming Insolvent

Lenders should consider the general principles of US federal bankruptcy law. Typically, loan documents will include provisions dealing with a borrower's potential bankruptcy, though such provisions are of limited or no value in a bankruptcy proceeding.

Borrowers Filing Bankruptcy Petitions

When a borrower files a bankruptcy petition, there is an automatic stay of all actions against a borrower's property, including foreclosure. If a security interest is foreclosed prior to the bankruptcy filing, then, in the absence of some defect in the foreclosure process, the foreclosed property does not become part of the borrower's bankruptcy estate, and the lender is free to exercise its state law rights regarding the property (including taking possession). Even in that scenario, a lender may be forced to ask the bankruptcy court for permission via a motion for relief from the automatic stay. In addition, the foreclosing lender may have an unsecured claim (a deficiency claim) to assert against the borrower in bankruptcy.

Alternatively, if a secured lender fails to foreclose its lien prior to a borrower's bankruptcy filing, the lender will be forced to assert its rights in the borrower's bankruptcy case. Typically, a lender will file a proof of claim and, depending on which bankruptcy chapter the borrower files under (eg, Chapter 7 (liquidation), or Chapter 11 or 13 (business or consumer reorganization, respectively)), will participate in the confirmation process as to the borrower's proposed plan of reorganization. While in bankruptcy, the lender may assert

the rights granted to it under the relevant loan documents.

Petitioning the Court

Prior to taking many actions that would otherwise be allowed outside bankruptcy, a lender must petition the court for relief from the automatic stay. In addition, as to non-residential property that is not a borrower's homestead, a lender's secured lien can be "valued" – ie, bifurcated into secured and unsecured portions after a valuation hearing with the bankruptcy court. Likewise, a wholly unsecured junior lien may be stripped off the property and treated as completely unsecured in certain circumstances.

Defaults

A borrower's insolvency will ordinarily lead to a default under the terms of the relevant loan documents and subsequent foreclosure of the secured collateral. In the commercial context, and depending on the commercial loan and property's size and characteristics, a borrower's insolvency might lead to a receiver being appointed under Alabama law; see Section 6-6-620 to -628.

3.10 Taxes on Loans

There are no taxes related to mezzanine loans besides taxes due on interest and income therefrom.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Alabama law (Title 11, Counties and Municipal Corporations) allows for regulations on property through zoning ordinances or subdivision regulation. See **4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction**. The property owner/developer should research any applicable planning and zoning regulations to the property by ordering a zoning report and communicating directly with the appropriate municipality(ies). In addition, the Alabama business license fee can vary depending on the location of the property and the use. See **8.3 Municipal Taxes**.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Local municipal corporations (cities and towns) may enact zoning laws and regulations through the creation of a comprehensive zoning ordinance, which must be compatible with the enabling statute (Section 11-52-1 et seq). Zoning laws generally designate areas into business, industrial, and residential districts, and control the type, character, kind, and use of structures and improvements in such designated zones or districts (Section 11-52-70). County governments may also enact zoning ordinances and building codes for flood-prone areas outside municipalities (Section 11-19-3).

Private restrictive covenants in the property's chain of title may also create similar controls on the development of property or refurbishment of an existing building.

4.3 Regulatory Authorities

Local zoning laws are passed by the local municipal planning commission and must be consistent with the local comprehensive plan, in accordance with Section 11-52-3. Zoning laws typically control:

- the permitted shape, proportion, and dimensions of lots and structures located thereon;
- the use of such structures;

- setback requirements; and
- the use of parcels in designated zones or areas.

For certain redevelopments, the Alabama Department of Environmental Management may have recorded restrictions on use, development, etc, into the chain of title of a property.

4.4 Obtaining Entitlements to Develop a New Project

Developers typically begin by engaging consultants, such as architects and civil engineers, and by contacting the local planning department for guidance on the permitting process. Developers should review the applicable zoning laws and obtain approval from the local zoning official/department before applying for a building permit.

Depending on the project, a developer may be required to obtain approval from various municipal departments before obtaining building permits. If a project requires a change to the zoning code, vacation of road, etc, public hearings are held, and third parties are permitted to comment and object. Local professionals, such as civil engineers, may be able to provide guidance on local customs to help navigate this process.

4.5 Right of Appeal Against an Authority's Decision

The process of appealing will differ based on the project and jurisdiction, and interested parties should consult the relevant state and local laws.

4.6 Agreements With Local or Governmental Authorities

The process for obtaining permits and approvals varies between different local governmental authorities and utility companies. Planned unit developments are sometimes used or required by a local government to facilitate the development of a project. Interested parties should consult the relevant local authority for further details.

4.7 Enforcement of Restrictions on Development and Designated Use

The first governmental enforcement mechanism for restricting development or designated use of a specific property is for a local planning department to refuse to issue a building permit. After issuance of a building permit, restrictions on development or designated use are enforced by an inspector named by the designated zoning official/administrator.

Private parties may also restrict the development or use of real property by creating a restrictive covenant that runs with the land. The Alabama Supreme Court defines a covenant as "an agreement or promise of two or more parties that something is done, will be done, or will not be done. In modern usage, the term covenant generally describes promises relating to real property that are created in conveyances or other instruments". See Collins v Rodgers, 938 So 2d 379, 385 n 15 (Alabama 2006).

In the real property context, restrictive covenants are generally memorialized by:

- restrictive language in a conveyance instrument;
- an express declaration of covenants, conditions, and restrictions created by a single property owner; or
- an agreement for covenants, conditions, and restrictions agreed to by two or more property owners, all of which may be recorded in the probate office of the county of the encumbered property.

Such private restrictive covenants may be enforced by the parties to the covenant or by the successor in title to such a party. However, Alabama does follow a "general rule that restrictive covenants are not favored in the law and, therefore, that they will be strictly construed, with all doubts resolved in favor of the free and unrestricted use of land and against the covenants". See Whaley v Harrison, 624 So 2d 516, 518 (Alabama 1993).

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Alabama law authorises the formation of corporations, general partnerships (GPs), limited partnerships (LPs), limited liability companies (LLCs), and real estate investment trusts (REITs) for the purpose of holding real estate.

The most frequently used ownership entities in Alabama are LLCs and LPs (including limited liability limited partnerships). Generally, LLCs are preferred to LPs as investment vehicles because none of an LLC's owners ("members") is liable for the entity's debts and obligations, while an LP is required to have at least one partner (the "general partner") liable for such debts and obligations. LLCs also have a potential tax basis advantage over LPs in qualifying for non-recourse basis treatment for an entity-recourse debt. Alternatively, an LP may be preferable if certain owners are not US citizens and if the requirements of their home country's tax laws would impose additional tax burdens upon them otherwise.

Both LPs and LLCs are usually preferred over corporations (other than real estate investment trusts (REITs), as described below) because corporate income is taxed at the corporate level, and then the dividends paid to the corporate owners ("shareholders") are taxed again.

Corporations that own real estate often do so in connection with their trade or business (eg, factories). Other entity types can be used to hold real estate assets as well, such as S corporations and general partnerships, but their use is infrequent due to taxation and liability concerns, respectively.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

With respect to LPs and LLCs, almost all features of their operations are negotiated among the partners or members in an LP's limited partnership agreement or in an LLC's limited liability company agreement, including how and by whom decisions are made as well as how the economics are divided. Major decisions typically require the consent of the partners or members, and often include:

- a sale or refinancing of the principal asset;
- certain major leases;
- construction matters, such as budgets and hiring of contractors; and
- decisions affecting the continuation of the entity, such as merger, termination, and bankruptcy.

These agreements also establish the priorities of economic distributions and the payment of agreed-upon fees among the partners or members, providing for how and when additional capital may be called from the partners or members. It is important that these agreements properly address income tax considerations, as the allocation of economic benefits and tax liabilities of ownership must comply with detailed US tax code regulations or risk unintended tax out-

comes. Both types of agreement will generally have provisions allowing for certain owners to buy the interests of other owners or to have the assets sold under certain circumstances.

Corporate Statutes and Judicial Decisions

Many activities of corporations, including REITs, are governed by Alabama corporate statutes and judicial decisions. In closely held corporations, the owners (shareholders) may enter into a shareholders' agreement, which establishes, among other things, how votes are cast and how interests in the corporation may be bought and sold or otherwise transferred.

Economic distributions within corporations are generally less flexible than distributions within LPs and LLCs. Each share in the same class of ownership shares is entitled to the identical economic distribution as each other share in that class. In order to allocate economics in a corporation differently among shareholders, multiple classes of shares must be created with different priorities of payments and claims on a corporation's distributions.

5.3 REITs

REITs are corporations or business trusts that elect for REIT status, allowing them to pass income through to their owners, like LPs and LLCs; however, because of the complex qualifications required of REITs under the US tax code, investments in REITs are normally limited to large income-producing assets or portfolios of assets. Many REITs are formed as Maryland corporations.

A REIT must pay the same filing fees as other Alabama entities required under Section 10A-1-4.31. When computing such fees under this Section, a REIT should treat its declaration of trust in the same manner as a certificate of formation. Section 10A-10-1.13.

REITs organized under Alabama law (Section 10A-10-1.01 to -1.24) should file its declaration of trust in the same manner as the certificate of formation of an Alabama domestic filing entity. Section 10A-10-1.06 identifies the requirements of a declaration of trust, and Section 10A-10-1.07 sets forth the division of classes of REIT shares permitted by Alabama law. REITs should follow 10A-10-1.11 regarding annual report requirements and submission requirements to shareholders.

5.4 Minimum Capital Requirement

There is no minimum capital requirement, though a nominal amount such as USD100 is common.

5.5 Applicable Governance Requirements

LP Governance

The governance structure of an LP is set out in the agreement of limited partnership, and generally provides that most decisions be made by the general partner. Alabama law allows certain voting rights for the limited partners without jeopardizing their status as limited partners; however, one reason why limited partners do not have liability for the obligations of an LP is because they generally do not have control of the day-to-day activities of the partnership.

LLC Governance

In an LLC, there are two types of governance structure.

One is the "member-managed" structure, where the members are responsible for managing the LLC, making decisions by majority, supermajority or unanimous vote, depending on the nature of the decision and the relative weight of each

member's vote as set forth in the limited liability company agreement.

The other structure is a "manager-managed" LLC, in which a person or entity is designated as the manager with decision-making rights as set forth in the limited liability company agreement. Members who are not managers often retain the right to consent to certain major decisions. A manager can be one person or several persons each having the ability to act independently or being required to act by majority, supermajority, or unanimous vote, depending on the nature of the decision and the relative weight of each member's vote as set forth in the limited liability company agreement.

Corporation Governance

For corporations, including REITs, governance is set forth in their articles of incorporation and their by-laws. The articles of incorporation are a filed, public document containing certain statutorily required information, such as the name, registered office, and registered address of the corporation. The by-laws govern:

- how shareholders vote for the members of the board of directors;
- how the board elects officers;
- the duties of the officers;
- the frequency of shareholder meetings;
- the frequency of board of directors' meetings; and
- other routine matters.

In most corporations, all day-to-day decisions are made by the officers without the approval of owners who are not officers. Certain decisions outside the normal course of business will be made by the board of directors, again without input from owners who are not part of the board. Unless an owner is a director or officer, its only governance right is to periodically vote for members of the board or in connection with certain statutorily required matters, such as merger transactions.

5.6 Annual Entity Maintenance and Accounting Compliance

Maintenance and costs are variable and will depend on ownership/accounting structure. Certain entities must pay an annual Business Privilege Tax in accordance with Sections 40-14A-21 through -29. The rate will vary depending on taxable income and net worth. See Section 40-14A-22.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A real property's fee owner may grant a leasehold estate or license to permit others to occupy and use the owner's real property for a limited timeframe. Leasehold estates allowing a tenant to occupy and use real estate without buying it outright are generally categorized into the following types.

- A tenancy for years is a leasehold estate "limited to endure for a definite and ascertained period, fixed in advance". See Waldrop v Siebert, 237 So 2d 493, 494 (Alabama 1970).
- A periodic tenancy is one where the lease has no stated duration and periodic rent is reserved or paid. See Gulf Coast Realty Co, Inc v Prof'l Real Estate Partners, Inc, 926 So 2d 992, 1007 (Alabama 2005). If no time for termination is stated, the law construes the term to be from December 1st to December 1st (Section 35-9-3).

- A tenancy at will or at sufferance is a lease "for an indefinite and uncertain term" and is sometimes called a tenancy from month to month. See Melson v Cook, 545 So 2d 796, 796 (Alabama Civil Appeal 1989). If a lease is specified as a tenancy at will, it may be terminated by either party at will by giving ten days' notice in writing (Section 35-9-3).

6.2 Types of Commercial Leases

There are no formal, legal distinctions between different types of commercial leases; however, commercial leases are generally divided between "net" leases and "gross" leases. In a net lease, a landlord charges its tenant a base rent plus additional rent for pass-through items, such as common area maintenance, insurance costs, advertising, etc; such pass-through items will vary based on the terms negotiated by the parties.

In a gross lease, a landlord charges its tenant one flat fee for rent, and the landlord is responsible for the property's maintenance costs; however, such maintenance costs are typically accounted for in the amount of the gross lease's base rent. Furthermore, certain categories of commercial leases often contain specialized terms that are unique to the subject matter involved.

6.3 Regulation of Rents or Lease Terms

There are no restrictions on the type or amount of rent charged under a commercial lease in Alabama. A lease term may not be longer than 99 years (Section 35-4-6). If any portion of a lease term is longer than 20 years, the lease or a lease memorandum must be recorded within one year of signing; otherwise, the portion of the term exceeding 20 years is invalid (Section 35-4-6).

Residential leases are generally more regulated than commercial leases and are subject to the Alabama Uniform Residential Landlord and Tenant Act (Section 35-9A-101 et seq).

6.4 Typical Terms of a Lease

Lease terms range from less than one year up to 99 years, depending on the terms of a specific lease.

Landlords typically maintain structural components of leased real estate, while tenants are often required to maintain the leased premises and those systems and improvements serving the leased premises in good working order, although the extent of such maintenance responsibilities varies widely.

Monthly rent payments are typical, but the parties may agree to different terms.

6.5 Rent Variation

The rent payable may vary between different payment periods during the term, based on the lease's terms, typically increasing as time passes during the term.

6.6 Determination of New Rent

Changes and increases in rent will be determined by the terms negotiated by the parties in the lease.

6.7 Payment of VAT

There is, typically, no governmental tax collected on rent paid to a landlord. However, transfer taxes are due when a lease (or memorandum of lease) is recorded in the public records in an amount equal to the tax consideration. See **6.20 Registration Requirements**.

6.8 Costs Payable by a Tenant at the Start of a Lease

Costs paid by a tenant at the start of a lease vary by transaction and the parties' negotiation.

Tenants may pay the first month's rent, a security deposit, broker's fees, or other landlord administrative fees at the start of a lease.

6.9 Payment of Maintenance and Repair

Net commercial leases often pass operating expenses (including common area maintenance and repair) through to the tenant, in accordance with the lease's terms, typically prorated among the tenants of a specific property based on the amount of square footage leased by each tenant at said property. Gross commercial leases typically require the landlord to pay for common area maintenance and repair, though these costs are also typically priced into the rent paid by the tenant.

For a residential lease, the landlord is required to "keep all common areas of the premises in a clean and safe condition", along with other requirements for the leased premises' working order and condition (Section 35-9A-204).

6.10 Payment of Utilities and Telecommunications

Net commercial leases often include utilities and telecommunications services serving an entire property (not just an individual tenant) in the operating expenses that are charged to tenants on a pro rata basis, while gross commercial leases may include the costs of such services, utilities, and telecommunications in the rent charged to the tenant. If such utilities or services are separately metered and service only a single tenant's leased premises, that tenant is often responsible for the payment for such utilities or services.

6.11 Insurance Issues

Payment of insurance premiums insuring leased real estate is typically done by a landlord, but such costs are often passed through to tenants as an operating expense in net commercial leases. Insurance coverages vary by property, but many commercial landlords carry general liability, casualty, flood, and fire insurance, as well as coverage for bodily injury, property damage, lost rents, etc.

6.12 Restrictions on the Use of Real Estate

Landlords may limit the way commercial tenants use leased real estate and often prohibit tenants from using the leased premises for certain exclusive uses negotiated with other parties. Applicable zoning laws and private restrictive covenants in the property's chain of title may impose further restrictions on tenant uses.

6.13 Tenant's Ability to Alter and Improve Real Estate

The terms of a lease will dictate whether a tenant is permitted to alter or add improvements. Often, tenants may receive a tenant improvement allowance to induce signing the lease, requiring that a landlord either installs certain improvements on the premises or reimburses the tenant for its costs.

Often, a lease requires a tenant to obtain the landlord's written approval for materials, plans, contractors, etc, involved in such improvements before starting the construction or installation of such improvements. Furthermore, trade fixtures may generally be removed by a tenant, though the tenant may be held liable if they damage the underlying real property in the process of removal. See LaFarge Bldg Materials, Inc v Stribling, 880 So 2d 415, 419 and 424 (Alabama 2003).

6.14 Specific Regulations

The Alabama Uniform Residential Landlord Tenant Act (Section 35-9A-101 et seq) governs any rental agreement ("all agreements, written or

oral, and valid rules and regulations adopted under Section 35-9A-302 embodying the terms and conditions concerning the use and occupancy of a dwelling unit and premises") related to the rental of any dwelling unit (a "structure or the part of a structure, including a manufactured home, that is rented as a home, residence, or sleeping place by one or more persons") to a tenant ("a person entitled under a rental agreement to occupy a dwelling unit to the exclusion of others"); Sections 35-9A-141.

This statute includes additional rules and regulations for both landlords and tenants in the residential context. Non-residential real estate leases may include specific restrictions related to the category or use of the leased premises, but such leases are generally not subject to specific regulations or laws due to the use or category of the underlying leased premises.

6.15 Effect of the Tenant's Insolvency

Leases often contain language stating that a tenant's insolvency or the filing of any bankruptcy petition, voluntary or involuntary, constitutes a default under the lease. However, if the lease remained in force at the filing of a bankruptcy petition, the leasehold estate is considered an asset of the tenant, which is protected by the Bankruptcy Code's automatic stay.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

In addition to requiring a tenant to provide a security deposit under the lease, a lease may provide that a tenant grants the landlord a security interest in the furniture, fixtures, equipment, inventory, etc, located at or related to the leased premises. The landlord may file such a security agreement under applicable law.

A landlord may also require the tenant to deliver a letter of credit or personal guarantee for costs related to any default by a tenant under the lease. However, for residential leases, liens or security interests of a residential landlord in a tenant's household goods are not enforceable unless perfected before January 1st, 2007 (Section 35-9A-425).

Commercial landlords are also granted statutory liens over crops grown on rented land (Section 35-9-30) and for the goods, furniture, and effects of a tenant or subtenant for rent due (Section 35-9-60).

6.17 Right to Occupy After Termination or Expiry of a Lease

Generally, a tenant does not have the right to continue to occupy the leased premises after the expiry or termination of a commercial lease. When a tenancy is for a certain period of time and the term expires under the lease, the tenant is bound to surrender possession without the landlord providing notice to quit or demanding possession (Section 35-9-8).

If a landlord has terminated the lease for a breach or default, the landlord must give the tenant notice of termination at least ten days prior to terminating a commercial lease, unless the lease provides for additional time (Section 35-9-6).

If the tenant does not deliver possession of the leased premises after demand, as described above, the landlord may pursue an unlawful detainer action in the district court of the county where the premises are located (Section 6-6-330). The landlord's complaint must be served on the tenant at least six days before the hearing date (Section 6-6-332).

If the district judge rules in favor of the landlord, the court will file a writ of execution, which requires the sheriff to restore the premises to the landlord (Section 6-6-337). The tenant may file an appeal of the judge's ruling within seven days, and a trial on the appeal is scheduled within 60 days of the date of the appeal (Section 6-6-350).

The landlord's right to possession will not be delayed by a tenant's appeal, and can only be prevented if the tenant pays all rent payable before the landlord regains possession by a writ of possession (Section 6-6-351).

6.18 Right to Assign a Leasehold Interest

Typically, the ability to assign the lease or sublease the premises is restricted to a certain extent in the lease, but a tenant generally has the right to sublease the property or assign the lease without the landlord's consent if the lease is silent about subleases and assignments. If the lease requires the landlord's consent before subleasing or assigning the lease, the landlord cannot "unreasonably and capriciously" withhold consent (Homa-Goff Interiors, Inc v Cowden, 350 So 2d 1035, 1038 (Alabama 1977)).

6.19 Right to Terminate a Lease

In Alabama, provided the remedy is included in the commercial lease, a landlord is typically allowed to terminate the lease for:

- failure to pay rent or other amounts due under the lease in a timely manner;
- default under the lease (sometimes after a required opportunity to cure);
- violation of applicable laws; and
- other terms specified in the lease.

For residential leases in Alabama, by statute, a landlord may terminate a lease by delivering written notice to the tenant specifying the acts or omissions causing the breach in the following cases:

- the tenant's material non-compliance with the lease;
- the tenant's intentional misrepresentation of a material fact;
- the tenant's material non-compliance with any of their statutory obligations; or
- if the tenant does not pay rent when due (Section 35-9A-421(a) and (b)).

If the breach arises from unpaid rent or other curable breaches, the lease shall terminate within seven business days of receiving the notice if not remedied by the tenant. Other breaches are not curable, including intentional misrepresentation of a material fact and certain acts on the premises (eg, possession of illegal drugs or criminal assault). See Section 35-9A-421(a), (b) and (d).

6.20 Registration Requirements

A lease must be either:

- properly acknowledged by an authorised officer (for example, a notary public); or
- attested by one witness.

See Sections 35-4-20 and 35-4-23.

If a lease term is 20 years or less, including options to extend, a memorandum of lease is not required to be recorded to be enforceable against a third party, if that third party had actual or constructive knowledge of the lease. Leases for more than 20 years, including options to extend, are void for the period of time over 20 years, unless, within one year of the lease's execution, the lease or a memorandum of the lease is recorded with the probate office in the

county where the leased property is situated. See Section 35-4-6.

Transfer taxes are due when the lease (or a memorandum of lease) is recorded in the public records (Section 40-22-1(a)). Transfer taxes are USD1 multiplied by the tax consideration.

The tax consideration is calculated as follows: term of lease (in months) multiplied by monthly rent multiplied by percentage from a lease percentage chart kept by the probate court of the county where the property is located (which is based on the term of the lease), divided by 1,000. See Section 40-22-1(c).

To obtain the proper lease percentage table, attorneys should contact the probate court of the county where the property is located. The tax consideration is rounded up to the nearest USD500 (Section 40-22-1(c)).

6.21 Forced Eviction

Residential Lease

For a residential lease, the landlord must give the tenant seven business days' notice of default; if the default is not cured, the landlord may file an unlawful detainer action, notice of which must be posted at the leased premises. The tenant then has seven days from the posting of notice to file an answer. Assuming the tenant does not answer, the landlord may file for a writ of execution with the district court for the county where the leased premises are located, which will be issued to the county sheriff, and it may take several weeks to actually serve and evict the tenant.

In total, the process can take several months or longer, based on the case's specific circumstances; see Section 35-9A-461.

Commercial Lease

For a commercial lease, the landlord must give the tenant ten days' notice of default (or more, if required under the lease); if the default is not cured, the landlord may file an unlawful detainer action, notice of which must be posted at the leased premises. The tenant then has 14 days from the posting of notice to file an answer. Assuming the tenant does not answer, the landlord may file for a writ of execution with the district court for the county where the leased premises are located, which will be issued to the county sheriff, and it may take several weeks to actually serve and evict the tenant.

In total, the process can take several months or longer, based on the case's specific circumstances; see Section 6-6-310 to -353.

6.22 Termination by a Third Party

Pursuant to its terms, a lease may be terminated by a third party in the case of condemnation or foreclosure on the part of a lender that pre-dated the lease. In the event that the leased premises are condemned, "the lessee is entitled to share in the total award only in proportion to [its] interest" (State Highway Department v Lawford, 611 So 2d 285, 288 (Alabama 1992)); and, if the fee owner is satisfied with the award for its interest in the property, but the leasehold owner is not, the circuit court can order a separate trial for the leaseholder on appeal (State v SouthTrust Bank of Baldwin City, 634 So 2d 561, 563-564 (Alabama Civil Appeal 1994)). Payment is based on the fair market value of the leasehold interest.

6.23 Remedies/Damages for Breach

An Alabama landlord may only accelerate rent in a commercial lease if the lease expressly permits this. A landlord may only pursue self-help to retake possession of the premises after a default if the lease permits re-entry on default. Alabama

law does not impose on a landlord a duty to mitigate damages absent an express obligation in the lease to do so (Bowdoin Square, LLC v Winn-Dixie Montgomery, Inc, 873 So 2d 1091 (Alabama 2003)). The typical form of an eviction proceeding involving commercial leases is an action for an unlawful detainer. See Section 35-9-1 to -100 and Section 6-6-310 to -353.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The type of pricing structure used for projects depends on several factors, including:

- the current economic climate;
- owner's desires;
- financing concerns; and
- public entity status.

In commercial construction projects, there are typically more guaranteed maximum or fixed-price contracts than open-ended cost-plus contracts, while fixed-price contracts are used almost exclusively in the public works sector.

7.2 Assigning Responsibility for the Design and Construction of a Project

Alabama law requires a registered architect to sign off on plans for the design and construction of a project (Section 34-2-32). For projects of USD50,000 or more, a contractor must be licensed by the Alabama Licensing Board for General Contractors (Section 34-8-9).

If there are engineering requirements, a licensed engineer must be consulted and approve the plans. In addition, most trades are required to be licensed by their respective governing authority, such as plumbers/gas fitters and electrical contractors (Sections 34-37-1 and 34-36-1 et seq). The project's owner will typically employ an architect and engineer to work with a general contractor to conceptualize the project; the general contractor then delegates subcontracts as necessary, often without being subject to owner approval, unless the owner contractually retains that right.

7.3 Management of Construction Risk

Owners and general contractors frequently utilize insurance policies and indemnification agreements in their contracts with each other, and in particular with their subcontractors. Since contribution among joint tortfeasors is unavailable, the only method for obtaining contribution is to contractually oblige the counterparty to indemnification. Waivers are generally acceptable, and interim and final lien waivers are highly recommended.

Each payment on a pay application should be accompanied by an interim lien waiver, and the final payment (including retainage) should be accompanied by a final, unconditional lien waiver and hold harmless agreement. Furthermore, limitations or caps on liability can be negotiated into the contract, in addition to provisions requiring the contractor to post payment and performance bonds from a reasonably acceptable surety.

7.4 Management of Schedule-Related Risk

Delays in construction should always be addressed in the contracting documents. While a penalty is not available, the contract can provide for an agreed-upon "liquidated damages" provision providing for a certain amount to be allocated for each day, week, or month that the project is behind schedule or for each milestone missed. Delay damages can be accounted for as

a back charge to the contractor to be deducted from payments due.

As additional security for paying material suppliers or remedying defects and delays in construction, owners and general contractors are entitled to hold back retainage; see Section 8-29-3. An owner or general contractor may retain 10% of payments to the general contractor or subcontractor, respectively; see Section 8-29-3(i) and (j).

The retainage may only be taken from the first 50% of the payments for completion, after which "no further retainage shall be withheld"; see again Section 8-29-3(i) and (j).

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Depending on the project's size, payment and performance bonds are the most common form of security to guarantee a contractor's performance on a project. As a general rule, the larger the project, the more likely it is for an owner to require more expensive security on a project. Public works are required to be bonded (see Section 39-1-1), but there is no requirement for any security or bonding to be posted by a contractor on private work.

The most common method is for the owner to require both a payment and a performance bond from a reputable surety. Other layers of security may be negotiated into the relevant contract if risk is increased.

7.6 Liens or Encumbrances in the Event of Non-payment

Any party who contributes work to the property that improves the property is eligible for a materialman's lien (Section 35-11-210 et seq). The work provided must be a lasting improvement, not temporary. For example, an architect's work in providing plans would be lienable, whereas a surveyor's work would not; Wilkinson v Rowe, 98 So 2d 435 (Alabama 1957).

If the lienor's work is commenced prior to the "creation" of a mortgage on the property, the lien will take priority over the mortgage; otherwise, the lien will be junior to the mortgage (Section 35-11-211). Liens may be removed from the property by transferring the lien to a bond using the statutory framework found in Section 35-11-233.

7.7 Requirements Before Use or Inhabitation

Each governmental jurisdiction has a building inspector's office, which must issue a certificate of occupancy prior to the project being inhabited, and which establishes standards for construction in its respective jurisdiction. Inspections are typically required to be conducted, and passed, prior to each phase of the work.

8. Tax

8.1 VAT and Sales Tax

Recording Tax

Alabama imposes a recording tax upon the filing of a deed or similar instrument conveying an interest in real estate with the county probate court where the real property is located (Section 40-22-1 et seq); the tax is USD0.50 per USD500 (rounded up) of value for the property conveyed. The obligation to pay the recording tax is on the buyer.

However, the parties do commonly negotiate the economic burden in real estate sales contracts. Under Alabama law, a deed or other instrument conveying such property must include a Real Estate Sales Validation Form (RT-1) provided

to the county probate court at the time the instrument is presented to the probate court for recording. This form must include either proof of the actual purchase price (if the property is being sold) or the actual value of the property (which may be evidenced by a licensed appraisal or the assessor's current value for the property).

Income Tax

Alabama imposes an income tax that is similar to the federal income tax system (Section 40-18-1 et seq). The maximum Alabama marginal income tax rate on taxpayers other than C corporations is 5%. The maximum Alabama marginal income tax rate on C corporations is 6.5%. The seller must report the gain on the sale of the real property in its annual income tax return. Unlike federal income tax law, Alabama's income tax law does not contain a preferential rate for long-term capital gains.

Withholding of Income Tax

Alabama imposes a withholding of income tax in connection with sales by non-Alabama resident taxpayers (Section 40-18-86). No withholding is required if the seller is an Alabama resident or a "deemed" resident, provided the seller provides a duly completed affidavit confirming such residency (AL Form NR-AF1).

Certain limited types of transactions are exempt from non-resident withholding under Section 40-18-86 (AL Form NR-AF3). If the seller is not an Alabama resident, and if the transaction is not an exempt transaction, the buyer is generally required to withhold either 3% (where the buyer is an individual) or 4% (where the buyer is an entity) of the purchase price.

However, if the gain recognized on the sale is less than the purchase price, and the seller provides the buyer with an Affidavit of Seller's Gain (see AL Form NR-AF2), the buyer may withhold 3% or 4% of the amount of the gain. If the amount to be withheld, as based on the purchase price or the gain, is greater than the net proceeds of the transfer, then only the net proceeds need to be withheld and remitted by the purchaser. Generally, the net proceeds of the sale are the net payments to the transferor as shown on the closing statement, but "net proceeds" may be calculated in other statutorily prescribed manners.

See **5.6 Annual Entity Maintenance and Accounting Compliance** regarding Business Privilege Tax.

8.2 Mitigation of Tax Liability

If the property being conveyed is located in more than one county in Alabama, there is a procedure for obtaining an order from the Alabama Department of Revenue (ADOR) to allocate the value of the property being conveyed among the relevant counties, so that the proper recording tax in each county can be determined.

8.3 Municipal Taxes

Each municipality is permitted to impose an annual business license tax on business conducted within its taxing jurisdiction, including leasing real estate.

8.4 Income Tax Withholding for Foreign Investors

Alabama has two withholding regimes related to income taxes attributable to non-Alabama resident taxpayers, including non-US taxpayers.

Income Tax Withholding Regime

See **8.1 VAT and Sales Tax** regarding withholding of income tax. In addition, non-Alabama resident owners of pass-through entities, such as partnerships or S corporations, are subject

to a composite payment regime under Section 40-18-24.2 (relating to partnerships and other "Subchapter K entities") and Section 40-18-176 (relating to S corporations).

Composite Payment Regime

Under the composite payment regime, the pass-through entity files and directly remits taxes to ADOR with respect to the allocable pass-through income of the non-Alabama resident taxpayer, including the share of gain from the sale of real estate by the pass-through entity.

8.5 Tax Benefits

Income tax benefits are provided under Alabama's income tax law, which is generally consistent with the federal income tax system.

In certain circumstances, Alabama law provides for tax incentives with respect to certain qualifying investments in the state, such as:

- the creation or expansion of industrial or research facilities;
- various job credits;
- data-processing centers;
- the relocation of corporate headquarters;
- investments to rehabilitate certain historic structures; and
- other qualifying projects.

The potential incentives may include abatements related to:

- income tax;
- state and local sales and use tax;
- state and local ad valorem tax; and
- state recording taxes.

To qualify for such incentives, the taxpayer must file the required applications and reports, and must be approved by the proper governmental authorities; the approved investment must also comply with additional compliance requirements. A summary of Alabama's taxes and tax incentives can be found on the ADOR website.

Trends and Developments

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Dentons

Dentons is a global law firm with a team of over 1,000 real estate lawyers in more than 80 countries across the globe, including more than 180 real estate lawyers spread across 45 locations in the United States, and 19 real estate lawyers throughout the state of Alabama. Dentons' team of real estate lawyers is adept at handling the myriad of needs pertaining to real estate developers and investors, including assisting clients in procuring capital and credit, often combining construction, permanent, mezzanine and tax credit facilities with equity participations. The team is also well equipped to handle zoning and other land use matters, as well as litigation and controversies, including eminent domain, design and construction, environmental regulatory enforcement, ejectments, and dealing with insolvent counterparties.

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Introduction

Although USA's real gross domestic product (GDP) increased at an annual rate of 2.5% last year, real estate sectors in 2023 "stutter-stepped" due to several different factors straining development and transactions. Stubborn inflation caused rate hikes and a delay in rate decreases, making debt more expensive. As debt rose in cost, equity followed suit, including completion requirements, returns, and more stringent market selections. Higher rates also slowed permanent refinancing of construction debt, causing more construction debt on lender books and less appetite for new construction loans.

Further, while construction materials costs decreased, labor costs generally did not, and construction costs ultimately remained relatively high in 2023. Joint venture equity agreements continued to be common, with developer completion guaranties becoming more strenuous as many deals and projects were delayed throughout the year. Nationally, the office sector faced loan maturities with lower occupancy, which caused lower values.

In comparison, multifamily endured as certain markets remained vibrant and active, even with a decline in new project starts. This imminent decrease in supply has caused many market participants to expect a spike in rents, which would result in a wave of new investments and construction. Retail and industrial assets continued trying to evolve in line with the new normal, which includes more online shopping and a greater desire for physical retail to incorporate experiential activities with traditional shopping.

This chapter will summarize how this past year's general real estate trends will shape the market in Alabama for the future.

The Housing Market

The housing market began to slow after a period of rapid growth since 2020, due largely to a competitive environment created by high mortgage rates and incredibly low availability for interested buyers. Recent homebuyers who bought when mortgage rates were much lower were able to afford more expensive houses. Now, these homebuyers have no reason to sell when similarly priced houses are less affordable due to higher mortgage rates. Other contributing factors included home prices undergoing significant increases, as homes on the market continued to sell above listing price. The inventory of housing at the end of the year was also at an all-time low, and the median sale price peaked in June 2023 at USD425,000, causing market averages that proved to be too competitive for the majority of consumers.

In the fastest-growing city in Alabama, Huntsville's major establishments (such as Google, NASA, Boeing, Toyota, and even the federal government) are continuing to recruit educated workers, particularly from the 24- to 34-year-old demographic, into the local real estate market. This demographic has held home ownership rates steady, especially those with household incomes of greater than USD100,000.

There were multiple lawsuits against the National Association of Realtors in 2023 focused on the commissions paid by homeowner sellers in residential transactions, with these commissions generally being divided among brokers for both buyer and seller in such transactions. In early 2024, a settlement resulting in the elimination of these commissions occurred, with over USD400 million in damages being paid to groups of homeowner sellers. At this point, it is unclear how the legislation and trend against anti-competition of

broker fees and commissions will impact on real estate markets.

Multifamily

Rental demand is back on the rise, and apartment buildings have proven yet again to be a resilient asset, despite high construction costs. However, high interest rates remained a cause of concern throughout the year, with flatter rents and less occupancy leaving investors waiting for stabilization, and resulting in a slowdown in new construction projects.

Nevertheless, Huntsville again remained a target for multifamily investment, and is commonly identified as a great market for rental property. Huntsville's population has continued to grow, driven in part by the technology and aerospace sectors attracting large employers to the state. Over the past few years, Huntsville has surpassed Birmingham as the largest city in Alabama, and will continue to outpace other areas in the state. One of the many reasons for such growth is the movement of FBI employees to its new facility in the Redstone Arsenal. This, among other large projects, has created a competitive and fast-paced market in the Huntsville-Madison area. Throughout Alabama (and nationally), certain markets and sub-markets were still active in multifamily.

Repurposing retail properties into multifamily and mixed-use projects continued through 2023, though this can be challenging due to construction costs and many zoning laws lacking provisions that contemplate adaptive re-use, coupled with a push to prioritize multifamily housing with moderate tier rents. In addition to a spike in "workforce housing" development, there was a moderate increase in single family rental developments and build-for-rent (build-to-rent) developments. These redevelopments have triggered an uptick in zoning/entitlements work, disputes (or threatened disputes) with neighbors and municipalities, and private title declarations and easement agreements.

Lending

The London Interbank Offered Rate (LIBOR) was phased out in 2023 as lenders transitioned to the Secured Overnight Financing Rate (SOFR), which seems to be the replacement rate of choice. The transition from LIBOR was facilitated by a working group of the Federal Reserve, which has promoted the SOFR index as a replacement. Being based on overnight transactions, SOFR relies entirely on transaction data, whereas LIBOR is based partially on expert estimations. Neither the amendments nor new loans using the SOFR benchmark caused any notable problems. Some bank failures occurred in 2023, causing many banks in the market to prioritize deposits over loans, and subsequently causing the volume of loans to decrease. At the same time, rates increased, also causing permanent financing loans to decrease. Ultimately, construction loans were not paid off, and there was less desire in the market for construction loans in general.

Suburbs

In 2023, the seller's market maintained its momentum, especially in the suburbs. Home prices continued to rise, with an unusual combination of low supply and high demand in popular suburban areas. Mortgage rates also continued to increase, rising past 8% for the first time in 20 years; the average monthly mortgage rate reached over USD2,600, growing at a faster rate than wages. However, rates began to steady towards the end of the year and are predicted to drop by mid to late 2024.

Suburban popularity is buoyed by the continued disinterest in office spaces and historically low inventory for potential buyers. The resulting outcome makes sense: if more people are staying at home in the suburbs, they are more likely to shop and support businesses in their immediate areas. Just as businesses followed people into cities, businesses are likely to follow the labor force into the suburbs, particularly given the lower rents and commute times. This proved to be true even with the prices of goods and services facing high rates of inflation.

Even as Gen Z joins the workforce, millennials are still considered a vital source of talent and remain the focus of HR professionals. They also remain the largest group in the workplace, with the power to set and maintain trends and to request change, particularly accommodation for work-from-home flexibility and coworking solutions. Millennials' homebuying decisions are disproportionately based on convenience and proximity to work; in other words, the decision on where to purchase a home relates directly to the job location. Coupled with millennials wishing to become first-time homebuyers are those who have finally recovered from the financial crisis of 2007–2008, resulting in a pent-up demand for quality homes in convenient locations.

Office

As is to be expected, the movement of office properties on the market continues to be minimal. Unlike in multifamily, which sees turnover from year to year even during difficult climates, office leases are generally much longer, and are showing signs that they are unlikely to reach pre-COVID-19 pandemic norms any time soon. While remote work was already growing in popularity, the pandemic jump-started a new normal for office work that creates an interesting dynamic. Nationally, office buildings as assets became higher risk. However, many workers in Alabama have returned to the office; as such, compared to the national landscape, there have been fewer office space foreclosures in Alabama.

Further, organizations and companies moving to Alabama cities such as Huntsville and Birmingham suggests that entities, not just individuals, may be looking to transition to more affordable places for central hubs. Even so, Birmingham continues to be an attractive destination for businesses. Brassfield & Gorrie announced plans to invest USD18.9 million to expand its national headquarters in the Lakeview District of Birmingham, and start-up Primordial Ventures recently announced plans to construct a USD3.3 million manufacturing operation in the city.

Suburbs and Office Space

Perhaps surprisingly, the US suburbs continue to hold a large percentage of total office space inventory and occupancy. Undoubtedly, this stems from cheaper land, availability, and a desire for spacious sites. Though vacancy has historically been higher in the suburbs, the gap between the central business district (CBD) and suburbs shrunk to a mere 35 basis points just prior to the pandemic. Annual growth rates for the suburbs have held steadier than the rates for the CBD in the past five years. Vacancy rates peaked in mid-2010, though rates declined faster in the suburbs than in the CBD. From 2005 to 2015 – just ten years – the CBD rent premium more than doubled.

The Birmingham office market ended Q4 of 2023 with a positive net absorption totaling 89,117 square feet and a vacancy rate of 19.0%, according to Cushman & Wakefield's MarketBeat report. With vacancies very slowly dropping and softening demand, owners are continuing to raise rents, though at a slower pace. Commer-

cial leasing remained steady, and multiple multi-tenant office redevelopments are ongoing in the CBD and midtown supermarkets, including the Hardwick, which is expected to add around 40,000 square feet of office space to the CBD. While some have predicted that office development will continue in the future, it is unclear whether this will favor the suburban market or the CBD/midtown areas, given the lack of growth over the past few years.

With office spaces open and generally fully functional, building owners and managers should stay up to date on the newest regulations to avoid potential liabilities. Specifically, the CDC has directed building owners to review the guidance from the Building Owners and Managers Association (BOMA), which assembled a task group from across North America to develop best practices for owners and managers. BOMA recommends that owners meet with their risk managers and insurance brokers to review policies and coverage, and to assess new and ongoing liability risks.

Guidance for Businesses and Employers From a Real Estate Perspective

In general, all the major asset classes are experiencing and undergoing evolution in design and use. Office spaces are now more efficient with the use of space, reducing space demand. Multifamily projects are transforming from simple complexes to luxury-oriented locations with a focus on extensive amenities, and retail continues to evolve with an increased focus on experiences tied with food and other activities, in addition to shopping.

Although there were fewer updates on any policies concerning health safety practices in 2023 than in previous years, it is important for employers to keep in mind that the CDC has provided Interim Guidance for Businesses and Employers, which offers guidelines and recommendations for employers to protect their workers and clients. Specifically, the CDC has referenced the guidance provided in ASHRAE Standard 180-2018, Standard Practice for the Inspection and Maintenance of Commercial Building HVAC Systems. The best insurance building owners can have is to schedule and document an inspection of HVAC systems. Current and potential real estate investors should carefully study each particular law, as they vary greatly regarding the types of businesses covered and the extent to which local health department guidance must be followed to qualify for immunity. Office owners and managers will want to review the current construction start-up guidance, particularly for HVAC systems that have been shut down or put on setback, and possibly to consult with legal counsel to cover all of their bases.

Employee burnout in workplaces continued in 2023. The American Psychological Association provides five areas of focus for employers and companies:

- employee involvement in decision-making;
- work-life integration;
- employee growth and development;
- employee recognition; and
- health and safety.

Employers would be wise to address these areas, and to show consideration for not only the physical health and safety of employees but also their mental health.

The Corporate Transparency Act

The Corporate Transparency Act (CTA) became effective on 1 January 2024, and now requires entities to report information, including specific beneficial ownership information, to FinCEN (the

US Department of Treasury's Financial Crimes Enforcement Network). While applying to most businesses, the CTA is likely also applicable to community associations, regardless of non-profit status. Business owners and those forming businesses should familiarize themselves with the new reporting requirements. In March 2024, the US District Court of the Northern District of Alabama declared the CTA unconstitutional; that decision is currently on appeal.

Remote Employees

The work-from-home model has now found its place in nearly every major business industry. On average, about 27% of US employees work remotely full-time, and 66% work remotely part-time. 36.2 million employees are expected to work remotely by the end of 2025. With this new norm comes new expectations and standards. Many companies who have invested in remote work state that they have no intention of requesting employees to return to the office, and with decreased expenses and many reporting higher productivity, this shift makes sense. The vast majority of employees who work from home state they experience a better work-life balance, reduced stress and improved morale, and companies are now intaking fewer sick days.

Birmingham's office market ended the year at USD21.03 per square foot, which was slightly above the 2022 rate. While additional growth is expected in 2024, it will likely be minimal. Nonetheless, because Alabama has experienced varying levels of office building use, a trend over the course of the past few years has been to blend and extend leasing, with some tenants seeking a reduction in the square footage of their leased premises.

Industrial

Total e-commerce sales in the USA increased by 7.6% from 2022. E-commerce sales accounted for 15.6% of total sales, with an expected rise to 16.6% by the end of 2024. The authors believe that Alabama experienced similar trends. Consequently, the acceleration in online sales has boosted the demand for industrial logistics spaces. Amazon accounted for nearly 37.6% of all US e-commerce in 2023. In Alabama, the online giant continues to announce new projects, the most recent being a distribution center in Dothan expected to create up to 200 jobs.

Industrial spaces have only experienced a mild hit, with demand for these spaces holding relatively well. A notable trend during this time has been an uptick in legal work related to the rezoning and development of new warehouse and industrial projects, with sale-leasebacks being used as a financing vehicle. With the inflated cost of building supplies and labor shortages, construction continued, but at a slower pace than usual.

Traditional Retail

Alabama's real GDP retail trade growth rate during the third quarter of 2023 rose to 24.7%. The primary thriving end users are grocery stores, home improvement stores, and dollar stores, as well as outparcel-like fast-casual and fast-food restaurants. While inflation rates have hit consumers hard, there is still strong evidence of successful growth in the retail space.

With retail moving from isolated stores to community integration, and with consumer preference for outdoor centers, the decline of popularity for indoor malls continued. There have been strong demands in the area from budget retailers who can more easily slide into suburban spaces. The enclosed mall spaces provide opportunities

to rethink the properties' potential; many suburban malls can be converted into office and professional spaces. The use of many consumer-focused spaces has also trended towards more experience-oriented entertainment activities such as:

- Top Golf;
- arcades;
- venues featuring putting courses (eg, the new PopStroke location in Tuscaloosa, Alabama); and
- new eateries that include family and group activities to enjoy.

Smaller retailers are finding their way back into consumer popularity, particularly in Birmingham and Huntsville. Even with smaller retailers facing much economic uncertainty, there has been continued success in the food industry in the metropolitan areas of Birmingham and Huntsville, proving the resilient nature of consumers today.

Tourism and Entertainment

Tourism is an important industry in Alabama. With close to 29 million visitors last year, tourism for the state generated nearly USD4.3 billion in direct earnings. Alabama's Gulf Coast is heavily reliant on tourism and was ranked fifth among most-searched summer getaways in 2023. Baldwin County saw 8.3 million tourists in 2023 alone (similar to 2022), and such consistency has had a ripple effect on many businesses and individuals in that part of the state.

Tourism spending in Alabama increased by 4.8% in 2023. Any lingering restrictions on leisure and recreational activities, as well as crowd limitations, are no longer felt by the tourism industry in Alabama. Alabama's Tourism Department Director Lee Sentell credits Alabama's tourism success to its moderately priced destinations, including its beaches, lakes, state parks, and museums. The Space and Rocket Center in Huntsville, being the top paid attraction in Alabama, draws roughly 850,000 visitors a year. Madison County was listed as the second most-visited region in Alabama, with Baldwin County being the most visited and boasting destinations such as Orange Beach and Gulf Shores. In total, approximately 240,000 jobs are generated from tourism in the state, and that number is expected to grow.

Construction

Some major issues in construction continued in 2023, as the length of time on construction projects increased, despite prices for steel, lumber, and other materials finally plateauing. In these projects specifically, there is not necessarily a labor shortage; rather, contractors and subcontractors have been so busy that delays are practically inevitable. These factors, coupled with inflation and disruptions in supply chains, have and will continue to have an impact on project timelines. Furthermore, construction litigation has increased, largely due to delays and surprising cost increases.

In practice, real estate owners will need to continue considering safety compliance and prompt payment of contractors, emphasizing regular communications between all involved on a building project and co-ordinating with material suppliers to avoid unnecessary delays, all of which create additional work and stress for owners. There may be an uptick in mediations and arbitrations, due to construction delays; litigation attorneys should be prepared to deal with the increased flow by updating their knowledge on ever-evolving compliance laws.

It is also important to note that, while climate change is not a huge factor in Alabama real estate transactions, the authors are seeing more climate-friendly amenities being included in projects, such as car-charging stations, window and roof updates, and so on.

Conclusion: Looking Ahead in 2024

2023 saw resiliency in the commercial real estate market reduced and limited to certain asset categories and markets. Developers needed to be able to thread the needle when planning to make projects work financially. Construction pricing and interest rate lines reduced new project acquisitions and debt/equity closings. Higher interest rates and stricter loan-to-cost and loan-to-value requirements have impacted on transaction flow. For private equity, dictated by equity investors, there has been an overwhelming surge toward preferred equity over common equity. While preferred equity offers investors return opportunities with less downside than common equity, a developer's/sponsor's other source of funds (equity) has also become more challenging in today's environment.

These factors appear to be impacting on all market segments of development, including multifamily, industrial, and retail. Alabama has felt the effects but has showed resiliency through the periods of extremely high interest rates, and has maintained its above-average status in the homeownership market and its below-average unemployment rate. While the Federal Reserve claimed that three rate decreases would occur in 2024, none have yet occurred, which has caused some concern as to whether the projected cuts will occur as planned or be pushed to the end of 2024 (or even 2025). However, more letters of intent (LOI) for transactions are being seen, even before the first promised rate decrease, which is a positive sign. When rates do go down and permanent refinancing goes up, the authors believe that construction credit will become more available, and this will drive further development going forward.

USA - FLORIDA



Law and Practice

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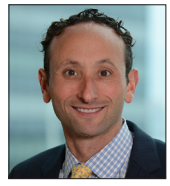
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Berger Singerman LLP has a real estate team that works out of each of its six offices in Florida. The team has comprehensive experience in the purchase and sale of real property in all asset classes, financing, real estate development, PPP, condominium, and homeowners' associations, distressed real estate, hospitality, leasing, senior housing and management. The firm assists clients with a variety of services related to the purchase, sale, leasing, development, financing, use and management of real property and real estate portfolios, including work relating to lease agreements, financing and loan documents, restructurings and workouts, purchase and sale agreement negotiations, real estate portfolio management and management of all types of properties, economic development incentives and programmes, and real estate development, including residential, multifamily, commercial and mixed-use projects.

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1. General

1.1 Main Sources of Law

The main sources of real estate law are common law, state statutes, and county and municipal laws and regulations.

1.2 Main Market Trends and Deals

Florida's location, growing population, business friendly environment and desirable climate offer a wealth of business opportunities across various sectors, and Florida has consistently ranked among the top states in terms of commercial real estate development; this past year was no different. In addition, Florida's commercial real estate market is heavily influenced by the influx of companies and businesses which have moved to the state, as well as foreign investment from South America, Europe and other parts of the world. Florida's commercial real estate market continues to outpace other regions in the US. Despite inflation, interest rates, and increased construction and other costs, investors and developers are active in and remain optimistic about the Florida real estate market.

Real estate trends in Florida over the past year include:

- an increase in vacant land development transactions in the central part of the state, particularly Tampa, Orlando, and Jacksonville;
- a high volume of loan refinances in the commercial office, multi-family, and retail spaces;
- significant development of multi-family projects and increased multi-family rental rates;
- transportation hub development in connection with the development of mass transportation;
- redevelopment of older properties and projects including continued redevelopment and new development of urban areas to accommodate the growing trend of urban lifestyles;
- a rallying industrial sector on the back of strong demand which absorbed new warehouse inventory resulting in a decrease in industrial vacancy rates;
- increased leisure travel and increasing business travel driving demand for hotel and hospitality options;
- increased need for affordable housing; and
- an overall strong commercial real estate market in retail, multi-family and industrial.

1.3 Proposals for Reform

This year, the Governor signed into law Senate Bill 1525 which takes away local municipalities' authority to restrict or prohibit demolition of unsafe structures, with the exception of (i) structures individually listed in the National Register of Historic Places, (ii) a single family home, (iii) a contributing structure or building within a historic district listed in the National Register of Historic Places before 1 January 2000, and (iv) a structure located on a barrier island in a municipality with a population of less than 10,000 people. Additionally, municipalities cannot limit the development of a site with an unsafe structure, require that the structure be replicated, or impose any requirements that would not apply to other properties in the same zoning district. Buildings that only have a municipal historic designation can now be demolished. This bill will have a huge impact on cities such as Miami Beach, where there are many historic districts with strict restrictions on renovation and demolition work. Developers can now proceed with demolitions or renovations to structures that they previously would not have been allowed to change.

The Live Local Act signed into law last year by the Governor provides zoning, tax and financing incentives to developers who incorporate work-

force housing into their projects for a particular period of time without the municipality's approval. The law was enacted in response to Florida's need for more affordable housing. For instance, if at least 40% of a proposed multi-family project's units will be affordable to those earning up to 120% of the area's medium income for a period of at least 30 years, then local governments must allow its development on properties that are zoned for mixed, commercial, or industrial use. Additionally, local governments are required to administratively approve multi-family and mix-used residential projects. This will have the effect of streamlining the approval process, lowering costs, and expediting completion of new projects.

Lastly, the State of Florida needs State-level legislation regarding insurance. The cost of insurance continues to increase to record-high levels, and it is impacting every asset class. One possible solution is for the State to create incentives to bring new insurance companies into the market. There is, unfortunately, no legislation on the horizon to combat this problem.

2. Sale and Purchase

2.1 Categories of Property Rights

Most sophisticated real estate investors in Florida acquire real estate in a legal entity. The type of entity depends on the overall goal of the acquisition, tax, limitation of liability, and other considerations, and can take the form of a partnership, corporation, or limited liability company (LLC), among others. Due to the corporate protections, tax benefits and flexibility of structural components, Florida and Delaware LLCs have become the most used for real estate transactions. The four basic types of ownership in Florida are: sole ownership, tenants by the entirety, joint tenants, and tenants in common.

2.2 Laws Applicable to Transfer of Title

Transfer of Real Property by Deed, by Quit Claim, or by Transfer of Equity in the Ownership Entity

In Florida, title to real estate is transferred by way of deed or transfer of ownership interest in the entity holding title to real estate by merger or otherwise.

Transfer by Deed

Each deed must be in writing (Florida Statutes Section 725.01), executed by the grantor in front of two witnesses and a notary public (Florida Statutes Section 680.01).

Transfer by Merger

The merger of a legal entity with another legal entity causes the transfer of the real property owned by such legal entity to the surviving entity without the requirement to record a conveyance instrument.

Payment of Documentary Stamp Taxes

Transfers of real property for value in Florida require the payment of documentary stamps taxes based on the consideration for the transfer.

No Special Transfer Laws or Regulations

Except with respect to licences required to operate certain types of real estate, there are no special laws or regulations that apply to the transfer of different types of real property in Florida.

2.3 Effecting Lawful and Proper Transfer of Title

In Florida, title to real estate is transferred by way of a deed containing the legal description of the property, which is signed by the transferor in front of two witnesses and a notary public. Sev-

eral types of deeds are used to transfer title, with the most common being a special warranty deed in which the transferor warrants title to the property from the time the transferor acquired title.

2.4 Real Estate Due Diligence

Due diligence can be divided into various components, including site information, site constraints, governmental approvals, development rights, and property condition. Clients are doing more of their own due diligence as opposed to outsourcing to third parties.

2.5 Typical Representations and Warranties

Typical Representations and Warranties Requested of the Seller – Knowledge Qualifier

A buyer will typically require the seller of real property to provide certain representations and warranties. To the extent that a seller will agree to property-related representations, the seller will typically limit representations concerning the operations, finances and property condition by this type of knowledge-qualifier.

Remedies of Buyer for Breach of Representations and Warranties

Subject to the terms of the purchase agreement, a buyer may bring an action for damages for the breach of a representation and warranty set forth in the purchase and sale agreement.

Limitations for Seller's Breach of Representation and Warranty

Typically, counsel for the seller of commercial real property will negotiate three limitations to the seller's liability arising from a breach of representations and warranties:

- a basket amount, which is typically a dollar amount of claims that must exist in the aggregate before a post-closing claim for breach of a representation or warranty may be raised by the buyer;
- a maximum liability amount, which is typically a maximum dollar amount of the seller's liability for the breach of the representations and warranties of the seller; and
- a time period for the survival of the representations and warranties given by the seller under the purchase and sale agreement.

2.6 Important Areas of Law for Investors

Foreign investors must pay attention to the tax implications of the underlying structure, as well as the investment vehicle involved. With respect to tax matters, the form and tax classification of the legal entity(ies) within the ownership and organisational structure for the real property has a significant impact on US federal income tax and any applicable state income tax on operating income and sales proceeds. There is also an impact on the federal and any applicable state transfer tax (eg, gift tax or estate tax) on the transfer of interests in the property during lifetime and/or at death.

2.7 Soil Pollution or Environmental Contamination

The owner of real property in Florida is liable for soil pollution or environmental contamination regardless of whether such contamination has been caused by that owner. These laws relate to the protection of human health or the environment, hazardous substances, and/or liability for or costs of other actual or threatened danger to human health or the environment. Some of the pertinent laws include the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the Emergency Planning and Community Right-to-Know Act, and the Hazardous Substances Transportation Act, to name a few.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Typically, the zoning applicable to any parcel of property is available on the applicable county property appraiser's website or applicable zoning map. In addition, a buyer may request a zoning confirmation letter from the relevant municipality (for a parcel in the incorporated area) or county (for a parcel in the unincorporated area), in order to ascertain the permitted uses of a parcel.

2.9 Condemnation, Expropriation or Compulsory Purchase

In Florida, most governmental agencies and some private entities may take or condemn private property through eminent domain. The Florida Constitution provides that "[n]o private property shall be taken except for a public purpose and with full compensation therefor paid to each owner."

2.10 Taxes Applicable to a Transaction

Florida Documentary Stamp Taxes – Deed

Florida documentary stamp taxes are due and payable upon the recordation of a deed conveying real property in Florida. Florida Statutes Section 201.02 provides that the tax on deeds or other instruments conveying interests in real property is calculated based upon the purchase price of the property and is generally USD0.70 for each USD100 (ie, 0.70%) of consideration. In certain counties in Florida (such as Miami-Dade County), a surtax is payable in addition to the documentary stamp taxes, with respect to the recordation of a deed transferring an interest in real property.

Transfer of Ownership in the Entity That Owns the Real Property

In a conveyance of real property transaction, the grantor of the real property may avoid paying documentary stamp tax if the transaction is structured as the transfer of the equity ownership interests of the grantor to the grantee in lieu of obtaining the transfer of the real property by the delivery of a deed.

Exemptions From Documentary Stamp Tax Liability for Deeds

Florida Administrative Code Rule 12B-4.013 (Conveyances Subject to Tax) and Rule 12B-4.014 (Conveyances Not Subject to Tax) list which conveyances are taxable and not taxable under Florida law for Florida documentary stamp tax purposes.

2.11 Legal Restrictions on Foreign Investors

State Level

In 2023 the Florida legislature passed legislation which prohibits the purchase of certain types of Florida real estate by "foreign principals" from "foreign countries of concern". Foreign countries of concern include the People's Republic of China, The Russian Federation, The Islamic Republic of Iran, The Republic of Cuba, The Venezuelan regime of Nicolas Maduro, the Syrian Arab Republic, and any agency of or any other entity of significant control of such foreign country of concern. Violations of the law can result in criminal penalties. It is also a crime for a person to "knowingly sell" property in violation of the law. A "foreign principal" is a person domiciled in a foreign country of concern and not a US citizen or lawful permanent resident of the US, a company having its principal place of business organised under the laws of a foreign country of concern or having its principal place of business in a foreign country of concern, and the government or any official of the government of a foreign country of concern. The law applies to agricultural land, land within ten miles of a military installation, and land within ten miles of criti-

cal infrastructure facility, all of which are defined in the law. Additionally, Chinese companies and persons domiciled in the People's Republic of China who are not US citizens or lawful permanent residents of the US face more restrictions and heavier penalties than other foreign principals. To comply with the law, buyers are required to provide a signed affidavit affirming they aren't foreign principals.

Federal Level

Historically, the USA has not heavily regulated foreign investment in real property, but some laws and regulations governing investment and ownership of real property are unique to foreign investors. Although some states like Florida impose certain additional restrictions, foreign investment in US real property is primarily regulated by federal law.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions can be financed by equity investment or debt, or by a combination of both, as is typically the case. The investors will often agree in advance to contribute or loan additional monies to the acquisition vehicle. An investor's failure to contribute as agreed may cause that owner's equity interest to become diluted relative to the other owner's interests and may also result in a suspension of that owner's distribution rights.

3.2 Typical Security Created by Commercial Investors

A mortgage is the most common security instrument used to secure borrowed funds for a commercial real estate venture in Florida. A Florida mortgage imposes a perfected lien on the real property described in the mortgage, if it is in proper form and recorded in the public records of the Florida county in which the encumbered real property is located.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Apart from various criminal laws directed at money laundering and influence-peddling, the USA Patriot Act intends to identify, verify, and record information on parties to a loan transaction. The law's focus is to verify that the parties do not engage in or conspire to engage in any transaction that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in any anti-terrorism law, including the Patriot Act or those that involve "blocked persons". Blocked persons include a person listed as such or made subject to an executive order of the President or a person or entity with which any bank or other financial institution is prohibited from dealing or otherwise engaging in any transaction by any anti-terrorism law.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Florida imposes a documentary stamp tax, which is an excise tax imposed on certain documents executed, delivered, or recorded in Florida. The documentary stamp tax on notes or other written obligation to pay money is USD0.35 per USD100 (or portion thereof) – ie, 0.35% – of the obligation evidenced by the taxable document. The tax is due on a note or other document containing a promise to pay an obligation that is executed and delivered in Florida.

If such a document is not secured by Florida real property, the maximum documentary stamp tax is USD2,450. If the indebtedness document is secured by a mortgage encumbering Florida real property, the stamp tax is due on the mort-

gage recorded in Florida. The tax would be paid in connection with recording the mortgage, and evidence of payment indicated in the promissory note.

In addition, a non-recurring intangibles tax is imposed on debt secured by a Florida mortgage. The intangibles tax is USD0.20 per USD100 (or portion thereof) – ie, 0.20% – of debt secured by a mortgage encumbering Florida real property. In a leasehold mortgage, the documentary stamp tax would be due, but not the intangibles tax. Recording fees in Florida are set by the counties and are most often based on the number of pages of the document being recorded.

3.5 Legal Requirements Before an Entity Can Give Valid Security

As with any action to be taken, the entity and its managers and owners must comply with relevant governing procedures, including proper notice and authorisation or ratification from the equity owners or others who may have consent or approval rights. Occasionally, land use restrictions, other governmental restrictions, or private agreements govern or restrict an entity's ability to pledge assets.

3.6 Formalities When a Borrower Is in Default

Upon default under a mortgage, a lender must comply with any notice provisions in the mortgage and provide the borrower with any cure rights that may be applicable under the mortgage. Lenders must also consider any notice that may be required under a security agreement separate and apart from the mortgage, and under the Uniform Commercial Code (UCC), and must also consider demand for turnover of rents, if relevant. If provided for in the loan documents, late fees and/or default interest may be imposed.

If it is determined that a default has occurred, that notice and cure rights have been provided, and that cure has not been affected within the time or in the manner specified in the governing documents, the lender may seek to enforce its remedies, including by foreclosing on the encumbered real estate. In Florida, foreclosure is a judicial remedy (non-judicial foreclosure is not permitted in Florida), requiring the filing of a lawsuit in the appropriate court with proper jurisdiction.

3.7 Subordinating Existing Debt to Newly Created Debt

It is certainly possible for existing debt to be subordinated to newly created debt by agreement. This happens in various contexts, most regularly where some type of early venture or bridge loan precedes permanent financing. A subordination agreement between the first lender and new lender, and usually including the borrower, is the most effective way to accomplish a subordination by contract.

3.8 Lenders' Liability Under Environmental Laws

It is customary for loan documents to provide indemnification and hold harmless provisions protecting the lender from any environmental liability. If a lender becomes the property owner by foreclosure or deed in lieu, then the lender/owner takes the property as it is, including subject to fines or remediation requirements as may exist at the time.

3.9 Effects of a Borrower Becoming Insolvent

The insolvency of a borrower raises several issues for the secured creditor. First, if insolvency results in a bankruptcy proceeding by the borrower, all actions to enforce rights or remedies against the borrower are stayed automati-

cally, by operation of the United States Bankruptcy Code. This means that foreclosure and other enforcement actions against the borrower or its property stop unless the bankruptcy court orders otherwise following notice and a hearing.

The bankruptcy court may lift the automatic stay by agreement of the borrower, or for a cause, including the lack of adequate protection of the secured creditor's interest in the collateral. A borrower may offer adequate protection in several ways, including through the periodic payment of interest at the non-default rate to the secured creditor.

The bankruptcy filing may also permit the borrower to challenge or seek to set aside the liens of the secured creditor. Generally speaking, a preference is a transfer of an interest in property (including the granting of a lien) on account of an antecedent debt, made while the debtor was insolvent, and which allowed the creditor to receive more than it would if the debtor were liquidated. Similarly, a debtor may seek to avoid transfers of property as fraudulent transfers.

These cases involve the transfer of property by an insolvent debtor for less than reasonably equivalent value, or where the debtor transfers property with the intent to hinder, delay or defraud creditors.

3.10 Taxes on Loans

This is not applicable in Florida.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Design and methods of construction in Florida are governed by the Florida Building Code, which contains strict standards governing construction methods to address the impact of storm surge and high velocity winds in certain areas of Florida, among other things. The Florida Building Code incorporates the Florida Fire Prevention Code and the Life Safety Code, which also regulate design and methods of construction. Local governments, including municipalities and counties, are responsible for enforcement, interpretation and regulation of the Florida Building Code.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Planning and zoning is typically governed by the municipality or county in which the property is located. Each jurisdiction has laws, commonly known as zoning codes, which shape how development must proceed within the respective jurisdiction. Most jurisdictions have implemented a form-based zoning code, whereby certain uses, heights, and densities are arranged by zoning district to promote a cohesive community. For example, dense residential and commercial uses may be located along major thoroughfares, while noxious manufacturing uses are sectioned off from residential and civic uses, such as schools, to protect the public from health and safety concerns. Along with zoning codes, jurisdictions also implement a comprehensive land use map (also known as a future land use map in some jurisdictions), which defines and implements the goals and objectives of the jurisdiction's vision

for future development. The zoning code must be consistent with these land use maps.

Zoning codes also typically implement design standards to promote the goals of a form-based zoning code. For example, in a residential zoning district, structures must be built a certain distance from the property line (ie, setbacks) to promote open space in residential neighbourhoods, whereas in commercial districts structures typically can be abutting. Other design standards may include the number of required parking spaces or the percentage of the property that may be covered by impermeable surfaces (eg, concrete). Various jurisdictions also include incentives within their zoning code to promote certain design standards. For example, the City of Coral Gables provides development bonuses for projects that are designed with Mediterranean Architecture (ie, an architectural style that exhibits the vision of the City's founder, George Merrick).

As noted above, planning and zoning is "typically" governed by the applicable jurisdiction. However, in 2023, Florida governor Ron DeSantis signed into law the Live Local Act, which pre-empts local planning and zoning laws, to promote workforce and affordable housing by increasing allowable height and density for projects that reserve 40% of the units to affordable housing. This act was recently amended by the Florida legislature and awaits Governor DeSantis' signature to, among other things, restrict the height of development for projects abutting residential neighbourhoods.

4.3 Regulatory Authorities

The primary government control regulating the design, appearance and method of construction of new buildings or refurbishment is the building code of the county in which the property is located and the Florida Building Code. As noted above, planning and zoning laws also impact the design and appearance of construction. Methods of construction are largely outlined in the Florida Building Code, which is regularly updated by the Florida Building Commission. The Commission is made up of 19 members with varying backgrounds, including architects, general contractors and engineers.

On the local level, jurisdictions issue permits to allow for new construction and alterations to existing buildings, which is the method by which the jurisdiction can ensure that the design and construction is in conformance with the building code. This is enforced by on-site inspections during and at the conclusion of the construction process. Each jurisdiction typically has a code enforcement division, which will also ensure compliance with the building code after a project has been constructed.

4.4 Obtaining Entitlements to Develop a New Project

The first step in the process is to plat the property upon which the new project will be developed. Platting creates lots, parcels and/or tracts that may be developed. Once a plat is approved, it is recorded in the public records of the county where the property is located.

In addition to platting, developers must obtain master plan and/or site plan approval from the local government. Florida law gives all persons the right to participate in and speak in opposition to or in support of development or redevelopment during the approval process, including platting and site planning.

4.5 Right of Appeal Against an Authority's Decision

Decisions on applications for development approval are typically appealed by petition for writ of certiorari, which is limited appellate review. The standard of review in certiorari review is whether procedural due process is accorded, whether the essential requirements of law have been observed, and whether the administrative findings and judgment are supported by competent substantial evidence (City of Deerfield Beach v Vaillant, 419 So 2d 624, 626 (Florida 1982)).

4.6 Agreements With Local or Governmental Authorities

The Florida Local Government Development Agreement Act, Section 163.3220, et seq, Florida Statutes, allows developers and local governments to enter into development agreements to facilitate development, provided the development agreement meets certain minimum substantive and procedural requirements set forth in the statute.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development may be enforced in several different ways. All building permits are conditioned on construction being consistent with development approvals. Violations of development and/or use restrictions may be enforced through a code enforcement process, which levies per day fines on the property, attached as liens.

Special magistrates or code enforcement boards adjudicate these code enforcement complaints. Recorded code enforcement liens may be foreclosed after two years.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

A purchaser of real property can acquire and hold the property through a variety of investment vehicles. The structure and form of entity or entities ultimately selected to hold real estate assets depend on the specific objectives for the property and can have a significant effect on, among other things, the owners' rights in the property, the management of the property, investors' liability and tax benefits, and liabilities associated with the ownership, operation, and disposition of the property.

Selection of an Ownership Entity

The ownership structure can greatly affect the success of an investment in real estate. The specific task and challenge at the outset are to create a structure that captures the underlying goals of the parties and meets the entity's technical, operational, financial, accounting, regulatory, legal, and tax requirements.

Most Common Vehicles

The most common types of legal entities, trusts and forms of direct ownership utilised to effectuate real property investments in the USA generally and in Florida specifically are as follows:

- LLCs;
- limited partnerships;
- general partnerships;
- limited liability partnerships in certain jurisdictions;
- corporations;
- real estate investment trusts (REITs);
- real estate mortgage investment conduits (REMICs);
- land or business trusts; and

- joint estates – ie, tenancy in common, joint tenancy, and tenancy by the entirety (between spouses).

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

LLCs

LLCs combine the opportunity for the liability protection of a corporation with the opportunity for tax classification as a partnership, with certain reflective features. LLCs are also extremely flexible with respect to the management and governance structure, distribution structure (the distribution waterfall), and other transactional matters. For these reasons, LLCs are increasingly popular entities to effectuate real estate joint ventures and transactions.

Ownership of an LLC is defined in terms of membership, with "members" owning equity interests in the company.

Advantages

The advantages of an LLC are numerous and have made the LLC one of the most used ownership vehicles for investing in commercial real estate and real property held for investment purposes.

Disadvantages

The flexibility in structuring and tailoring the organisational documents, operations and management of an LLC truly limit disadvantages associated with this legal entity but there are certain drawbacks, including greater complexity and cost in preparing LLC agreements and related organisational documents, when compared to a corporate structure.

Limited Partnerships

A limited partnership is an association of two or more parties formed under the laws of any state and consisting of at least one general partner (holding a general partnership interest) and at least one limited partner (holding a limited partnership interest). Most states have adopted the Revised Uniform Limited Partnership Act (RULPA), which provides the statutory framework for limited partnerships.

Advantages

A limited partnership offers many of the same advantages as an LLC, including the combination of the limited liability available to limited partners and the tax classification as a partnership.

Traditionally under RULPA, limited partners did not become liable as general partners unless they took part in the "control of the business". RULPA also provided certain rights that limited partners could exercise without taking part in the "control of the business".

Disadvantages

Limited partnerships must comply strictly with the requirements of the state in which the limited partnership is organised and operating. If the limited partnership is formed incorrectly, then the entity is treated as a general partnership for the purposes of liability, and limited partners may not be protected.

Fairly recently, many states, including Florida, have sought to mitigate this issue, adopting statutes that authorise and provide for limited liability limited partnerships (LLLPs), which are limited partnerships (formed under the governing limited partnership statute in the applicable state) that have elected LLLP status.

General Partnerships

A general partnership is an association of two or more persons to carry on as co-owners of a

business or investment activity for profit. It can be formed by the actions of the parties, even if there is no formal or written partnership agreement, or if the participants lead third parties to believe that they are a partnership, and the third parties rely on that assumption.

There are three main characteristics: the sharing of profits and losses, joint ownership of the capital and partnership assets, and joint control and management of the enterprise.

Advantages

The principal advantage of the general partnership structure is the classification of the concern as a partnership for US tax purposes (also available for LLCs and limited partnerships).

Unlike a limited partnership, there are typically no filing requirements or costs associated with the formation of a general partnership and, unlike a corporation, there are no formal operational requirements that demand compliance.

Disadvantages

The most significant disadvantage of investing through a general partnership is that all the partners have unlimited, joint and several liability for anything that occurs at or with respect to the property or otherwise with respect to the partnership's business and activities. Recourse liabilities are shared by the partners jointly.

Like the concept of an LLP, many states, including Florida, have sought to mitigate this issue by adopting statutes that authorise and provide for LLPs, which are general partnerships with elected LLP status. With a valid election in effect, the default rule on general partner liability for the obligations of the general partnership reverses and, by statute, the general partner is not so liable. Here again, the use of an LLP does not yet provide complete assurance of limited liability for the general partner of the limited partnership, based on the potential for conflict between the governing law of different states.

Corporations

A corporation is a distinct legal entity formed by filing articles of incorporation or other charter instrument with the appropriate state agency.

Advantages

The principal advantage of a corporation as an investment vehicle limits the personal liability of the shareholders to their investment in the corporation. Shareholders become personally liable for corporate liabilities only in rare circumstances, usually involving the failure to observe corporate formalities.

Disadvantages

Perhaps the single biggest disadvantage of a corporate structure is a higher effective federal and state income tax rate generally associated with the two-tier framework of corporate income taxation in the USA, as described herein. Many investors may find this additional cost unacceptable.

An S-corporation with no C-corporation history is generally a "transparent" or "pass-through" entity subject to a single tier of US federal and state income tax. However, an S-corporation is not optimal for most real estate joint ventures, being subject to substantial limitations. An S-corporation must always have only a single class of equity interest outstanding.

Other Real Estate Ownership Structures

REMIC

A real estate mortgage investment conduit (REMIC) is an investment entity used to hold a fixed pool of real estate mortgages. REMICs

were developed as a result of the growing interest in collateralised mortgage obligations (CMOs) as a conduit for investors investing in real estate mortgages. If a qualified entity elects REMIC status, it is no longer a taxable entity. The REMIC's income is passed directly through to the REMIC's interest holders.

To qualify as a REMIC, substantially all the assets of the REMIC must be real estate mortgages. The mortgages must also be transferred into the REMIC, either as part of its formation or within three months of its formation.

Land or business trusts

Land trusts, or business trusts, are allowed in some but not all states. In a land trust, both legal and equitable title to the property is held by a trustee, who holds the property for the beneficiary and only acts when directed by the beneficiary. Although the trustee holds actual title to the property, the beneficiary has the exclusive right to manage and control the property, to have possession of the property, and to receive proceeds from the property.

Joint estates

Tenancy in common

A tenancy in common gives two or more persons or entities an undivided fractional ownership interest in real property. Tenancies in common are typically governed by a tenants in common agreement.

Other features of a tenancy in common are as follows:

- the right of each co-tenant to possess the entire estate;
- no right of survivorship, which means a deceased owner's share passes to their heirs through probate; and
- the right of each co-tenant to unilaterally sell, mortgage or otherwise devise its tenancy in common interest.

Joint tenancy

A joint tenancy gives two or more persons or entities an equal and undivided right to use and possess a property. A joint tenancy generally features the right of survivorship, which means that, when an owner dies, the surviving owners automatically absorb the deceased owner's share in the estate. Some states require the right of survivorship to be expressly provided in the deed.

To form a joint tenancy, the owners must satisfy the four unities of ownership:

- time, whereby each joint tenant must receive title at the same time;
- title, whereby each joint tenant must receive title under the same instrument;
- interest, whereby each joint tenant must receive the same equal share of ownership; and
- possession, whereby each joint tenant must have an identical right of possession of the entire estate.

Joint tenants cannot sell, mortgage, or otherwise dispose of their shares in the joint tenancy without the consent of all the joint tenants. If a joint tenant conveys its interest to a third party, then the joint tenancy is destroyed and a tenancy in common is formed.

Tenancy by the entirety

Tenancy by the entirety is similar to joint tenancy with a right of survivorship, in that the deceased owner's interest in the real property is transferred and vests automatically in the surviving joint owner. However, tenancy by the entirety is

available only to married couples and does not require express language in the deed to create a right of survivorship between the spouses.

Unless the deed provides otherwise, real property acquired by a husband and wife is generally presumed to be held as tenants by the entirety in Florida. Common practice in Florida is to include the marital status of the spouses in the deed when the spouses intend to create a tenancy by the entirety.

5.3 REITs

A REIT is a federal income tax classification that allows holders of beneficial interests in a trust to own real estate. REITs offer real estate investors many of the benefits of the corporate form, including limited liability for investors, centralised management, and a ready market for transferring shares.

While taxed at regular corporate income tax rates, a REIT can deduct dividends paid to shareholders if it meets certain qualifications. This deduction effectively eliminates the double taxation (ie, two tiers of income tax) associated with corporations because, with the deduction, income from the REIT is taxable only at the shareholder level. Deductible losses, however, cannot be passed through to shareholders.

Dividends paid by a REIT constitute either ordinary dividends, which are attributable to operating or active business income, or capital gain dividends, which are attributable gains realised by the REIT on the sale of its investment assets. REIT shareholders report and pay tax on their share of the REIT's taxable income and gains. Both US and non-US individual investors are eligible for the long-term capital gains rate on their allocable share of long-term capital gains of the REIT. Non-US investors are subject to statutory withholding with respect to their share of both ordinary dividends and capital gain dividends.

5.4 Minimum Capital Requirement

There is no minimum capital required in the state of Florida.

5.5 Applicable Governance Requirements

An LLC is typically classified as either "member-managed" or "manager-managed", with the applicable classification defining and providing the power and authority to govern the company. An LLC may choose – but is not required – to implement a governing body to act subject to member control and with supervisory authority over any appointed officers. An LLC structure is flexible in establishing protocols for any meetings of members and/or managers.

General partners have the exclusive power and authority to govern and manage a limited partnership (including an LLP). A limited partnership structure is also flexible in establishing protocols for any meetings of partners.

5.6 Annual Entity Maintenance and Accounting Compliance

Please seek guidance from an accounting professional.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

In Florida, a person or entity can occupy and use real estate for a limited period without buying it outright by leasing the real estate or obtaining a licence to use it. There are differences between

the two, including their interest in the property and ability to transfer.

6.2 Types of Commercial Leases

Commercial leases can be categorised into four types – net, double net, triple net and gross – with the main difference between them being how the rent is calculated:

- in a net lease, a tenant pays some of the landlord's real estate taxes, insurance and maintenance expenses, in addition to rent;
- in a double net lease, a tenant pays the landlord's real estate taxes and insurance, in addition to rent;
- in a triple net lease, a tenant pays all the landlord's real estate taxes, insurance, and maintenance, in addition to rent; this type of lease is typical for a ground lease; and
- in a gross lease, the tenant only pays rent and the landlord pays directly for all of its costs of owning and maintaining the property.

6.3 Regulation of Rents or Lease Terms

In Florida, leases are governed by Chapter 83, Florida Statutes.

Regulations relating to the leasing of residential property are more extensive than regulations relating to commercial leases, which are limited to matters such as rights and remedies upon default, landlord lien rights and actions for removal. The regulations for residential leases include these matters as well as "consumer protection" provisions.

6.4 Typical Terms of a Lease

Except for a lease that has an unlimited term, the length of a lease is not regulated by the state. The typical length of a commercial lease is three to five years. Ground leases are typically for 99 years.

Tenants are typically responsible for the maintenance and repair of the real property occupied by the tenant, other than the roof and exterior walls of a structure, which are typically the maintenance responsibility of a landlord.

Landlords typically collect rent payments monthly. Florida law provides that, if there is no written lease, the duration of the lease is based on the frequency of the rental payments. For example, if rent is payable weekly, then Florida law provides that the tenancy is from week to week.

6.5 Rent Variation

Whether rent payments remain the same for the duration of a lease depends upon the terms of the lease agreement. Typically, commercial leases in Florida contain rent escalation clauses pursuant to which the amount of rent payments increase on the annual anniversary of the rent commencement date or other specified date. The rent increase is usually tied to a specific percentage increase.

6.6 Determination of New Rent

Lease agreements typically contain provisions relating to rent increases, typically on a percentage basis, and usually occur on the yearly anniversary date of when the rental payments commenced. If a tenant has an option to extend the term of the lease, payments are typically adjusted for the extended term to fair market value based on an appraisal or other stated formula or process. Changes or increases in rental payments are contractual in nature and not governed or regulated by the State.

6.7 Payment of VAT

Florida imposes sales tax on lease agreements and licences to use real estate, except certain tenancy rights which are specifically exempt from sales tax, such as non-transient, residential

leases with a term greater than six months. This tax is based on the total rent payable under the lease or licence agreement.

6.8 Costs Payable by a Tenant at the Start of a Lease

In addition to the first month's rent (plus sales tax), tenants are typically required to pay a security deposit and the last month's rent (plus sales tax) at the commencement of a lease.

6.9 Payment of Maintenance and Repair

Although landlords will pay the costs of maintaining and repairing common areas, such costs are typically reimbursed by tenants through common area maintenance charges equal to a pro rata share of the costs as set in net leases.

6.10 Payment of Utilities and Telecommunications

If utilities and telecommunications services, etc, are not separately metered, then a lease will typically provide that the tenant is responsible for paying its pro rata share of the cost of such services, utilities, and telecommunications to the landlord.

6.11 Insurance Issues

Landlords typically remain responsible for insuring the leased real estate, and for repairing or replacing the real estate if it is damaged as a result of a casualty event. In a ground lease, the tenant is usually responsible for insuring the real estate and for repairing or replacing the real estate if it is damaged as a result of a casualty event.

6.12 Restrictions on the Use of Real Estate

Leases are purely contractual in nature and landlords may impose various restrictions on how a tenant may use real estate. For instance, a landlord may restrict the tenant's use of the property to a specific type of business. Florida zoning and land use laws also impose restrictions on how real estate may be used.

6.13 Tenant's Ability to Alter and Improve Real Estate

If a lease is silent on such matter, then the tenant may alter or improve the real estate during the lease term, with the only limitations being the practical limitation of the cost of the improvements versus the length of the lease term. Typically, though, landlords impose various restrictions and requirements on tenant alterations and improvements in order to ensure that any alterations and improvements are pre-approved by the landlord, and comply with all laws, rules, and regulations.

6.14 Specific Regulations

Although Part I of Chapter 83 of the Florida Statutes addresses commercial leases such as leases for industrial, office and retail property, such leases are not regulated to the extent of residential leases. Many local governments also impose restrictions on those who rent their homes on Airbnb and other similar platforms, including registration, licence, and requirements, in addition to requirements relating to the collection of taxes and fees.

6.15 Effect of the Tenant's Insolvency

To the extent that a tenant's insolvency results in a bankruptcy, Section 365 of the Bankruptcy Code addresses the rights and remedies available to the landlord and tenant. Pursuant to Section 365, a debtor may:

- reject leases determined to be burdensome, creating only a pre-petition damage claim limited under Section 502(b)(6) of the Bankruptcy Code;

- assume or assume and assign leases to third parties (notwithstanding pre-petition defaults or anti-assignment provisions in the leases), as long as defaults are cured and the assignee provides adequate assurance of future performance; or
- negotiate amendments to the terms of its leases.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Landlords typically require tenants to post a security deposit to protect against a default of its lease obligations by the tenant, and to provide security for any damage done to the leased premises. The security deposit can be in the form of cash, letter of credit, or a security bond. The amount of the security deposit varies but it is usually equal to one- or two-months' rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

If the lease expires and the tenant holds over in the possession of the premises, this is considered a tenancy at sufferance. If the landlord accepts rent during the holdover term, this is not a renewal of the term. However, if the landlord provides written consent to the holdover, the tenancy becomes a tenancy at will.

The term of a tenancy is based on the frequency of the rental payments.

6.18 Right to Assign a Leasehold Interest

In most cases, a tenant is permitted to assign and/or sublease its leasehold interest, but any such transfer is usually subject to landlord approval. The landlord's approval, in most cases, shall be reasonable and based upon numerous factors, including the proposed assignee or sublessee's financial health, reputation and business. In the event the landlord approves of the tenant's request to assign a lease, the original tenant will usually continue to remain liable under the lease (but will nevertheless be protected from such liability in the assignment documents). Any additional consideration paid in connection with a transfer – whether by way of a lump sum payment or agreed upon rent that is greater than the amount contemplated by the original lease – will either be forfeited to the landlord or split among the landlord and original tenant.

6.19 Right to Terminate a Lease

A landlord can typically terminate a lease for a monetary default. A landlord may also terminate a lease if a tenant fails to comply with the non-monetary obligations under the lease.

6.20 Registration Requirements

In Florida, there are no registration requirements or particular execution formalities. As of 1 July 2020, Florida abolished the need for commercial leases greater than one year to be signed in the presences of two witnesses. Factors like the pandemic and the growing use of electronic signature heavily contributed to the introduction of the original witness rule. Landlords will normally include express language in leases forbidding a tenant from recording leases or memorandums of leases in the public records. The only exception is ground leases, where the tenant is usually permitted to record a memorandum of lease putting third parties on notice of their lease interest encumbering the real property. Normally, the only fees payable in connection with the recordation of a ground lease are standard recording fees – no taxes or doc stamps.

6.21 Forced Eviction

A landlord may evict a tenant in the event of a tenant default prior to the lease expiry date. An

eviction action in Florida may take as little as two weeks from the notice delivery to the final removal of a tenant, or could last much longer, depending on the nature of the default in question. By way of example, it is much easier to prove a payment default than a maintenance default.

The exact length of a Florida eviction depends on the reason for the eviction, how fast the landlord moves, and whether the tenant responds so that the tenant can challenge the landlord's allegations in court.

6.22 Termination by a Third Party

The government may take private property via eminent domain, provided the government is going to use the property for a public purpose and pays both the landlord and tenant full compensation. A taking is a relatively quick procedure once the condemning authority files the lawsuit and sets the order of taking hearing, at which the condemning authority must prove:

- that the property is necessary;
- that the taking is for a public purpose; and
- that it has prepared a good faith estimate of value based on a valid appraisal report.

Once the judge enters the order of taking, the condemning authority deposits the good faith estimate of value into the court registry and becomes the owner of the property. After the order of taking hearing, the second stage of the quick-take action begins, in which a 12-person jury decides the amount of compensation to be paid to the property or business owner for the taking.

Commercial tenants are considered "property owners" and may share in compensation for real estate encumbered by their leasehold. This "sharing" is usually done pursuant to court order, mediated settlement agreement, or pre-suit settlement that apportions the compensation for the taken real estate between the fee-owner and leaseholder.

6.23 Remedies/Damages for Breach

In addition to recovering possession of the premises in an eviction action, a commercial landlord often seeks monetary damages in a breach of contract action against a defaulting tenant. The terms of the lease agreement largely determine the type and amount of damages claimed. Under Florida common law, when a tenant breaches a commercial lease, a landlord may, among other remedies, retake possession of the premises for the tenant's account, holding the tenant responsible in damages measured by the difference between the stipulated rent and any amount the landlord can recover in good faith by re-letting the premises. A landlord also has the right to accelerate the rent if the lease specifically includes an acceleration of rent provision. This means that the entire balance of the rent payable from the date of default through the end of the term automatically becomes payable.

Landlords will almost always require a security deposit (or a letter of credit) before entering into a commercial lease agreement with a tenant. Security deposits are intended to provide a landlord with protection against damage to the premises caused by or attributable to the tenant and they also provide security for a tenant's payment obligations under the lease. Florida does not have a statute specifically addressing security deposit requirements for commercial leases. Instead, they are entirely negotiable between landlord and tenant. Florida law does not require a commercial landlord to hold a security deposit in an interest-bearing account.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Florida construction law practitioners typically use the American Institute of Architects (AIA) suite of documents for construction projects, with modifications to the base forms based upon the terms of the transaction.

The price structures that are used for construction projects include the following:

- fixed price or lump sum;
- guaranteed maximum price (with savings either retained by the owner or shared with the general contractor, as negotiated); and
- reimbursable based upon various calculation methods, including unit price and cost-plus fixed fee.

7.2 Assigning Responsibility for the Design and Construction of a Project

There are several ways to organise the contracting of a construction project, including the following methods.

Design-Bid-Build

The owner engages the design team directly and the design team produces a set of construction documents that are used as the basis for a competitive bidding process.

Construction Manager as Agent

The owner engages a contractor when it engages the design team so that the owner/construction manager/design team work together in collaboration.

Construction Manager at Risk

The owner engages the contractor when it engages the design team so that the owner/construction manager-contractor/design team work together in collaboration for the project.

Design/Build

The owner retains a contractor to provide a turn-key completed project; the contractor retains the architect and is responsible for designing and building the project based upon the owner's design criteria and budget.

7.3 Management of Construction Risk

Construction risk is allocated by several methods, depending upon the structure of the transaction and the terms of the negotiated agreements. Accordingly, the initial construction risk-shifting method used by owners is to select the contracting structure that best suits the risk tolerance of the owner for the proposed project. These methods include indemnification by contractor, warranties, liquidated damages for delay, and waivers of certain types of damages.

7.4 Management of Schedule-Related Risk

Owners typically address this issue by negotiating a "per day" liquidated damages amount in the event the project is not substantially complete as of a certain date set forth in the agreement. Contractors may negotiate a fee plus amount if certain construction milestones are met ahead of schedule.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Typically, the cost of the payment and performance bond is paid by the owner, either directly or by inclusion of such costs in the contract sum payable to the contractor. In lieu of a payment and performance bond, an owner may require the contractor to post a letter of credit to secure their performance.

7.6 Liens or Encumbrances in the Event of Non-payment

Prior to construction, the owner and the owner's construction lender typically require the mortgage securing the mortgage loan to be recorded in the public records prior to the recordation of a notice of commencement. A notice of commencement is a two-page form that is recorded in the public records of the county in which the real property is located and is posted at the job site.

7.7 Requirements Before Use or Inhabitation

Occupancy of improved real property is a local law issue that is determined by the Florida Building Code or other applicable county and municipal laws, rules, codes and regulations. Typically, a municipality requires the issuance of a certificate of occupancy or certificate of completion (that the structure is complete, such as a building, but does not grant occupancy) before a building or structure that has been constructed upon real property may be occupied. A temporary certificate of occupancy may also be issued, which permits temporary occupancy until certain conditions are satisfied.

8. Tax

8.1 VAT and Sales Tax

Several primary federal and Florida tax considerations are inherent in addressing a corporation's transfer of real property situated in the USA, as described below.

A "corporation" for this purpose includes both a state law corporation (a legal entity formed under a state's corporate statutes) and any entity classified as a corporation for US tax purposes. The category may also include certain non-US entities which, under US tax law, have a corporate classification as the default status.

Income Taxes

A corporation is generally subject to income tax at the entity level with respect to all income and gains, including gain realised on the sale of real property situated in the USA. Additionally, depending on the ownership of the corporation and other factors, a second tier of income or withholding tax may apply with respect to the distribution or application of the corporation's retained earnings attributable to the sale.

Federal and Florida income taxes apply at the corporate level, including with respect to net taxable gains realised by a corporation on the sale or disposition of real property. The federal corporate income tax applies at a top marginal rate of 21% (recently reduced from 35%, as described below), and the Florida corporate income tax applies at a 5.5% rate.

Liquidating distributions

Corporate and partnership structures pose significantly different US income tax results in connection with the sale of real property. Notably, a corporation (again, a C-corporation) is not eligible for a rate preference with respect to long-term capital gains. Standard federal and Florida corporate income tax rates apply to gains realised by a corporation on the sale of real property.

Only individual taxpayers and certain trusts are potentially eligible for the favourable long-term capital gains rate.

Liquidating distributions by a corporation that result in a redemption of a US person's equity interest in domestic corporation for federal income tax purposes are generally treated as

payment in exchange for the shareholder's equity interest in the distributing corporation.

Takeaway, planning implications

The selection of the proper legal entities through which to own and operate US real property is fact intensive. As a guiding principle, the partnership structure frequently remains more favourable in the closely held setting if the business exigencies and investment requirements will accommodate the use of LLCs, limited partnerships and other legal entities.

State Transfer and Related Tax Considerations

Transaction-related taxes

Florida imposes several primary transfer-based or collateral-based taxes with respect to real property transactions, each of which generally applies to both corporate and individual taxpayers.

Successor liability for taxes

Florida statutory law makes a purchaser of more than 50% of a business or the assets of a business jointly liable for certain unpaid taxes of the seller, including sales and use taxes.

Certain pre-sale considerations: federal transfer taxes

The predicate for this discussion – the ownership of US real property through the corporate form – calls attention to choice-of-legal-entity considerations within the context of overall US tax and estate planning. In establishing and perpetuating an organisational structure for the ownership of US real property in the closely held setting, US federal transfer taxes pose material, potential liability and add another layer to the analysis. This exposure is especially acute in the US-inbound setting.

The USA imposes a transfer tax system that consists of a gift tax, an estate tax and a generation-skipping transfer tax (GST).

8.2 Mitigation of Tax Liability

In a conveyance of real property transaction, documentary stamp tax may be avoided if the transaction is structured as the transfer of 100% of the equity ownership interests of the grantor to the grantee in lieu of a transfer of the real property. However, in 2009, the Florida legislature amended Section 201.02, Florida Statutes, which resulted in the documentary stamp taxes being due and payable in connection with certain indirect transfers and transfers without change of beneficial ownership. As amended, Florida law imposes documentary stamp tax on so much of the consideration that is paid on the sale of interests in a "conduit entity" as is attributable to the value of any Florida real property that was transferred to the conduit entity within the preceding three-year period.

In a mortgage loan refinance transaction, an existing borrower that is seeking to refinance an existing mortgage loan may save on the documentary stamp taxes and intangible taxes payable with respect to the new mortgage loan if the new lender obtains an assignment of the existing mortgage loan from the existing lender rather than paying off the existing mortgage loan and providing a new mortgage loan.

8.3 Municipal Taxes

Florida levies a sales tax on commercial rental, as well as a sales tax (transient rental tax) on guest accommodations and residential leases of six months or less. The baseline rate is 6%, subject to increase by local surtax.

With respect to related party or inter-company leases, it is possible in appropriate fact patterns

to implement a capital lease or "synthetic" lease, which is generally treated as a sale transaction (and not an operating lease) for financial and tax accounting purposes, including Florida sales tax purposes.

8.4 Income Tax Withholding for Foreign Investors

Taxation of Non-US Person's Sale of US Real Property

FIRPTA (the Foreign Investment in Real Property Tax Act of 1980) is a taxing statute that subjects a non-US person (both individuals and non-US entities) to tax with respect to the sale or disposition of real property situated in the USA (more broadly, the sale of US real property interests – USRPIs). In establishing the basis for taxation, FIRPTA classifies the seller for this purpose as being engaged in a trade or business within the USA during the tax year of the sale, and classifies the gain or loss realised on the sale as being effectively connected with the trade or business. Specific withholding requirements apply to the sale of a USRPI by a non-US person, as described below.

Equity and profit participation interests in legal entities that hold USRPIs constitute USRPIs as well, if held by the non-US person not solely in the capacity as a creditor. Such interests may include, for example, corporate stock, an LLC interest, a partnership interest, certain beneficial interests in a trust, rights to share in the appreciation of such equity interests, and rights to share in the appreciation in the value of or income, profits or proceeds from the underlying real property.

Planning Considerations

Special rules apply where a non-US corporation generates earnings and profits from the direct conduct of a business in the USA. The USA generally taxes such income when repatriated from the USA or withdrawn from the US trade or business through a branch profits tax (BPT), which generally applies at a fixed statutory rate of 30% of the non-US corporation's "dividend equivalent amount", unless a treaty provides a lower rate or eliminates the BPT.

8.5 Tax Benefits

The US income tax treatment of real estate ownership, including real property used in connection with an active trade or business, generally remains favourable in terms of cost recovery and other income tax attributes. Under the Tax Cuts and Jobs Act of 2017, qualifying property acquired and placed in service after 27 September 2017, is eligible for 100% bonus depreciation in the year placed in service. The 100% rate drops by 20% per year beginning in 2023, until it is eliminated in 2027.

Under the Tax Cuts and Jobs Act of 2017, 100% expensing now is available (for the first time) for both new and used property. Eligible assets for bonus depreciation are those with a depreciable life of 20 years or less including without limitation "qualified improvement property" (QIP) – ie, certain improvements to the interior of a non-residential building that occur after the building is placed in service.

Drafting Error

As a result of a drafting error contained in the Tax Cuts and Jobs Act of 2017, Congress did not assign a 15-year class life to QIP (from the 39-year class life applicable under prior law), which drafting error precluded QIP from qualifying for 100% expensing. However, Section 2307 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) corrected that drafting error by reducing the recovery period of QIP to 15 years, thereby making QIP immediately eligible

for bonus depreciation. This CARES Act corrective provision is retroactive to the effective date of the Tax Cuts and Jobs Act of 2017 (1 January 2018), meaning taxpayers may amend prior year returns to capture the benefit of the corrective action and receive an expeditious refund.

Real estate entrepreneurs are engaged in the business of acquiring commercial office buildings trending towards retaining consultants to perform cost segregation studies to maximise available tax benefits associated with depreciation.

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act of 2017 added Section 1400Z-1 and Section 1400Z-2 to the Internal Revenue Code in an effort to encourage private investment in low-income communities designated as Qualified Opportunity Zones (QOZs). As an added incentive for such investment, Section 1400Z-2 provides favourable tax benefits for real estate investors (and other investors) with eligible capital gains who invest in QOFs.

The Opportunity Zone legislation was conceived by congress as an economic development tool intended to incentivise the migration of equity capital into these designated areas for purposes of the formation and establishment of new businesses, the development and redevelopment of real estate, and other forms of economic stimuli, with the ultimate goal of job creation and poverty reduction in the QOZs. The tax incentives potentially available to investors with eligible capital gains willing to invest in these QOZs by way of investment vehicles known as QOFs include temporary deferral of income taxation on such eligible capital gains, elimination of a portion of the deferred gain via a basis step-up, and the exclusion from gross income of all post-acquisition capital appreciation in the QOZ investment.

For real estate investors (and other investors) to achieve complete deferral of gain under Section 1400Z-2(a), only an amount up to the gain on the real property (or other qualifying property) sold must be reinvested in a QOF. There has been significant activity in the real estate sector in this area.

Income Tax Rates and Timing

With respect to effective income tax rates, individual investors can structure their ownership of US real property so as to be eligible for long-term capital gains treatment on gain realised upon sale. This rate is generally 20% under current law (exclusive of the additional 3.8% tax on net investment income), subject to a 25% rate applicable to certain depreciation recapture (which is an adjustment to reflect the fact that cost recovery deductions during the ownership phase may offset ordinary income from other activities).

In terms of timing of the taxable event upon a sale, the continued availability of deferral pursuant to a “like-kind exchange” of real property for replacement real property can provide material tax benefits to an investor perpetuating its investment in the form of real property. There is no ceiling on the duration of this deferral, allowing multiple like-kind exchanges over an indefinite period until the investor chooses to monetise its investment.

If an individual taxpayer dies owning replacement real property acquired in “like-kind exchange”, there is a step-up in basis at death. This results in the elimination of all the deceased taxpayer’s deferred gain, which can provide material tax benefits to the heirs of the deceased taxpayer.

Trends and Developments

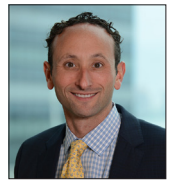
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Berger Singerman LLP has a real estate team that works out of each of its six offices in Florida. The team has comprehensive experience in the purchase and sale of real property in all asset classes, financing, real estate development, PPP, condominium, and homeowners' associations, distressed real estate, hospitality, leasing, senior housing and management. The firm assists clients with a variety of services related to the purchase, sale, leasing, development, financing, use and management of real property and real estate portfolios, including work relating to lease agreements, financing and loan documents, restructurings and workouts, purchase and sale agreement negotiations, real estate portfolio management and management of all types of properties, economic development incentives and programmes, and real estate development, including residential, multifamily, commercial and mixed-use projects.

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Florida's location, growing population, business-friendly environment and desirable climate offer a wealth of business opportunities across various sectors, and Florida has consistently ranked among the top states in terms of commercial real estate development; this past year was no different. In addition, Florida's commercial real estate market is heavily influenced by the influx of companies and businesses which have moved to the state, as well as foreign investment from South America, Europe and other parts of the world. Florida's commercial real estate market continues to outpace other regions in the US. Despite inflation, interest rates, and increased construction and other costs, investors and developers are active in and remain optimistic about the Florida real estate market.

Real estate trends in Florida over the past year include:

- an increase in vacant land development transactions in the central part of the state, particularly Tampa, Orlando, and Jacksonville;
- a high volume of loan refinances in the commercial office, multi-family, and retail spaces;
- significant development of multi-family projects and increased multi-family rental rates;
- transportation hub development in connection with the development of mass transportation;
- redevelopment of older properties and projects including continued redevelopment and new development of urban areas to accommodate the growing trend of urban lifestyles;
- a rallying industrial sector on the back of strong demand which absorbed new warehouse inventory resulting in a decrease in industrial vacancy rates;
- increased leisure travel and increasing business travel driving demand for hotel and hospitality options;
- increased need for affordable housing; and
- an overall strong commercial real estate market in retail, multi-family and industrial.

USA - IOWA



Law and Practice

Contributed by:
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1. General

1.1 Main Sources of Law

Iowa real estate law mainly consists of a mixture of common law and state statute. Certain specialised areas, such as environmental, lending, and brokerage laws, are subject to federal law or state agency regulations.

1.2 Main Market Trends and Deals

Iowa continues to see strong interest in the development and expansion of data centres and renewable energy, including wind and solar projects. This is despite the prevalence of increasingly organised resistance at the local level for necessary permits and approvals, typically from non-participating landowners in the vicinity of a project. Legal challenges to such projects have been largely unsuccessful on the merits, but nevertheless result in delays and increased costs to the projects.

Higher interest rates have reduced the volume of residential real estate transactions and led to an increase in the use of seller financing in commercial real estate transactions, such as assumption of existing loans, subordinated seller promissory notes for a portion of the purchase price, and outright instalment sales. Typically, these are intended as short-term financing mechanisms with an expectation that the buyer will refinance the full purchase price within two-to-three years in an improved interest rate environment.

Another trend in commercial real estate transactions is the repurposing of vacant commercial real estate, primarily caused by the increase of remote work, into governmental or multi-family uses. Such transactions typically involve agreements with public entities and utilisation of various tax credit programmes.

1.3 Proposals for Reform

Opposition to the use of eminent domain power in the development of carbon capture pipelines has resulted in the introduction of multiple iterations of bills restricting such power in the state legislature. It is unclear if any version will achieve ultimate passage. Senate File 2204, signed into law in 2024, will create additional reporting requirements for foreign entities owning Iowa agricultural land.

2. Sale and Purchase

2.1 Categories of Property Rights

Iowa law is consistent with common law principles of property rights as a “bundle of sticks”, meaning a wide range of real property interests may be acquired and held. These include fee simple ownership, leasehold rights, easement rights, as well as other traditional common law forms of full or partial real property interests.

2.2 Laws Applicable to Transfer of Title

Basic common law and statutory recording laws apply to all transfers of Iowa real estate, without regard to the use or other classification of the particular real estate involved.

2.3 Effecting Lawful and Proper Transfer of Title

Iowa is a notice state. Lawful and proper transfer of title to real estate is effectuated primarily through the execution and recordation of deeds. Subject to certain exceptions, a deed conveying title to real estate will only be recorded by the local county recorder’s office if accompanied by a declaration of value setting forth the consideration paid for the real estate, together with a groundwater hazard statement setting forth certain known hazards related to the property or a statement on the deed explicitly stating that

there are no groundwater hazards. The matters covered by a groundwater hazard statement are:

- whether any known private burial site is situated on the property;
- whether any known wells are situated on the property;
- whether any known disposal site for solid waste which has been deemed to be potentially hazardous by the department of natural resources exists on the property;
- whether any known underground storage tank subsection exists on the property;
- whether any known hazardous waste exists on the property; and
- whether any known private sewage disposal system exists on the property.

The following language must be included on a deed when no groundwater hazard statement is required: "There is no known private burial site, well, solid waste disposal site, underground storage tank, hazardous waste, or private sewage disposal system on the property as described in Iowa Code section 558.69, and therefore the transaction is exempt from the requirement to submit a groundwater hazard statement."

Pursuant to Iowa's marketable title statute, additional instruments may serve as muniments of title. For example, a properly admitted last will and testament of a decedent who was the vested titleholder of real estate may serve as a muniment of title. Additionally, a properly drafted divorce decree may serve as a muniment of title.

The sale of title insurance is prohibited in Iowa. Thus, although out of state title insurance companies may write title insurance policies on Iowa land, and the State of Iowa offers the equivalent of a title insurance policy through its Iowa Title Guaranty division, most Iowa real estate transactions involve the issuance of an attorney's title opinion based upon examination of an abstract of title. Additionally, transactions are typically closed through an attorney's office or an escrow company, and not a title insurance company.

Nearly all documents must be notarised to be recordable in Iowa. Following the temporary approval of electronic notary services during the COVID-19 pandemic via Governor's proclamation, the Iowa legislature adopted a permanent revision to Iowa Uniform Law on Notarial Acts allowing such service.

2.4 Real Estate Due Diligence

The nature and manner of due diligence performed by buyers of real estate is largely dependent upon the nature of the transaction. In residential transactions, subject to certain exceptions, sellers must disclose defects related to the property as mandated by the Iowa Code. The disclosure statement must be delivered prior to making or accepting a written offer for the transfer of the real property and must include information relating to the condition and important characteristics of the property and structures located on the property, including significant defects in the structural integrity of the improvements.

Certified Inspectors

Generally, properties which include a private sewage disposal system (ie, a septic system) must be inspected by a certified inspector. A copy of the certified inspector's report ("time of transfer inspection") must accompany any deed conveying title to property which includes a septic system. The county recorder's office will not record a deed upon the books which is not accompanied by the required time of transfer inspection.

Residential Property

In the residential context, attorneys may assist or facilitate in obtaining or reviewing the mandatory disclosures or forms that will accompany the title transfer documents. The bulk of any true due diligence is usually carried out, however, by the purchaser and the purchaser's home inspector. The primary exception to this general rule is with regard to examination of title.

Abstracting State

Iowa is an abstracting state, wherein an abstract of title is prepared for the property subject to transfer and the attorney makes an examination of the abstract to certify whether the proposed transferor possesses marketable title. Conversely, in the commercial context, the attorney may take a more active role in reviewing due diligence materials other than those affecting title, such as surveys, inspector reports, rent rolls and the like.

2.5 Typical Representations and Warranties

In a typical commercial transaction, where there is a due diligence period, the seller will make few, if any, representations and warranties, as the buyer will be given adequate opportunity to inspect the property during the due diligence period. No generally applicable Iowa law mandates certain disclosures in the commercial real estate context. Instead, the scope of any representations and warranties is driven by negotiation between buyer and seller, and buyers will typically rely upon their own due diligence rather than seller warranties. A breach discovered pre-closing will typically allow a buyer to terminate the purchase agreement and receive a refund of earnest money, while a breach discovered after closing will form the basis of a claim for money damages, subject to any limitations in the purchase agreement. The seller will typically negotiate a limitation period of one year or less in which a buyer must bring a claim for breach after closing. In larger transactions, such as multi-family housing transactions, the seller will typically demand a cap on liability, which is often a relatively small percentage of the purchase price. Buyers may seek to negotiate an escrow holdback of a portion of the purchase price for breaches of representations and warranties discovered post-closing, but this is not typical in Iowa transactions. Representation and warranty insurance is also not typically used in Iowa real estate transactions.

2.6 Important Areas of Law for Investors

Considerations for an investor in Iowa real estate are typical of investments in real estate in other states. These would include the desire to purchase through an investment entity, in order to avoid exposure to personal liability for matters such as environmental contamination or premises liability as well as to facilitate issues of common ownership that are cumbersome through co-ownership via a tenancy in common. The costs of Iowa land transactions tend to be lower than many states, as a result of the typical avoidance of title insurance as well as nominal recording fees, a modest transfer tax, and the absence of mortgage taxes.

2.7 Soil Pollution or Environmental Contamination

In general, a buyer of Iowa real estate could face strict liability for certain environmental contamination on the acquired real estate, unless the buyer qualifies for an innocent landowner defence under applicable environmental laws. In all but the most routine residential real estate transactions, buyers are advised to obtain what is known as a "Phase I environmental report" to examine whether there are any known environmental risks. The allocation of risk of environmental liabilities as between buyer and seller is

the subject of negotiation under the purchase agreement and will typically take the form of the representations and warranties – and corresponding indemnities – that a seller is willing to provide.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

As in all jurisdictions, the cities and counties in Iowa restrict the use of real estate through zoning ordinances. Given the differences in designations and permitted uses across counties and municipalities, the most efficient mechanism for determining the permitted uses of any particular tract of real estate is by requesting a zoning report from the local zoning authority. Developers of real estate may find it advisable to enter into development agreements with the locality (and are quite frequently required to do so).

These development agreements can serve as useful mechanisms to attempt to effectuate a change in zoning designations for particular parcels of property. The change in zoning designation will, however, almost always require the consent of several levels or departments of local government, after notice and public hearing regarding any change in zoning designation.

2.9 Condemnation, Expropriation or Compulsory Purchase

Condemnation or eminent domain are possible in the state of Iowa through a statutory process. The state, city, or county identifies properties affected by a particular project, inspects and values the property, and makes an offer to the owner. If the property owner does not accept the government's offer, there is a quasi-judicial process which unfolds, including determination of "just compensation" by an appointed county commission.

Either party may appeal the determination of the commissioners. The appeal is heard by ordinary judicial process.

2.10 Taxes Applicable to a Transaction

Iowa imposes a transfer tax, which is collected at the time the conveyance document is recorded with the county recorder. Transfer tax is incurred at the rate of 80 cents for every USD500 of consideration paid in excess of USD500. Transfer tax is typically paid by the seller.

Aside from transactions in which consideration is less than USD500, there are a host of exceptions, including transfers to newly created business entities or as part of reorganisation of business entities. Note that transfer or sale of shares of a company which owns real estate does not trigger the obligation for payment of transfer tax in Iowa.

Conversely, real estate taxes are usually prorated between buyers and sellers as of the date of possession of the property. In Iowa, property taxes are incurred on a fiscal calendar (ending 30 June) and are paid in arrears (the first half payable 30 September and the second half payable 31 March of the following calendar year). Because of this, some care is required when it comes to payment and responsibility for payment of real estate taxes between buyers and sellers.

In a typical real estate transaction, the seller will pay the cost of transfer tax, preparation of the instruments transferring title, and the cost to update the abstract for review by the buyer's attorney. The seller will also generally be responsible for the preparation and recording fees related to any instruments necessary to cure defects in the seller's title. Buyers will typically pay the cost related to examination of the abstract, the

recording fees for the instruments conveying title, and the cost for updating the abstract post-closing to reflect the transfer and any mortgage.

2.11 Legal Restrictions on Foreign Investors

While not numerous, there are some important considerations for foreign persons investing in real estate in the state of Iowa. Chief among them is an Iowa statute which generally prohibits non-resident aliens, foreign businesses, foreign governments, or an agent, trustee, or fiduciary thereof from purchasing or otherwise acquiring agricultural land in Iowa. There are several exceptions.

For example, an interest in agricultural land, not to exceed 320 acres, acquired for an immediate or pending use other than farming, is permitted. Pending the development of the agricultural land for a purpose other than farming, the land shall not be used for farming, except under lease to an individual, trust, corporation, partnership, or other business entity. Recent changes to CFIUS regulations have not yet had a major impact in Iowa.

Sales agreements continue to include customary representations related to OFAC and FIRPTA.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of Iowa commercial real estate are typically financed through mortgage financing offered by commercial banks. In the typical process, the lender would first issue a loan commitment letter to the potential buyer/borrower setting forth the amount, interest rate and other main terms of the loan to be made to purchase the real estate, together with the requirements that must be satisfied before the loan will be made. Such requirements would include due diligence matters, the collateral that must be provided to secure repayment of the loan, and business covenants that must be met.

The loan documents to be signed at closing would reflect the requirements set forth in the loan commitment, and would typically include a loan agreement setting forth both the lender's obligations with respect to disbursements of loan funds as well as the borrower's current and ongoing requirements with respect to the loan, a promissory note evidencing the debt owed to the lender, and a mortgage encumbering the newly acquired real estate as well as other security documents that might encumber the borrower's financial accounts, equipment and inventory, or other personal property.

The process for acquisition of large real estate portfolios or companies holding real estate would be the same. However, a viable option in such scenario may be to acquire ownership of the titleholding entity or entities, rather than a direct acquisition of title to the real estate. Structuring the transaction in this way would not trigger real estate transfer tax.

3.2 Typical Security Created by Commercial Investors

The type of security interest required by a lender financing the acquisition and/or development of Iowa commercial real estate may vary by transaction, but should involve the borrower granting a mortgage against the real estate in favour of the lender to secure repayment of the loan. Iowa law also recognises that a borrower may give a lender a deed of trust; however, in practice, the difference will be merely in the form of the instrument as deeds of trust and mortgages

are foreclosed in the same manner under Iowa Code Chapter 654. In addition to the mortgage, some lenders may require a separate assignment of any rents generated from the acquired real estate, though these may be granted within the mortgage instrument itself.

A wide variety of security interests may also be granted against a borrower's personal property, in the form of a general security agreement which may be supplemented and/or perfected by the filing of UCC financing statements.

It is possible that a seller may choose to finance the buyer's acquisition of the real estate, particularly in an environment of high interest rates for new bank loans. If so, the seller and buyer would typically enter into a real estate instalment contract, providing for a down payment to be made at closing and the balance of the purchase price to be paid to the seller in regular instalments with interest.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Purely in terms of the nature of the documentation and the process involved, there would be no special regulatory hurdles or restrictions affecting foreign lenders as compared with domestic lenders in a transaction involving Iowa real estate. However, foreign lenders should consider the facts and circumstances involved in the particular transaction as well as other transactions the lender may be involved in within the state in order to evaluate whether the lender may be deemed to be transacting the business of banking in Iowa. If so, then the lender would be subject to the terms of the Iowa Banking Act.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Iowa law does not impose a mortgage tax on the granting or enforcement of a mortgage against real estate. Nominal recording fees on a per page basis are charged in order to file the mortgage in the county recorder's office. Normally, a transfer tax equal to USD1.60 per USD1,000 of consideration in excess of USD500 is due upon a transfer of real estate. Such transfer tax is not due upon the issuance of a sheriff's deed pursuant to a mortgage foreclosure, but must be paid if the foreclosing bank subsequently sells the property after acquiring title through the foreclosure process.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Iowa law does not impose any restrictions on an entity's ability to give a valid security interest against its real estate assets unless such restrictions are set forth in the entity's organisational documents (ie, articles of incorporation, by-laws, operating agreement, etc).

3.6 Formalities When a Borrower Is in Default

A Defaulting Borrower

When a borrower is in default under a mortgage loan, the lender must review the loan documents to determine if they impose any special requirements or procedures governing their enforcement. Under Iowa Code Section 654.2D, residential borrowers are entitled to a 30-day notice of default and opportunity to cure before a lender may enforce the mortgage for a borrower default under a mortgage against the homestead. If the mortgaged property is agricultural land, the borrower is entitled to a 45-day notice of default and opportunity to cure under Iowa Code Section 654.2A, and, additionally, the lender must ordinarily obtain a farm mediation release under the

procedures of Iowa Code Chapter 654A prior to enforcing the default.

While there is no legal requirement to provide a notice of default and opportunity to cure to a borrower under a mortgage encumbering commercial real estate, under Iowa Code Section 654.4B applying to all mortgages, a lender must provide at least a 14-day demand for the accelerated balance due under the mortgage loan prior to commencing a foreclosure action in order to qualify for an award of attorney fees in such action.

Iowa law does not recognise a "power of sale" in a mortgage instrument purporting to grant the lender authority to conduct a private sale of the mortgaged property to satisfy the secured debt. Rather, all mortgages and deeds of trust must be foreclosed judicially under the procedures set forth in Iowa Code Chapter 654 or under statutory non-judicial procedures. In general, the judicial process involves a civil action to establish the validity of the debt and mortgage and the borrower's default thereunder, and, if successful, will result in a decree of foreclosure issued by a judge that directs the county sheriff to conduct a public auction under statutory procedures to sell the mortgaged property in satisfaction of the debt.

A lender may avoid the judicial procedures of Chapter 654 by pursuing the statutory non-judicial foreclosure procedures provided under Iowa Code Section 654.18 and Iowa Code Chapter 655A, but each alternative procedure requires the assent of the borrower to some degree in order to avoid the need for a judicial action.

While certain moratoria were put in place during the COVID-19 pandemic, no such restrictions are ongoing and there do not appear to be any lingering pandemic effects on lenders' decisions to enforce or forbear enforcement of security interests in the current market.

Lender Security Interest

A lender perfects its security interest against real estate by recording the mortgage in the county recorder's office at the time of the loan closing. No further action is required to maintain the priority of the security interest as against other persons acquiring an interest in the real estate so long as the mortgage remains unsatisfied of record. When a foreclosure action is filed in district court, the clerk of court will enter the action in the clerk's lis pendens index, and any person acquiring an interest in the property subsequent to such entry will be subject to the outcome of the foreclosure action, whether or not such person is joined as a party to the action.

3.7 Subordinating Existing Debt to Newly Created Debt

In general, the priority of debt secured by a mortgage against real estate is determined based upon the time of recording the mortgage in the county recorder's office. One exception to this rule occurs for mechanics' liens under Iowa Code Chapter 572, which secure payment for material or labour furnished for the improvement, alteration or repair of real estate. If such material or labour were first furnished prior to the recording of the mortgage, the claimant may obtain a lien with priority ahead of the mortgage (as of the date the furnishing of material or labour was first commenced) so long as the claimant files its mechanic's lien within 90 days after completion of the furnishing of material or labour.

A second exception may occur by voluntary agreement between the original mortgagee and the holder of a later-recorded mortgage to sub-

ordinate the priority of the first mortgage to the second mortgage.

3.8 Lenders' Liability Under Environmental Laws

If the lender has not acted as an owner or operator of the contaminated property prior to becoming the owner by enforcing its mortgage, the lender will not have personal liability for pollution of the real estate by the borrower or previous owners. However, upon foreclosing on the real estate the lender will be faced with a problem in that the contaminated real estate may be difficult if not impossible to sell, except at a substantially reduced value.

3.9 Effects of a Borrower Becoming Insolvent

The insolvency of a borrower will not of itself affect the validity or priority of a lender's recorded mortgage lien under Iowa state law, unless the mortgage itself was created as part of a fraudulent conveyance. In the event that a borrower files for protection under federal bankruptcy laws, whether before or during an event of default under the mortgage, the lender should appear in and protect its interests in the bankruptcy proceedings. In general, the filing of a bankruptcy petition will effect an automatic stay of any proceedings to enforce a mortgage or other security interest while the bankruptcy action is pending.

However, a lender may often successfully request a lifting of the stay with respect to a recorded mortgage, and once this is granted, the lender may proceed to foreclose its mortgage during the pendency of the bankruptcy proceedings.

3.10 Taxes on Loans

No recording fees or similar taxes are charged in connection with mezzanine loans affecting Iowa real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Both urban (city government) and rural (county government) areas may be subject to local zoning ordinances adopted pursuant to zoning statutes, subdivision ordinances adopted pursuant to the subdivision statute, and site plan ordinances adopted through home rule authority. See the balance of **4. Planning and Zonin** g for further details.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The design, appearance and method of construction of new buildings or refurbishment of existing buildings are controlled by multiple layers of governmental regulations under Iowa law. The applicability and nature vary by municipality and county, but may include state and local building codes, zoning ordinances, subdivision ordinances and site plan ordinances. Building codes address construction requirements designed to address safety concerns. Zoning law involves the division of land within a city or county into districts and regulates uses and developments according to district.

Subdivision ordinances govern the landowner's ability to divide a larger parcel of land into one or more smaller parcels, with the goal of promoting orderly development of the land as a whole. Site plan ordinances generally work to ensure that

the details of the development of a parcel comply with all applicable laws and promote orderly development at the parcel level.

Many counties have adopted standalone ordinances governing development of commercial wind energy projects.

4.3 Regulatory Authorities

Local governments, meaning municipal government and county government, are responsible for regulating the development and designated use of individual parcels of real estate in Iowa. Local governments must comply with any applicable state law in implementing these controls, but otherwise have general "home rule" authority to exercise control over local matters. For example, Iowa Code Chapter 414 authorises municipalities to enact local zoning ordinances. Such local ordinances must comply with the general rules set forth in Chapter 414, but individual ordinances may vary.

4.4 Obtaining Entitlements to Develop a New Project

Zoning Entitlements

The process for obtaining zoning entitlements to develop a new project or complete a major refurbishment of an improvement on Iowa land may vary to some extent based upon local ordinance. In general, zoning laws divide a city or county into districts setting forth "permitted uses" within each district. If the proposed project is a permitted use, then the developer need not take any further action under the zoning laws, but nevertheless must obtain approval under the site plan ordinance as to the development of the proposed permitted use as well as obtaining all applicable building permits.

Rezoning

If the proposed project is not a permitted use, then the developer must pursue either a rezoning, an exception or conditional/special-use permit, or a variance.

A parcel of land may be rezoned either by the decision of the local governing body (ie, the city council or the county board of supervisors) on its own accord or upon a petition for rezoning from the landowner. In either case, a rezoning may only be adopted after a public hearing on the proposal with proper notice as required by law. Parties in interest and the general public are entitled to be heard at the public hearing.

Further, landowners or neighbouring landowners are entitled to file written protest of a proposed rezoning prior to the hearing, and if a statutory threshold of opposition is met, a super-majority vote of the local governing body will be required to approve the rezoning. If agreed to by the landowner, the local governing body may impose conditions upon the approval of the rezoning.

Conditional Land Use

Certain uses of land may not be allowed as a permitted use by a landowner as a matter of right but may be allowed conditionally upon satisfaction of certain standards. Such uses are variously called "special exceptions", "special uses" or "conditional uses" depending upon the local ordinance. To qualify for such a use, the landowner must file a petition with the zoning board of adjustment.

The decision to grant or deny such a request is made following a public hearing before the zoning board of adjustment.

A proposed use of land that is otherwise prohibited by a local zoning ordinance may nev-

ertheless be permitted upon the granting of a "variance". A variance may only be granted upon a showing by the landowner of "unnecessary hardship", meaning:

- the land cannot yield a reasonable return under the permitted uses;
- the plight of the owner is due to unique circumstances and not general conditions of the neighbourhood; and
- the proposed use will not alter the essential character of the locality.

The decision to grant or deny a request for variance is made by petition to the zoning board of adjustment and a public hearing before such board.

4.5 Right of Appeal Against an Authority's Decision

The process to appeal an adverse decision in a zoning matter depends upon the nature of the decision being appealed. An appeal of an enforcement of a zoning ordinance is first made to the zoning board of adjustment. If the petitioner is not satisfied with the determination of the zoning board of adjustment, the decision may then be further appealed for judicial review in the state district court.

Similarly, a landowner who disagrees with a zoning board of adjustment's decision on a request for a special exception or variance may appeal to the district court for judicial review. A petition for judicial review must be filed within 30 days of the decision by the zoning board of adjustment. A zoning decision made by a city council or county board of supervisors may also be challenged by judicial review in the district court.

Typically, such actions must be challenged within 30 days of the decision by a petition for certiorari similar to judicial review of actions by the zoning board of adjustment. However, defects in the process or action taken by the local governing body that are deemed "jurisdictional" may generally be challenged at any time by a declaratory judgment action.

4.6 Agreements With Local or Governmental Authorities

While it is not generally required to enter into agreements with local authorities or utility suppliers to facilitate a development project in Iowa, for larger-scale commercial developments it is a common practice. It is common for a developer to engage in pre-application meetings with local government planning, zoning and economic development staff to discuss the proposed development in light of building, zoning, subdivision and site plan approvals, as well as potential economic development incentives that may be available, such as tax increment financing or tax abatement programmes.

The developer and the local governing body will often enter into a development agreement requiring the developer to commit to threshold value improvements on the property or construction of public infrastructure improvements in exchange for or contingent upon desired zoning, subdivision and site plan approvals or receipt of economic incentive packages.

4.7 Enforcement of Restrictions on Development and Designated Use

Local governments are able to enforce development and use restrictions under their general zoning and other police powers. In addition, when developers have entered into development agreements, restrictive covenants or other voluntary agreements with the local governing body or with neighbouring landowners, such agreements are binding on future owners or other

interest holders when recorded and generally enforceable under property and contract law.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The following entities may be formed under Iowa law by investors and all are empowered to own and operate real estate assets:

- general partnerships (GPs);
- limited partnership (LPs);
- limited liability partnerships (LLPs);
- limited liability limited partnerships (LLLPs);
- limited liability companies (LLCs); and
- business corporations.

Limited liability companies are the most common vehicle to hold real estate investments in Iowa, given the combination of tax benefits and the flexibility available under the statute in designing the investment/ownership and management structures of the entity. Entities formed under the laws of other states may own real estate assets in Iowa, but investors should take care to evaluate requirements to obtain a certificate of authority to do business in Iowa for the foreign entity depending on the nature of activities being undertaken.

Investors seeking to acquire agricultural land in Iowa must be mindful of the restrictions of Iowa Code Chapter 9H. This chapter restricts the authority of most entity forms to own and operate Iowa agricultural land, subject to prescribed exceptions for family entities, small entities and acquisitions of land for non-agricultural purposes. The details of Chapter 9H must be evaluated on a case-by-case basis whenever an entity seeks to acquire an interest in Iowa agricultural land.

In addition, the similar restrictions of Iowa Code Chapter 9I must be evaluated where a non-resident alien seeks to acquire an interest in an entity owning Iowa agricultural land.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

The main features of the constitution and governance of entities created under Iowa law are similar to what will be found in other states.

General Partnership

A general partnership is an exception to the general rule that a filing with the Iowa Secretary of State is required to create the legal existence of the entity. Rather, a general partnership is created by the association of two or more persons to carry on, as co-owners, a business for profit. The details of the partners' rights to manage the partnership and share in its profits and losses are governed by a written or unwritten partnership agreement and Iowa Code Chapter 486A.

The main drawbacks of a general partnership structure are less flexibility in structuring the relations among partners and no limitation of liability – that is, all partners are jointly and severally liable for obligations of the partnership.

Limited Partnership

A limited partnership is formed by filing a certificate of limited partnership with the Iowa Secretary of State. The details of the partners' rights to manage the partnership and share in its profits and losses are governed by a written or unwritten partnership agreement and Iowa Code Chapter 488. The difference between a general and a limited partnership is that the latter includes two classes of partners – one or more general part-

ners who have the sole authority to manage the operations of the partnership, except for major actions that require the approval of the limited partners, and limited partners who have rights to share in profits and losses but limited voting rights.

In a limited partnership, general partners are jointly and severally liable for obligations of the partnership, while limited partners have no liability solely by virtue of their status as limited partners. A common practice in a limited partnership is to have a corporation or limited liability company act as the general partner to achieve limited liability for its owners.

Limited Liability Partnerships and Limited Liability Limited Partnerships

A limited liability partnership operates for all intents and purposes as a general partnership, except that, by filing a statement of qualification with the Iowa Secretary of State electing to become a limited liability partnership, the general partners are relieved of joint and several liability for obligations of the partnership solely by virtue of their status as partners. Similarly, when a limited partnership adopts a certificate of limited partnership stating that the limited partnership is a limited liability limited partnership, its general partners are relieved of joint and several liability for obligations of the partnership solely by virtue of their status as partners, and the partnership for all intents and purposes operates in the same manner as a limited partnership.

Limited Liability Companies

A limited liability company is formed by filing a certificate of organisation with the Iowa Secretary of State. The details of management of the company and distribution of its profits and losses are governed by a written or unwritten operating agreement and Iowa Code Chapter 489. The equity owners of a limited liability company are called members.

The persons with general authority to operate the day-to-day affairs of the limited liability company may be the members or may be managers appointed in accordance with the company's operating agreement. Chapter 489 affords broad flexibility in structuring the internal operations of a limited liability company. Neither members nor managers are personally liable for obligations of a limited liability company solely by virtue of their status as members or managers.

Business Corporations

A business corporation is formed by filing articles of incorporation with the Iowa Secretary of State. The details of management of the company and distribution of its profits are governed by duly adopted by-laws and Iowa Code Chapter 490. The equity owners of a business corporation are called shareholders.

The business and affairs of the corporation are governed by a board of directors elected in accordance with the company's articles of incorporation and by-laws and Chapter 490, and the board of directors may elect officers to carry out the directions of the board of directors. Neither shareholders, directors nor officers of the corporation are personally liable for obligations of a corporation solely by virtue of their status as shareholders, directors or officers.

Broadly speaking, partnerships and limited liability companies are the preferred vehicles for investment in Iowa real estate from a tax perspective. This is due to the fact that these are considered "pass-through" entities, meaning there is no separate income tax on profits earned at the entity level, but instead there is only income tax to the individual equity own-

ers based on the entity's profits. In contrast, a corporation must pay a corporate income tax on its profits, and when dividends from those profits are issued to its shareholders those dividends will be taxable income to the individual shareholders.

5.3 REITs

There is no authority for the creation of a real estate investment trust under Iowa law.

5.4 Minimum Capital Requirement

There is no express minimum capital requirement to form an entity to invest in real estate under Iowa law. However, the failure to properly fund an entity may be a factor considered by a court in determining whether to "pierce the corporate veil" and impose personal liability on an entity's equity owners for liabilities of the entity.

5.5 Applicable Governance Requirements

See **5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity**.

5.6 Annual Entity Maintenance and Accounting Compliance

All entities that are formed by filing with the Iowa Secretary of State must file biennial reports with the Iowa Secretary of State for a filing fee that varies by entity type, but in each case is less than USD100.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Generally, the only method by which another can occupy real estate without purchasing the property is through a lease. However, a licence agreement or easement agreement will allow a party to use property without entitling the party to exclusive occupancy or possession.

6.2 Types of Commercial Leases

The two primary methods of commercial lease are differentiated by the method of rental payments.

Net Lease

Under a "net lease" arrangement, the tenant will pay base monthly rent, as well as the tenant's share of operating expenses as additional rent. Additional rent typically includes items such as the tenant's share of property taxes, insurance, and expenses related to the maintenance and repair of the common areas on the property. The usual net lease will also include a true-up provision to account for any unforeseen variance in the operating expenses which occur over the course of the lease year.

Gross Lease

A "gross lease" arrangement obligates a tenant to pay only monthly base rent without the additional rent. In a gross lease, the landlord accounts for all expenses as part of the monthly base rent, which requires the landlord to have a firm grasp on anticipated operating expenses of the property if the landlord wishes to enter into a multi-year lease with the tenant.

Ground Lease

Though not used as frequently, in a ground lease, a lessee lets real estate from a lessor for the purpose of constructing improvements upon the leased ground. Lease arrangements vary as to who will be deemed the owner of the improvements at the expiration of the ground lease.

6.3 Regulation of Rents or Lease Terms

In Iowa, rent and lease terms are governed by three separate and distinct chapters of the Iowa Code depending upon the property being let:

- the general code chapter (Chapter 562) applies to commercial leases and agricultural leases;
- the Iowa Uniform Revised Landlord Tenant Act (Chapter 562A) applies to all residential leases; and
- the Manufactured or Mobile Home Landlord and Tenant Law (Chapter 562B) applies to the leasing of manufactured or mobile home spaces (as opposed to rental of the home itself, which is governed by Chapter 562A).

While Chapter 562 governs commercial leases, such leases are still primarily controlled by the lease instrument and common law. Chapter 562 mandates certain terms be included in a lease (eg, agricultural leases must commence on 1 March and must be terminated by written in notice by 1 September of the year preceding the termination). In contrast, both Chapter 562A and Chapter 562B have a significant number of lease terms which are deemed to be a part of every lease, whether expressly set forth in the lease or otherwise. Additionally, both chapters include very precise procedures for defaults, notices to be delivered upon default, and the manner and method of evictions.

While certain moratoria on evictions were imposed during the COVID-19 pandemic, no such restrictions survive any longer.

6.4 Typical Terms of a Lease

While it is difficult to say that there are "typical terms" in a commercial lease, there are some commonalities with regard to certain terms such as length of the lease, maintenance obligations and frequency of rent payments. Frequently, a commercial lease will have an initial term of five to ten years, with an option or series of options for renewal periods (such options most commonly being granted to the tenant).

As it relates to maintenance and repairs, the landlord will generally be responsible only for those matters which affect the structural integrity of the building, such as roof, foundation and exterior of the building. Virtually all other expenses will be borne by the tenant directly or indirectly as part of the operating expenses in a net lease. For example, the cost for maintaining the parking lot will initially be borne by the landlord, but will be recouped through the tenant's payment of its pro rata share of operating expenses.

Finally, most leases require the tenant to pay monthly rent. As noted above, in the situation of a net lease, the tenant is also required to pay its pro rata share of operating expenses of the building. The landlord will generally provide the tenant with a yearly budget of anticipated operating expenses for the year and the tenant will pay 1/12 of the tenant's pro rata share each month. Any necessary adjustment upward or downward at the end of the year to account for actual operating expenses is accomplished through a true-up.

6.5 Rent Variation

It is a common occurrence for the monthly rent, even the monthly base rent, to vary over time. Especially for leases with longer terms, landlords and tenants will build in variations of rent over time. Most often, the variances are effectuated through rental escalators where the rent increases by a set percentage for each renewal term.

In certain circumstances, the rent may be based upon retail sales (if applicable) with rent varying

based, at least in part, upon retail sales. In some agricultural leases the rental escalators which are built in are derived through an annual cash rent survey, which is compiled and published by Iowa State University.

6.6 Determination of New Rent

See **6.5 Rent Variation**.

6.7 Payment of VAT

No taxes or governmental levy is payable on rent in Iowa, beyond state and federal income taxes.

6.8 Costs Payable by a Tenant at the Start of a Lease

Generally, a tenant may be required to make payments to the landlord at the commencement of the lease in addition to the first month's rent. In almost every case, the tenant will be required to pay a security deposit, which the landlord will hold in trust pending the tenant's fulfilment of its obligations under the lease. Further, a tenant may be required to contribute some amount to capital improvements, although this practice varies greatly from lease to lease.

In some cases, any capital improvements to the leased premises must be contracted for, carried by, and paid for by the tenant. In other cases, the landlord will undertake all capital improvements and figure the cost of such improvements as part of the rental to be charged. In certain other circumstances, the landlord may provide a build-out allowance, with any additional improvements to be paid for by the tenant.

6.9 Payment of Maintenance and Repair

See **6.4 Typical Terms of a Lease**.

6.10 Payment of Utilities and Telecommunications

As with charges for maintenance and repairs to common areas of the rental property, charges for services, utilities, and telecommunications are most frequently paid indirectly by the tenant through the additional rent payments made as part of operating expenses. However, any services which are provided directly to the tenant, or which are capable of being separately metered, will most often be paid directly by the tenant to the service provider. Services which are not separately metered or not capable of segregation are generally covered by the operating expenses owed by each tenant.

6.11 Insurance Issues

As part of the operating expenses, the landlord will usually carry extended coverage insurance against loss, damage, or destruction by fire or other casualty, which will insure the building, most often for an amount not less than the full insurable value on a replacement cost basis. The tenant will ordinarily be required to carry casualty and liability insurance in given amounts depending upon the tenancy, protecting the landlord against such things as harm to person or property. The tenant may also be required to insure their personal property within the leased premises.

6.12 Restrictions on the Use of Real Estate

A landlord is entitled to restrict the tenant to particular types of use of the property. For example, the landlord may restrict the tenant to only operating a retail business out of the rented space or may prohibit the tenant from operating certain types of businesses. In almost every lease, the landlord will expressly prohibit the tenant from carrying on any business practice which is a vio-

lation of any federal, state, or local law, including criminal laws.

6.13 Tenant's Ability to Alter and Improve Real Estate

In most commercial leases, a landlord will restrict the manner or type of alterations to the real estate. Frequently, the landlord will define a category of "major alterations", usually delineated by the cost of the improvements, which can be completed only upon prior written consent of the landlord. For all other alterations, consent is not required.

However, in any event the landlord will require that the premises be returned to the same state they were in at the commencement of the tenancy, ordinary wear and tear excepted. The landlord may also set forth that any tenant improvements become the property of the landlord at the expiration of the lease upon the landlord's election.

6.14 Specific Regulations

See **6.3 Regulation of Rents or Lease Terms**.

6.15 Effect of the Tenant's Insolvency

In almost all commercial leases, one of the events of default under the lease terms will be the tenant's insolvency, bankruptcy or the like. Thus, if the tenant is deemed to be insolvent under the terms of the lease, the landlord would be entitled to pursue its default remedies under the lease.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

The primary form of security which will be required of a landlord to secure a tenant's performance of its lease obligations is a security deposit. In the commercial lease context, there are few restrictions when it comes to requiring and retaining a security deposit. In the residential context, however, landlords are limited in how much they can require for a security deposit.

Further, in the residential setting, use and retention of the security deposit is governed by statute. The statutory provisions are the subject of a fairly large body of case law, which has grown significantly within the last decade.

Finally, in non-residential settings, the Iowa Code provides several statutory liens to landlords depending upon the nature of the tenancy. Iowa Code Section 570.1 does provide for a landlord's lien upon all crops grown on the leased premises, together with other personal property of the tenant used by or kept upon the leased premises. Additionally, Iowa Code Chapters 578A and 579 provide for lien rights to property owners who rent space to individuals for self-storage and for storage of motor vehicles, respectively.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant's right to occupy the premises rented ceases upon expiration of the lease term.

A tenant who holds over after the expiration of the lease term can be evicted by summary proceedings. As a general rule, the commercial lease should provide for the scenario in which the tenant holds over with the permission of the landlord since the statute in question does not directly provide for this situation. Thus, for example, it is advisable to include lease language which creates a month-to-month tenancy.

In the context of the agricultural lease, a tenant who holds over and who has not been provided a notice of termination is entitled to remain in possession of the property for an additional

year upon the same terms and conditions as the original lease. In the residential setting, a tenant who holds over with permission of the landlord has created a month-to-month tenancy.

6.18 Right to Assign a Leasehold Interest

A tenant is freely permitted to sublet or assign a lease unless prohibited by the terms of the lease. Where landlord consent is required, the law may impose a requirement that the landlord's consent not be unreasonably withheld. Typical conditions include the financial viability of the tenant, compatibility of the proposed use, and the original tenant remaining jointly liable with the assignee for performance of the tenant's lease obligations.

6.19 Right to Terminate a Lease

Commonly, the events of default which trigger the landlord's right to terminate the lease will be numerous. Essentially, the failure of the tenant to comply with any obligation under the lease may give rise to termination. Importantly, however, the type of default will likely determine how the landlord is required to proceed.

In a residential lease, the statute dictates what notices must be provided, how they must be provided, when they must be provided, and how long the tenant has to cure a breach. Even in the commercial lease setting, there will most likely be different cure periods depending upon the breach. For example, it is fairly common for a default in the payment of rent to contain a ten-day cure period, while the breach of any other obligation will afford the tenant 30 days to cure the default.

6.20 Registration Requirements

Any lease for a term of one year or more must be memorialised in writing signed by landlord and tenant. Leases of Iowa real estate are not required to be notarised or recorded, and bona fide purchasers are placed on inquiry notice of the rights of any tenant in possession of the real estate. However, it is common in long-term leases or leases containing an option to purchase the leased premises to record a memorandum of the lease to ensure third parties are bound by constructive notice of the lease. Nominal recording fees are charged for recording the memorandum, and are typically charged to the tenant.

6.21 Forced Eviction

Tenants in any type of lease may be forcefully evicted if they default in the performance of their lease obligations. For commercial leases, the procedure, types of notices, and timing are governed almost exclusively by the lease terms. In the residential lease context, there is a very precise set of notices, with specific language, and for which care must be given to the timing and method of service.

In either the commercial or residential lease context, the procedure will involve a notice served or sent to the tenant apprising them of the breach and providing a set period during which the tenant may cure the breach. If the breach is not cured, the landlord may file a civil action for eviction under an Iowa statute which provides for expedited proceedings for evictions. In an ordinary eviction of a residential lessee for non-payment of rent, the tenant may be evicted from the property in as little as two weeks.

It is important to note that a landlord may be divested of its right to avail itself of these expedited proceedings, if it fails to act within 30 days of the date the cause of action accrued. The exact steps which must be taken in either a commercial lease or a residential lease are beyond the scope of this document, and practitioners

must make diligent inquiry as to the various statutes at issue.

6.22 Termination by a Third Party

Generally, a lease may be terminated by a third party (ie, a person not a party to the lease) only in circumstances involving condemnation or eminent domain. In Iowa, the compensation due to a landlord or tenant is determined based upon their respective property interests. Damages for condemnation of a leasehold interest are generally measured by the value of the remainder of the lease term in excess of the rent to be paid. Unlike valuation of an interest in fee simple, lost business profits may be taken into consideration in determining the value of a leasehold interest.

6.23 Remedies/Damages for Breach

The Iowa Uniform Residential Landlord-Tenant Act imposes limitations on the nature of damages that a landlord may claim, generally limiting recovery to actual damages and also subject to the landlord's duty to mitigate damages. Recovery of damages in the commercial leasing context is generally consistent with contract law principles, subject to the landlord's duty to mitigate damages. Security deposits in residential leases are tightly regulated by statute, whereas in the commercial context are only limited by agreement of the parties. Commercial leases are frequently secured by security deposits, which may be commingled with a landlord's personal funds, and by personal guaranties.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are myriad types of construction contracts used in Iowa. However, the most prevalent types of construction agreements in the residential construction context are generally the cost-plus agreement, with or without a guaranteed maximum price, time and materials agreement, and stipulated sum agreement (as well as combinations thereof).

7.2 Assigning Responsibility for the Design and Construction of a Project

The most common project delivery methods are as follows.

Design-Bid-Build/Traditional Method

The owner contracts separately with a design professional, who handles all design responsibilities, and a general contractor, who handles all construction responsibilities.

Design-Build Method

The owner hires a single entity, termed the design-builder, to perform both design and construction responsibilities under a single contract with the owner.

Construction Management Methods

The owner separately contracts with a design professional to develop the design of the project and with a construction manager.

The construction manager as adviser (CMa) method

The construction manager contracts with an owner to act as its consultant/adviser in the pre-construction/design phases and to provide construction management services during the construction phases. Under this method, the owner holds the subcontracts and assumes the risk of delivery of the project regarding cost and schedule.

The construction manager at risk (CMAR) method

The construction manager contracts with an owner to act as its consultant in the pre-construction/design phases, to generally provide for the actual construction of the project ordinarily through use of a general contractor, and to otherwise perform construction management services. Importantly, under this method, the construction manager guarantees the cost of the work such that the construction manager assumes the risk with the owner of exceeding such cost. The cost of the work is generally cost-plus with a guaranteed maximum price, but can also be a stipulated sum price.

7.3 Management of Construction Risk

The primary method for management and allocation of risk as between contractor and owner is through warranties and indemnifications provided in the construction agreement. Contractors will often provide express limited warranties (usually of one to two years in length) and some may otherwise attempt to have the owner waive all other warranties, implied or express. Contractors will often additionally affirmatively disclaim any knowledge of certain aspects of the construction (eg, soil composition on the construction site).

However, Iowa courts have long held that all construction contracts are subject to an implied warranty of workmanlike construction. In certain circumstances, a construction contract may also be subject to the implied warranty for a particular purpose.

7.4 Management of Schedule-Related Risk

Timing and deadlines are important aspects of construction agreements, with contractors generally attempting to remove any firm deadlines from the construction agreement, and owners generally attempting to include more firm deadlines along with a per-diem liquidated damages amount to be imposed for a contractor not meeting the deadlines. An important caveat is that certain contractors will include milestone billing in their agreements. To the extent the contract includes deadlines, however, damages will generally be recoverable by owners and contractors in the event of delay unless the contract includes a provision for no damages upon delay. Additionally, there are numerous exceptions to enforcement of delay damages.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

There are numerous additional forms of security which an owner may require to guarantee a contractor's performance. Generally, these additional forms of security are not negotiated in residential construction agreements. However, in larger commercial transactions, and in construction agreements involving state, county, or municipalities as the owner, owners generally require the contractors to obtain payment and performance bonds, and, at times, maintenance bonds.

In some real estate development settings, the more prevalent method is through a requirement that the developer provides a letter of credit from a financial institution for the amount of the improvements.

7.6 Liens or Encumbrances in the Event of Non-payment

For non-public projects, Iowa has a mechanics' lien statute which permits a lien in favour of a contractor or subcontractor who furnishes any material or labour for the improvement, alteration, or repair of any building and/or land. Generally, a properly perfected mechanic's lien is

superior to all other liens upon the building or land, except those liens recorded prior to the original commencement of contractor's work. However, liens resulting from construction mortgages are superior to all mechanics' liens of claimants who commenced their particular work or improvement subsequent to the date of the recording of the construction mortgage lien.

For public projects, subcontractors have the right to file claims against the retainage held by the public entity under Iowa Code Chapter 573, as well as claims against the payment bond.

7.7 Requirements Before Use or Inhabitation

Iowa law requires that a certificate of occupancy be issued prior to construction being used or inhabited. The state statute delegates issuance of certificates of occupancy to the particular governmental subdivisions within the state. The certificate of occupancy must, at a minimum, state that the building complies with the Iowa state building code.

8. Tax

8.1 VAT and Sales Tax

No VAT or equivalent is payable on the sale or purchase of corporate real estate in Iowa, only transfer tax. See **2.10 Taxes Applicable to a Transaction**.

8.2 Mitigation of Tax Liability

The transfer tax due upon conveyance of Iowa real estate is only payable upon consideration given for real property. Accordingly, two methods to reduce or avoid the payment of transfer tax are:

- to allocate a portion of the total consideration paid in a transaction to personal property acquired, if any; and
- to acquire equity interests in an entity that owns real estate rather than acquiring the real estate itself.

8.3 Municipal Taxes

No municipal taxes are paid on the occupation of business premises or payment of rent in Iowa.

8.4 Income Tax Withholding for Foreign Investors

Beginning in 2022, most Iowa pass-through entities must file a composite tax return and pay Iowa income tax on behalf of its non-resident owners' Iowa-source income from the pass-through entity. A non-resident owner and the related Iowa pass-through entity may annually file a joint election out of this requirement if the non-resident owner agrees to pay income taxes on its Iowa-source income independent from the entity in which it has an ownership interest. As in all states, withholding for federal income tax is often required. At the federal level, the sale of real property in Iowa is generally subject to withholding at a rate of 15% and foreign investors must file a federal tax return to recoup this amount where no tax is ultimately due.

8.5 Tax Benefits

Real estate investors benefit greatly from utilising depreciation deductions from their federal and state tax returns. While this creates additional gain on the eventual sale of the real estate, tax benefits such as 1031 exchanges or investment in qualified opportunity funds can defer the recognition of that gain for long periods of time. Additionally, financing costs are generally amortised over the life of the loan and many operational costs can be deducted currently, further reducing an investor's taxable income.

Depending on the nature of a development, real estate investors may be able to utilise state and federal tax credits programmes – such as historic, brownfield, or new market tax credits – to reduce the investors' tax burden or reduce development costs by sale of the benefits of the tax credits to outside investors.

Utilisation of these programmes typically requires a co-ordinated approach from start to finish among an experienced team of legal counsel, tax and accounting specialists, investor diligence professionals, state and/or federal agency representatives, and engineering and design professionals to ensure compliance with detailed regulations and proper structure to ensure the intended benefits accrue to the intended parties.

Trends and Developments

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Dentons Davis Brown has a real estate department consisting of approximately 20 attorneys, many of whom practice in other areas of the law which intersect with real estate, such as real estate litigation, property tax appeals, environmental law and estate planning. The firm has three offices in central Iowa, and is part of the global Dentons firm. The firm performs real estate-related legal work throughout the state, in the areas of residential real estate, agricultural real estate, commercial real estate, industrial real estate and various tax credit transactions. The firm carries out residential and commercial lending work for financial institutions and insurance companies including Wells Fargo Bank, NA; US Bank, NA; and many other regional or local institutions. It has represented Facebook in matters concerning its investments in Iowa and negotiating tax incentives, and worked with the City of Des Moines on the development of a multi-building mixed-use project in downtown Des Moines. It does work for developers including R & R Investors and Hubbell Realty Company.

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Unlocking Opportunities: Exploring Current Economic Incentives for Development in Iowa

Iowa offers a variety of tax and related economic incentive programmes for development. Economic incentives serve as useful tools to encourage development in Iowa, particularly in Iowa's rural communities where development may not otherwise make financial sense as an investment for developers. Iowa has come to be known as a "silicon prairie" in recent years, with major data centres being developed in the state by Meta (formerly known as Facebook), Google, Microsoft, and Apple, which were each a recipient of a combination of economic incentives at both the local and state levels. Iowa has a long history of offering incentives to developers for both large and small projects, and continues to introduce legislation promoting investment and growth in Iowa. There is currently pending legislation that could increase incentives for developers. Although there is a push for investment and development in Iowa, the state's agricultural identity remains an important consideration in the state's development incentive programmes, as agriculture remains a cornerstone industry for the state. Iowa's land is one of its most prized resources. As a result, incentives in Iowa are nuanced with protections for Iowa's agricultural land, and navigating Iowa's requirements for development projects to qualify for and receive tax and other economic incentives can be complex. The most common economic incentive opportunities are explored below.

Common tax incentives available to developers in Iowa

Some common tax incentives available to developers in Iowa include property tax abatements, tax increment financing, low-income housing tax credits, tax-exempt private activity bonds, workforce housing tax credits, redevelopment tax credits, and historic preservation tax credits. These tax incentives are governed by a variety of different governmental entities. The Iowa Code places requirements on how some of these incentives may be implemented, such as by requiring that specific areas of a community be specially designated by a city council and/or county board of supervisors as a basis to qualify for incentives, for example, being designated as "urban renewal areas" and/or "urban revitalisation areas." A number of these incentives can be combined together.

Tax abatement

Tax abatement provides an incentive to developers by exempting a project from paying property taxes for a period of time. Typically, a tax abatement is granted only on the increased property value amount resulting from the improvements made to a property. A base property value is established prior to the development of improvements, and the difference or a portion thereof between the base value and the new value of the property after construction of the improvements is "abated" and not subject to local taxation for a period of time. Tax abatement is implemented and approved at the local level by city councils and/or boards of supervisors, subject to restrictions in the Iowa Code.

Tax increment financing

Tax increment financing (TIF) is an incentive that reallocates property tax revenues within a designated area of a city or county to finance projects in that designated area. TIF areas allow a city or county to make direct economic development grants or loans to developers for projects. A base property value is established prior to the development of improvements, and the property is assessed with a new valuation post-development. The difference between these two values is the incremental amount that the portion of taxes being reallocated back to a city or

county is based upon. TIF is implemented and approved at the local level by city councils and/or boards of supervisors. The creation of TIF areas involves an intricate statutory framework with certain restrictions on the areas that can be designated as TIF requiring the local governmental body to hold a public hearing and pass resolutions and ordinances to establish urban renewal areas and urban revitalisation areas and corresponding detailed plans for the designated areas.

Low income housing tax credits

Low Income Housing Tax Credits (LIHTCs) are federal tax credits that promote investment in the development of multi-family residential rental housing for individuals or families with fixed or limited incomes. LIHTCs offer a direct reduction in investors' federal tax obligations equal to the amount of their investment in developing affordable rental housing. By contributing equity, investors support the construction of housing for low-income individuals, enabling some units to be rented at rates below the market average. In exchange for their investment, investors receive tax credits distributed annually over a period of time. The LIHTC programme allows developers to deliver high-quality affordable housing to low-income individuals, and gives investors an opportunity to generate a financial return; however, both the application process and the compliance requirements after the project is completed are complex. Iowa's LIHTCs are managed and awarded by the Iowa Finance Authority. There are two LIHTC programmes available; one is a 9% tax credit and the other is a 4% tax credit. The application process is highly competitive, particularly for the 9% tax credit. Projects are evaluated and scored based on criteria such as feasibility, affordability, location, amenities offered to residents, etc. Collaboration with and buy-in from local communities is important for a project's LIHTC application to be successful.

Tax-exempt private activity bonds

In addition to administering LIHTCs, the Iowa Finance Authority issues private activity bonds, which are tax-exempt bonds to help finance the private development of qualifying projects, such as affordable housing, solid waste disposal facilities, and projects for non-profit corporations. Some 4% LIHTC projects also qualify for private activity bonds. Typically, tax-exempt bonds are issued by state and local governments for projects that serve a public purpose and benefit the general public. However, there are exceptions for certain bonds that serve private interests but also provide significant public benefits, which are known as private activity bonds and are allowed to be tax-exempt. Private activity bonds are repaid using revenues generated by the private users of the facilities or projects they finance. It is solely the developer's responsibility for repaying private activity bonds, and the state of Iowa has no liability for repaying the debt.

Historic tax credits

Historic tax credits are awarded for projects involving the rehabilitation of historic buildings. Historic tax credits can be combined with other tax credit incentives, such as LIHTC. The Iowa Economic Development Authority and the State Historic Preservation Office (SHPO) administer the State Historic Preservation Tax Credit Program, which consists of a state income tax credit. There is a related Federal Historic 20% Rehabilitation Tax Credit, which is administered by SHPO, the National Parks Service, and Internal Revenue Service. Iowa also has a County Historic Property Tax Exemption Program, which is administered by SHPO and county boards of supervisors.

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Redevelopment tax credits

Developers have the opportunity to receive tax credits for revitalising properties categorised as "brownfield" and "grayfield" sites. Brownfield sites include abandoned, inactive, or underused industrial or commercial properties where either actual or perceived environmental contamination hinders redevelopment, such as properties previously used as gas stations, dry cleaning facilities, and other businesses that may have used hazardous materials in their operations. Grayfield sites include abandoned public buildings and vacant industrial or commercial properties that are deteriorating, obsolete, or underused. The Iowa Economic Development Authority administers this tax credit initiative.

Workforce housing tax credits

The Workforce Housing Tax Incentive Program is administered by the Iowa Economic Development Authority consists of state tax credits awarded in an amount of up to USD1 million per project to developers providing housing in Iowa communities, with a focus on projects that rehabilitate abandoned, empty, and dilapidated properties. Local matching funds are required for a project, which can be through tax abatement from the city, cash grants, or other means.

Common real estate documents required for Iowa's tax incentive programmes

Development agreement

Developers are often required to enter into a development agreement with benchmarks for completion of the project and other obligations set forth in the agreement. Often, a corresponding memorandum of the development agreement is filed of record with the county recorder in the county where the property is located.

Minimum assessment agreement

In conjunction with tax abatement and TIF incentives, developers are often required to enter into a written minimum assessment agreement, which establishes an agreed-upon minimum post-development assessed value for the land with completed improvements.

Land Use Restriction Agreement (LURA)

A LURA between the developer and the Iowa Finance Authority is required for LIHTC projects that sets forth compliance obligations for a project, such as income qualifications for tenants, transfer restrictions, record keeping requirements, etc. The LURA is filed of record with the county recorder in the county where the property is located.

Demand for increased development in Iowa attracts attention of Iowa legislature

There has been a push in the Iowa legislature recently to expand incentives that encourage development that is gaining traction, specifically with respect to incentives for development of "mega sites" consisting of over 1,000 acres of land. Iowa's prized agricultural land has historically received extensive statutory protection, such as through restrictions on ownership of agricultural land by both domestic and foreign entities. As a result, legislation for development incentives that affects agricultural land requires a delicate balance between preserving farmers' interests while promoting development.

New proposed legislation, Senate File 574, would create the Major Economic Growth Attraction (MEGA) Program to be governed by the Iowa Economic Development Authority, which would increase the number of acres of agricultural land that can be owned by foreign entities and would provide tax incentives to foreign businesses if they meet certain requirements and are not

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designated as foreign adversaries of the United States. There are protections for Iowa's farmers included in the bill, including a prohibition on a MEGA Program applicant from actively engaging in farming. According to the proposed bill, the purpose of the proposed legislation is to attract businesses in the advanced manufacturing, biosciences, and research and development industries. The MEGA Program would provide a number of tax incentives to developers for development of sites consisting of over 1,000 acres of land with a project cost of over one billion dollars. Incentives would include an investment tax credit, a wage withholding tax credit, and a sales and use tax refund. The MEGA Program was proposed in legislation at the end of the legislative session last year with bipartisan support, but did not make it through both chambers for approval before the end of the session; however, it was proposed again this year and appears to be on track to be signed into law this session. The MEGA Program legislation could bring new industries to Iowa, create jobs, grow the state's population, and allow the state to compete with other states that offer similar incentives to large projects. Iowa's rural communities have faced a population decline over the years, and this legislation could help attract major projects to be built on the development-ready sites located in rural communities that are designated as "Certified Sites" by the Iowa Economic Development Authority.

There is also pending legislation, House File 2420, that proposes to increase the annual maximum amount limits for the Iowa Workforce Housing Tax Credits for qualified housing projects in both large and small cities. This proposed legislation would allow for more projects to receive tax credits.

Conclusion

The efforts to preserve Iowa's historical agricultural identity sometimes conflict with the state's goal of attracting new investment and development. This tension requires real estate developers in Iowa to navigate various local and state laws that continue to evolve. Developers and investors in development projects should consult with tax professionals and attorneys to determine eligibility for their projects, as Iowa's incentive programmes are subject to changes at both the legislative and local government levels. While the state of Iowa values its agricultural identity and takes legislative steps to preserve it, there are plenty of attractive incentives offered in Iowa for developers to take advantage of for both large and small projects that enhance Iowa as a whole. Iowa's incentive programmes and pending legislation clearly show that the state is making development a priority.

USA - LOUISIANA



Trends and Developments

Contributed by:
Jeffrey P Good and Susan M Tyler
Jones Walker LLP

Jones Walker LLP has a 35-strong real estate team with a footprint extending through ten cities across six states, including Texas, Louisiana, Mississippi, Alabama, Florida and New York. The team counsels clients on the largest and most complex real estate projects and developments, including hotel and hospitality development, industrial projects for the petrochemical and energy sectors, medical and healthcare projects, development of gaming facilities, office building leasing and development, and multi-family apartment and condominium projects. Jones Walker is known for its ability to assemble teams with specialist expertise in areas such as government relations, environmental matters, construction law, land use matters, corporate and business organisation issues, and federal, state and local tax matters.

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The COVID-19 pandemic leaves what will be long lasting social and economic changes. Louisiana real estate markets are no exception, although it should be noted that the impacts of the global health crisis were mixed. Where one industry, sector, or region faced significant challenges, another found opportunities.

Meanwhile, the real estate industry is watching a mixture of economic and political factors, particularly a new republican governor and governing coalition in Baton Rouge and a federal government that is rapidly spending money on clean energy.

With this in mind, this overview of Louisiana real estate trends and developments will begin by looking at some of the most pronounced effects of the pandemic, particularly in the hospitality, retail and tourism sectors. Other geopolitical, climate change, and sociocultural forces – including the impact of the Russian invasion of Ukraine on global energy markets – have also had an influence on real estate activity in the state, particularly given Louisiana's sizeable oil and gas, chemicals, manufacturing and related industries. A number of developments "closer to home", including emerging legislation and new infrastructure projects, will also be discussed in order to provide a more complete picture of Louisiana's commercial, industrial, and multi-family residential real estate markets.

COVID-19: One Person's Challenge Was Another's Opportunity

For a number of companies, including brick and mortar retailers, restaurants, entertainment venues and nightclubs, hotels, and other tourism-related businesses, the pandemic had a devastating effect on revenues. In many cases, these businesses were unable to weather the storm. In turn, some landlords lost revenue as their tenants' businesses folded, others agreed to rent abatements or deferrals.

This situation was not, however, universal. In Baton Rouge, for example, after retail occupancy rates hit an eight-year low in 2020, the market rebounded strongly. As of April 2022, 91.2% of leasable retail space in shopping centres of 15,000 square feet or larger was occupied, the highest level since 2018. Among survey respondents, 67% reported vacancy rates of 10% or less, and only 4% of centres indicated that they were more than half vacant. Recent reports indicate that retail vacancy rates have further dropped in Baton Rouge.

For a variety of reasons, including federal and state stimulus programmes, eviction moratori-

ums, rental supports, etc, many businesses had the flexibility and capacity to (at least temporarily) re-think the ways they served customers and quickly reoriented themselves to the new environment. In mid-2022, as COVID-19 infection rates dropped relative to previous highs and as political and public health officials declared an end to the pandemic, customer demand has significantly increased.

This new environment continues to create opportunities for local and regional business owners – as well as owners and investors from other states – to take advantage of available retail, restaurant, and entertainment spaces. Supply and demand appear to be balanced; despite some of the highest month-to-month inflation rates in recent memory, rents do not appear to be rising excessively. Similarly, lease terms do not appear to have tightened, despite some concerns that landlords affected by recent business closures and an inability to collect rents from some past tenants would try to protect themselves unreasonably.

In the same vein, as in-person shopping fell and retail malls and shopping centres lost anchor tenants during the pandemic, many online retailers saw surges in revenue and customer demand. As a result, some of these brick-and-mortar properties have been torn down while others have been repurposed entirely and are now being used for expanded, centrally located warehouses and fulfilment centres, training centres, medical facilities, and light manufacturing operations. No better project exemplifies this trend than the conversion of the Cortana Mall in Baton Rouge into an Amazon fulfilment centre.

Regional and national buyers of hospitality and hotel projects are also demonstrating increased interest in properties, particularly high-end and boutique projects in the central business district (CBD) and historic French Quarter, Marigny and Uptown neighbourhoods of New Orleans. Recently opened hotels include the Four Seasons Hotel & Residences, the Hotel St. Vincent, Virgin Hotels New Orleans, the One11 Hotel, and the Kimpton Hotel Fontenot. Still other hotels and restaurant spaces (some recently re-positioned and others expected to be re-positioned) have sold over the past year. While short-term rentals continue to face changing regulations, there have been a number of non-traditional hotel projects under development.

Residential Projects are Stabilising and Attracting National Buyers

In the residential real estate market, Louisiana is – to paraphrase Charles Dickens – experiencing the worst of times and the best of times, relatively speaking. According to a March 2022 Bankrate report, housing-price appreciation is among the lowest levels in the nation and mortgage delinquencies are among the highest.

Local housing markets vary widely, of course. According to March 2024 statistics from Redfin, New Orleans and Shreveport home prices were down 7.9% and up 6.1%, respectively, year over year, while Baton Rouge prices were up 1.1% during the same period (after taking a significant cut the year before).

The impact of inflation and, in response, the Federal Reserve's rate increases, have slowed the residential real estate market. Another significant impact has been the availability and affordability of insurance for all real estate properties (residential and commercial alike). It remains to be seen whether the new administration will be able to address the lack of affordable insurance which is not an issue limited to Louisiana.

One area that is showing signs of strength across the board is sales of high-end condominium projects, particularly as relatively affluent knowledge workers and business owners respond to new ways of doing business that allow for greater remote-work flexibility. The combination of proximity to downtown areas plus increased floor space for home offices has driven purchasing activity for units that meet these requirements.

Major Projects are Taking Off

Construction is surging across the US Gulf Coast, with more than USD25 billion in capital investment in 2023 (USD100 billion since 2016) according to the Louisiana Department of Economic Development. Many of the Louisiana projects are energy-related, including Origin Materials' USD750 million biomass facility and Renewable Energy Group's USD950 million improvement and expansion of a renewable diesel production facility, both located in Geismar. Other notable projects include the Strategic Biofuels Louis Green project in northern Louisiana at the Port of Columbia, DG Fuels sustainable aviation fuel facility in St. James Parish and a continued multi-phase effort to widen Interstate 10 in Baton Rouge. Perhaps one of the largest projects in Louisiana's history is the USD7.8 billion Venture Global LNG facility being developed in Plaquemines Parish.

In New Orleans, major projects include the deal between Tulane University and developers 1532 Tulane Partners, Inc., and SKK Opportunity Zone Fund I, LLC, for the university to occupy nearly 350,000 square feet of New Orleans' former Charity Hospital. The property will be transformed into a major, mixed-use project featuring apartments, retail space, educational facilities, and other uses. Closed since Hurricane Katrina in 2005, the structure will now serve as a linchpin in a major expansion of properties in the city's biomedical corridor.

In addition, the Four Seasons Hotel & Residences, together with the affiliated Vue Orleans cultural attraction and observatory, continue to effect transformative change of the riverfront at the foot of Canal Street, with the renovation of Spanish Plaza nearing completion and the construction of a new floating ferry terminal well underway. Also in New Orleans, the Ernest M. Morial Convention Center is in the middle of a five-year, USD557 million capital improvement project that aims to revitalise 47 acres of land upriver of the centre. The developers of that project are working to bring new dining, retail, entertainment, and other venue options within walking distance of the CBD.

Top Legislative and Executive-Branch Issues

For professional associations and lobbying groups in Louisiana, 2021 was a significant year for passing and defeating legislative proposals that would impact the state's real estate market. Among other significant wins (from an industry perspective) were the passage of an amendment to the state constitution that simplified the collection of sales taxes, and the approval of laws regarding real estate licensing renewal designed to protect consumers and licensees. In 2022, a significant focus was on creating a more robust insurance market, with a special session called to create a significant financial incentive for insurers to offer property insurance in Louisiana. 2023 legislative outcomes included bills to grow the insurer market, support infrastructure assets including funding ports, address carbon capture and offshore wind and further develop state-wide economic incentives. The first 2024 legislative session focused on addressing crime and the second legislative session is shaping

up to include a significant number of bills to strengthen the governor's power.

Lastly, the Industrial Tax Exemption Program, a tax abatement programme, is being closely watched. Although its use was limited under the prior administration, the new governor has implemented a number of changes to loosen requirements and change the local approval process.

Climate Change a Concern, but Resilience and Opportunity-Seeking are Ingrained

Severe weather events are on the rise globally, however 2023 was a relatively calm storm season.

That said, for most of its recorded history, Louisiana has been subject to extreme weather. Endurance and nimbleness are built into the culture of the region and, in recent years, a number of coastal resilience initiatives have been put into motion to reduce the impact of hurricanes and related flooding. Federal and state legislation – including the federal Infrastructure Investment and Jobs Act, which directs USD492 million to the NOAA National Coastal Resilience Fund, among other programmes – has focused on restoring or expanding natural infrastructure such as wetlands and barrier islands that can reduce the devastation caused by major storms.

Further inland, projects such as the USD225 million Five Bayous Project and the USD343 million Diversion Flood Control Project are designed to limit storm-related flooding along major drainage canals and rivers in the Baton Rouge area.

One of the most significant areas for potential growth and investment in Louisiana is carbon sequestration. The state is a natural fit for activities related to the capture and storage of CO2, for several reasons.

- Louisiana is already home to a highly developed oil, gas, and chemicals production, refining, and distribution infrastructure, much of which could be easily repurposed to redirect CO2 and related byproducts into short- and long-term storage. Carbon sequestration projects that relied on conversion of existing facilities would be significantly cheaper than acquiring land and building new operations.
- From a geological perspective, much of the state is situated over geological formations known as salt domes and over subsurface porous spaces (or "pore spaces"), some of which are naturally occurring and others that are the result of previous petroleum and natural-gas extraction. Currently filled with saline water, these spaces could take advantage of emerging storage and sequestration technologies.
- The Louisiana state and federal governments have a long history of working collaboratively to manage underground wells and to protect drinking water from extraction and injection activities. The US Environmental Protection Agency (EPA) has granted the Louisiana Department of Natural Resources primary authority, or primacy, to administer Class I-V wells, and EPA recently approved the state's application to manage Class VI wells, which are used for the injection and geological sequestration of CO2.
- Louisiana's existing legal framework (including the Louisiana Geologic Sequestration of Carbon Dioxide Act, the Louisiana Civil Code, the Louisiana Mineral Code, and other statutes) has established processes that enable parties to obtain pore-space, salt dome, and other ancillary rights relating to carbon sequestration.

Taken together, Louisiana can act as a closed-loop provider of CO2 sequestration for industrial and manufacturing activities within the state, and provide related services to facilities outside its borders.

Conclusion

If anything, the last several years have demonstrated the wisdom of exercising caution when peering into the real estate crystal ball. The COVID-19 pandemic continues to ripple across the country, inflation may persist for the remainder of the year, supply chain disruptions and labour shortages remain, and a new season of severe weather events is on the horizon.

Louisiana, however, is the product of overcoming challenges and seizing opportunities in the face of even the greatest adversities. This can-do, creative spirit is perhaps the region's greatest strength and is likely to foster an active, growing real estate market in 2024.

USA - NEW JERSEY



Law and Practice

Contributed by:
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Greenberg Traurig LLP has more than 600 real estate attorneys in its real estate practice, which is a recognised leader in the industry, serving clients from key markets around the world. The New Jersey real estate team handles all aspects of real estate law, including acquisitions and dispositions, joint ventures, restructurings, workouts, lender finance, commercial leasing, and cross-border transactions. The team has experience in all property sectors, including office, industrial, mixed-use, retail, commercial and residential, affordable housing, and hospitality. While the firm's attorneys do a considerable amount of work in New Jersey, their representations frequently extend to cities and other locations throughout the world. The New Jersey team works closely with GT lawyers in New York and around the globe.

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1. General

1.1 Main Sources of Law

Real estate law in New Jersey requires attention to a variety of substantive skills and practice areas. In addition to being a good draftsperson, well versed in contract and commercial law, an effective real estate practitioner in New Jersey must view each transaction in the context of the particular property, the asset class, and the client's goals. In virtually every deal, there are tax issues, corporate issues, government issues, environmental issues, and labour and employment issues, among others.

In addition, an attorney must understand their client's business objectives and tolerance for risk. A real estate attorney must take a holistic approach to any transaction to ensure careful examination of each issue that could create risk, impact practice areas outside of what is strictly "real estate", or otherwise frustrate the spirit of the contemplated transaction.

1.2 Main Market Trends and Deals

Trends and deals occurring in New Jersey cannot be shared at this time.

1.3 Proposals for Reform

The most important reform proposal is New Jersey Assembly Concurrent Resolution 89, which proposes a temporary constitutional amendment allowing a State constitutional convention convened to reform the system of property taxation to propose statutory changes.

2. Sale and Purchase

2.1 Categories of Property Rights

Fee Simple Absolute

Fee simple absolute is the greatest interest in real estate in NJ, granting the owner the full and exclusive right to use, possess, sell, hypothecate and even damage the property. The transfer of real property in New Jersey is deemed to be the transfer of an absolute fee simple estate, subject to the terms of the conveyance instrument. N.J.S.A. 46:3-13. New Jersey does recognise variations on fee simple ownership, including fee simple defeasible estates and fee simple estate subject to a condition subsequent.

Tenancy in Common

In New Jersey, tenancy in common (TIC) is the most frequent form of ownership structure where there are multiple parties that will co-own real estate. Except in the case of spouses or express language in the deed, real property transfers in New Jersey to two or more grantees will create a tenancy in common in equal percentages and undivided (interests are all shared). N.J.S.A. 46:3-17. Deeds may also create a tenancy in common using the following language: "Grantor grants and conveys ownership of the property described below to Grantees, as tenants in common, along with all of its rights and appurtenances." The deed may recite different ownership percentages for each tenant in common. Since there is no right of survivorship, upon the death of a tenant in common, the deceased party's interests transfer pursuant to intestate statutes or the provisions of a TIC agreement.

Joint Tenancy With the Right of Survivorship

Joint tenancy is a form of co-ownership which is viewed less favourably in New Jersey than tenancy in common, and is primarily known for having a "right of survivorship" which does not

occur with a tenancy in common. The rights of a deceased joint tenant automatically transfer to the surviving joint tenants. Pursuant to N.J.S.A. 46:3-17, co-owners must have express language to create a joint tenancy; accordingly, deeds should recite the following: "Grantor grants and conveys ownership of the property described below to Grantees, as joint tenants with right of survivorship and not as tenants in common, along with all of its rights and appurtenances."

Tenancy by the Entirety

A tenancy by the entirety is a form of joint property ownership available only to spouses. Transfer of real estate to a husband and wife creates a tenancy by the entirety unless the deed provides otherwise. Features of tenancy by the entirety include a right of survivorship where a surviving spouse becomes full owner of the property upon the death of the other spouse. N.J.S.A. 3B:9-1. Most sophisticated or commercial property is not held in this manner.

Life Estate

A life estate in New Jersey will convey an interest in real property granting the right to possess the property to a "life tenant" until the death of a named person. Upon death of the named person, the property automatically transfers to a designated remaindermen. A deed in New Jersey may include the phrase "during the natural life of" to name the person whose death triggers the transfer to the remaindermen, and the phrase "the remainder over at death to" to identify such remaindermen.

Leasehold Estate

In addition to the above, New Jersey also recognises non-freehold estates such as the leasehold estate, which involves possession but not ownership. The term is also for a finite or predictable period of time and can be determined in advance. Variations of leasehold estates and lesser categories of ownership, such as an estate for years and/or an estate at sufferance, also exist in New Jersey.

2.2 Laws Applicable to Transfer of Title

The main statute governing transfer of title is Title 46 of the 2022 New Jersey Revised Statutes; NJSA 46. For any property that has multiple dwellings (including hotels and motels), the New Jersey Hotel and Multiple Dwelling Law (N.J.S.A. 55:13A-1 et seq.) may also apply. Properties that have been used as "industrial facilities" as defined by ISRA, will also be subject to compliance with the Industrial Site Recovery Act (ISRA) (N.J.S.A. 13:1K and N.J.A.C. 7:26B). In addition, there are over 500 municipalities in New Jersey, and each has its own ordinance with respect to transfers of property. In view of the above, inexperienced purchasers of real estate in New Jersey would be well advised to keep in mind the following:

- ISRA compliance with respect to industrial establishments;
- New Jersey bulk sales compliance;
- "Green Cards" for the conveyance of multiple dwelling properties,
- motels, and hotel properties; and
- certificates of occupancy or other transfer certificates in certain municipalities.

Industrial Site Recovery Act (ISRA)

ISRA is a unique New Jersey statute that requires that owners of certain facilities investigate and remediate property prior to or in connection with property transfers, business sales or when a business ceases operations. Whether or not a business is subject to ISRA is based on its North American Industry Classification System (NAICS) classification, and the use or presence of hazardous substances in its operations. If

both conditions of this test are met, in connection with an ISRA-subject triggering event, the parties are required to comply with ISRA's provisions, which entails notice to the state and the retention of a licensed site remediation professional (LSRP) to evaluate and then propose and oversee remediation, if necessary. While ISRA obligations default to the seller, ultimate compliance and performance may be contractually allocated between the parties. If the property is ISRA-subject, appropriate provisions must be inserted in the purchase contract to ensure compliance and protection of the parties. The actions of the LSRP are tightly regulated by the state to ensure compliance with the state's laws by a non-state entity. ISRA is a complex and detailed statute, and its provisions cannot be adequately summarised in this format.

"Green Cards"

The Bureau of Housing Inspection administers the New Jersey Hotel and Multiple Dwelling Law which requires that multi-family properties, hotels, and motels maintain valid Green Cards which are issued after property is registered, inspections and reinspections have been conducted, all violations are corrected, and all fees paid. As part of any transfer of property relating to this subject asset class, purchasers should request to see Green Cards as part of their diligence efforts and should look to ensure they are valid as of the closing date. Green Cards are issued, and state inspections therefore take place, every five years.

Bulk Sales

New Jersey has a bulk sales law which imposes on purchasers an obligation to notify the New Jersey Department of Treasury, Division of Taxation ("Division") of any transaction involving the transfer of business assets outside the ordinary course of business of the owners. The purpose is to identify and capture the taxes owed by the owner before sales proceeds are distributed from the closing of the transaction. Failure to comply with the bulk sales law could render a purchaser liable for a seller's outstanding state tax obligations.

The bulk sale notification process is as follows: the purchaser first submits a Form C-9600 which must be properly completed and include the following: (i) a valid New Jersey tax ID number for the seller and purchaser, (ii) the specific closing date, which must be at least ten business days after submission, (iii) a proper mailing address for each of the parties and/or their respective legal counsel, (iv) the signature of the purchaser or the purchaser's attorney, and (v) a copy of the executed contract of sale, court order, or assignment agreement clearly showing the sales price and all the terms and conditions of the transfer. Often, the purchase and sale agreement requires that all of the above information be provided in a timely manner so as not to delay the purchaser's bulk sale filing. In addition, if required by the Division, the seller submits a Transfer Tax Declaration form to the Division. The Division generally promises a response within ten business days of the submission of a complete filing, at which time the Division will either issue a tax clearance letter, directions for an escrow of a portion of the seller's proceeds, or a demand letter. If the Division fails to respond to a completed bulk sale notification within ten business days, the purchaser will not be liable for any state tax obligation of the seller. The purchase and sale agreement also will typically provide that both parties agree to comply with the instructions of the Division.

Certificates of Occupancy

There are over 500 municipalities in New Jersey, and each has its own ordinance with respect to

transfers of property. Accordingly, many require the issuance of a certificate of occupancy upon a conveyance, commonly referred to as a "CO". Custom and practice is to contact the zoning or building office in the municipality where the property is located in order to determine the specific requirements. Each municipality will impose its own rules such as requiring the cure of violations, deferred maintenance obligations, and/or closing out open permits. The property owner usually must complete the application for inspection and issuance of the CO along with payment of a fee.

2.3 Effecting Lawful and Proper Transfer of Title

In New Jersey, lawful and proper transfer of title to real estate is effectuated by execution, delivery, and recordation of a proper deed with the county clerk for the county in which the subject property is located along with the payment of the applicable taxes and fees in order to perfect the transfer. The deed must be signed, acknowledged, and contain an adequate description of the property. The most commonly used deed is a Bargain and Sale Deed with Covenants Against Grantor's Acts and it must include a statement, at the top of the first page, which states "Prepared by:" followed by the name of the New Jersey attorney that drafted the deed. In nearly all cases, a statement of the true consideration for the transfer must be recited in the deed, the acknowledgment, the proof of the execution, or an appended affidavit by one of the parties to the deed.

If the conveyance is for new construction, the words "NEW CONSTRUCTION" in upper case lettering shall be printed clearly at the top of the first page of the deed and an affidavit must also be submitted.

Flood Hazard Disclosure

As to any transactions of real estate in New Jersey after 20 March 2024, the Flood Hazard Disclosure Law shall apply and names certain required disclosures that must be made before a purchaser is obliged under a contract for the purchase of real estate. The disclosure must include whether the property is located in the Federal Emergency Management Agency (FEMA) Special or Moderate Risk Flood Hazard Area, as well as certain other disclosures which are listed below:

- Is any or all of the property located wholly or partially in the Special Flood Hazard Area (100-year floodplain) according to FEMA's flood insurance rate maps for the property?
- Is any or all of the property located wholly or partially in the Moderate Flood Hazard Area (500-year floodplain) according to FEMA's flood insurance rate maps for the property?
- Is the property subject to any requirement under federal law to obtain and maintain flood insurance?
- Has the seller received assistance, or is the seller aware of any previous owners receiving assistance, from FEMA, the US Small Business Administration, or other federal disaster flood assistance for flood damage to the property?
- Is there flood insurance on the property?
- Is there a FEMA elevation certificate available for the property? If so, it must be shared with the buyer.
- Has seller ever filed a claim for flood damage to the property with any insurance provider, including the National Flood Insurance Program? If the claim was approved, what was the amount received?
- Has the property experienced any flood damage, water seepage, or pooled water due to a natural flood event, such as heavy rainfall,

costal storm surge, tidal inundation, or river overflow? If so, how many times?

In making the required disclosures, the disclosure form must also include a notice that state-wide flood risks are increasing, and that the buyer may review these risks by going to the website that the New Jersey Department of Environmental Protection will manage.

While no remedy is expressly stated for failure to make the required disclosures, the language provides that the disclosure must be given before the buyer is obliged to purchase the property. This has resulted in a question as to whether the buyer will have a termination right for the seller's failure to make the disclosure.

2.4 Real Estate Due Diligence

It is generally advisable and customary for purchasers of real estate in New Jersey to conduct due diligence prior to closing. Typically, there is a period of time following execution of a contract, during which time all such diligence activity is conducted and, during such time, the deposit remains refundable to the purchaser in the event of a termination by the purchaser for any reason or no reason. This is often referred to as a "free look".

In a residential context, this is often as simple as a home inspection and a title review process handled primarily by the purchaser's legal counsel. In a commercial context, the due diligence process is more complicated and the level of scrutiny would depend on the facts. Typically, this involves the review and inspection of the following by the purchaser's attorneys: title reports, surveys, rent calculations for compliance with rent regulations, leases and tenant estoppel certificates, service contracts, warranties, property condition reports, zoning, environmental reports (Phase I and Phase II), and certificates of occupancy. Sophisticated clients typically handle some of the above diligence activities on their own; specifically, review of rent rolls and rent calculations, operating statements, and service contracts on the property. This allocation of responsibilities has remained constant in recent years, though certain diligence services traditionally performed by attorneys have adapted to innovations in technology. Examples include lease abstracting, where clients have outsourced to independent vendors for a fraction of the cost.

It is worth noting that the diligence process in New Jersey is not dissimilar from the process in other jurisdictions; however, the environmental diligence is more nuanced as a result of New Jersey's environmental laws. In this context, it is typical and often advisable for a seller of real estate to prohibit a prospective purchaser from using an LSRP from entering the property or otherwise having any involvement with purchaser's investigations.

2.5 Typical Representations and Warranties

In New Jersey, purchase and sale agreements have representations and warranties of both purchaser and seller. Typically, a seller's representations and warranties are significantly more involved and are heavily negotiated, though sellers seek to limit representations to the types of discoveries that a purchaser would otherwise be unable to uncover with diligent efforts. A purchaser's representations are typically limited to authority and financial ability to consummate the closing.

In addition, it is common for a purchaser to insist that the purchase and sale agreement provide that the seller's representations and warranties survive closing for a given period of time. Sur-

vival periods vary, and are a typical negotiation point in most deals. If such representations do not survive closing, a merger clause will merge any and all representations made into the deed. To backstop the representations and warranties post-closing, sellers will occasionally agree to either a post-closing holdback escrow or a guaranty from a credit-worthy guarantor.

In commercial transactions, a purchase and sale agreement typically includes, at a minimum, the following representations and warranties:

- organisation and formation of the seller along with full right, authority, and capacity to execute the agreement and to perform its obligations under the purchase and sale contract;
- no pending or threatened lawsuits against the seller or otherwise affecting the property;
- the seller's resident or non-resident status;
- no pending or threatened eminent domain or condemnation proceedings against the property;
- no third parties have any options to purchase the property or other possessory rights which may frustrate the sale;
- no known environmental defects with the real property or any actions being taken by any agency with respect to the environmental condition of the real property;
- the existence of all licences, permits, and certificates necessary for legal use or occupancy of the real property; and
- no pending or threatened changes in the zoning classification of the property.

2.6 Important Areas of Law for Investors

Foreign investors must register with the New Jersey Department of Treasury as a foreign entity authorised to do business in the state of New Jersey.

Foreign investors that are non-US entities or persons should pay attention to the usual issues on a federal level such as:

- international tax considerations;
- collateral regulatory burdens; and
- the Committee on Foreign Investment in the United States (CFIUS) review.

There are no additional regulations for non-US purchasers imposed by the state of New Jersey. Foreign investors must understand whether they will be subject to other federal or state regulatory laws, including securities regulations, environmental laws, foreign corrupt practices statutes, and laws requiring the reporting of the acquisition of ownership of US real estate. If foreign investors will have a controlling interest in the owner, the transaction may be reviewed by the federal government.

The Foreign Investment in Real Property Tax Act can subject foreign investors to federal income tax liability and the withholding of proceeds from a sale or transfer. While recent changes to CFIUS have resulted in modifications to process and breadth, in practice it has not had a major impact.

2.7 Soil Pollution or Environmental Contamination

New Jersey is known for having among the strictest environmental statutes in the United States. Sellers will typically seek:

- a disclaimer of all liability for environmental conditions and a full release by purchaser upon closing;
- a prohibition on purchasers' use of an LSRP for due diligence; and
- confidentiality provisions which will compel the purchaser to keep all results of its

investigations strictly confidential, except as required by law.

Purchasers seek to protect themselves by reserving extensive environmental due diligence rights, including the right to conduct a Phase I environmental assessment and, if required, a Phase II which would include soil samples and borings. These issues are often very heavily negotiated by sellers and purchasers. As a general matter, the contract negotiation often results in the purchaser and seller allocating responsibility in the purchase and sale agreement, each taking responsibility for any conditions on the property that were caused during its respective period of ownership and indemnifying the other during such period.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In New Jersey, zoning matters are governed by state law and by municipal ordinances, so the rules vary by municipality and location. A buyer may have legal counsel perform a zoning analysis of the property during due diligence. Municipalities will typically provide a zoning letter which certifies that a property is compliant with current zoning and/or may be used as intended by a purchaser of the property. Owners who wish to change the zoning of a property may seek to change the municipality's zoning ordinances, or they may obtain variances or other approvals and permits from local municipalities.

2.9 Condemnation, Expropriation or Compulsory Purchase

While it is typically only a remote risk, governmental taking through eminent domain or condemnation is possible in New Jersey where such power has been delegated to various agencies, public bodies, and public utilities. New Jersey's exercise of condemnation rights is most typically seen with respect to widening roads and highways and otherwise in connection with utilities. As a general matter, the condemnation process is as follows:

- there must be an attempt to resolve the acquisition outside of litigation through bona fide negotiations with the property owner (which includes an offer in writing by the condemnor);
- provided that such attempt does not result in an agreement, there must be a final disposition by judgment of the authority and due exercise of the power of eminent domain by the condemnor;
- there must be a non-binding arbitration of the issue of just compensation by commissioners appointed by the court; and
- there is a trial of the issue of just compensation.

Issues relating to condemnation are typically addressed in the purchase and sale contract and will often recite that upon any taking by a governmental authority, the parties would have the ability to terminate the transaction and the purchaser would receive a refund of the deposit. Occasionally, termination rights are tied to the taking of a given percentage of the property (eg, upon a taking of 10% of the property or a taking that affected access, visibility, or a main tenant, the purchaser would be entitled to terminate).

2.10 Taxes Applicable to a Transaction

New Jersey does not have any mortgage recording taxes. However, New Jersey does have a realty transfer fee (RTF), a controlling interest transfer tax (CITT) and a mansion tax. The mansion tax, paid by the purchaser, is 1% of the consideration where that consideration exceeds USD1 million, and applies to purchase of certain real estate in classes 2 and 4A, including

some residential and some commercial (including office) properties.

The RTF is typically paid by the seller, see **8. Tax**.

2.11 Legal Restrictions on Foreign Investors

Foreign investors are required to register with the New Jersey Department of Treasury as a foreign entity authorised to do business in New Jersey.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial property are typically financed by mortgage loans, mezzanine loans, and investments of preferred equity.

Mortgages

New Jersey is a lien theory state and, therefore, regardless of the language of the mortgage, title to real property does not vest in the mortgagee but remains with the borrower. A mortgage is generally accompanied by an assignment of rents and leases, which should be an "absolute" assignment in order to protect the rental stream from other creditors' claims in bankruptcy. The mortgage and assignment of rents and leases must be acknowledged and are recorded in the county wherein the property is located.

Commercial mortgages are also typically supported by various types of guaranties from the borrower's principals.

Mezzanine Loans

In situations where the borrower's principals lack sufficient equity, a mezzanine lender, whose loan would be secured by a pledge by the borrower's principals of their ownership interests in the borrower, can be requested to provide mezzanine financing for the acquisition. Since mezzanine financing is not as secure as mortgage financing, the interest rate is typically higher than in a mortgage loan.

Investments

The borrower may seek additional capital by accepting an investor from a "preferred equity" source, usually a privately held fund established for such purposes. Here, the preferred equity investor becomes a partner in the borrower and demands a "preferred return" on its investment and a portion of the profits from the property in exchange for its investment. Both the mezzanine lender and preferred equity investor will be able to exert a fair amount of control over the borrower, much more than a mortgage lender typically would.

3.2 Typical Security Created by Commercial Investors

The security provided to a mortgage lender typically consists of a first- priority mortgage loan and an assignment of leases and rents. In certain circumstances a first-priority lender may allow secondary financing (ie, a second subordinate mortgage). Priority of a mortgage is based on its recording date and although it is not required, some lenders elect to file UCC-1 financing statements in the state where the borrower was formed to secure its lien on other non-real estate assets.

A mezzanine lender's lien is secured by a pledge of ownership interests in the property owner and such security interest can be perfected both by the filing of a UCC-1 financing statement in the state where the pledging principal of the borrower resides and, if the lender requires the borrower to "opt-in" to Article 8 of the UCC, delivery of actual ownership certificates.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

See **2.6 Important Areas of Law for Foreign Investors**.

There are no specific New Jersey laws relative to this issue other than general corporate laws which require all entities which earn money from businesses located in New Jersey to be authorised to do business in New Jersey. Earning money from a borrower located in New Jersey sufficiently constitutes doing business in New Jersey such that authorisation (to do business in the state) is required. If authorisation is required and not obtained, the lender may be barred from bring claims before the courts in New Jersey until such time as all required state taxes have been paid.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

New Jersey does not currently have a mortgage tax. If a lender forecloses on its mortgage and accepts a deed in lieu of foreclosure and seeks to have the mortgage survive the conveyance, the RTF will be applied on the outstanding balance of the mortgage loan. In addition, the "mansion tax" will be imposed on the transaction (certain classified properties) if the outstanding balance of the mortgage exceeds USD1 million.

If the lender elects to discharge its mortgage prior to or simultaneously with the deed in lieu of transaction, there will not be any RTF or mansion tax imposed.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Generally, there are no New Jersey laws or requirements that require compliance by an entity providing security to a lender. Lenders and title insurance companies will review a borrower's organisational documents to confirm that all approvals and consents from the borrower's owners and/or officers required thereunder have been obtained.

3.6 Formalities When a Borrower Is in Default

With respect to commercial transactions only, debtor protections, if any, would appear in the loan documents. These might include notice and an opportunity to cure a default before it becomes actionable by the lender. With respect to residential foreclosures, laws enacted during the 2008 recession require mortgage lenders to take many time-consuming steps before they can foreclose a mortgage loan.

As a practical matter, New Jersey permits only judicial foreclosures, which are lengthy proceedings; even with respect to a non-contested commercial loan default, judicial foreclosure typically requires not less than nine months to one year to conclude. This time frame may enable a borrower to attempt to seek alternative financing or an amicable resolution of the dispute between it and the lender.

Once a lender elects to commence an enforcement action, there is nothing it needs to do to perfect, create, or enhance the priority of its mortgage. New Jersey is a race-notice state and, therefore, once a mortgage is recorded, its priority is established. Within the foreclosure process, there are steps a lender needs to take to maintain the priority of its mortgage, such as conducting a rundown title search to make sure its foreclosure complaint lists all junior lienors.

The interests of those junior lienors will need to be extinguished through the foreclosure process. Counsel for the foreclosing lender will also file a lis pendens in the county where the property is

located to ensure that any new lienors cannot interfere with the foreclosure and will be bound by its outcome, even if not a party thereto. Real estate taxes, municipal water and sewer charges, and certain environmental liens will always have priority over a mortgage, regardless of when such charges are imposed.

3.7 Subordinating Existing Debt to Newly Created Debt

A lender entitled to priority on its mortgage may agree to subordinate its priority to a subsequent mortgage lender's mortgage through a subordination or postponement agreement.

New Jersey recognises the doctrine of equitable subordination. Under this doctrine, a mortgagee who negligently accepts a mortgage without knowledge of intervening encumbrances will subrogate to a first mortgage with priority over the intervening encumbrances to the extent that the proceeds of the new mortgage are used to satisfy the old mortgage. This provides the new lender with the same priority as the old lender. Please note that if the new lender has actual knowledge of the prior encumbrances, it is not entitled to the priority described.

3.8 Lenders' Liability Under Environmental Laws

Lenders in New Jersey may be exposed to environmental liability for hazardous substances affecting their collateral under federal and state laws. However, New Jersey has created "safe harbours" for lenders which, in general, should shield lenders if they act properly under the law.

New Jersey law provides that if a lender does not participate in the management of a facility, it is not deemed an owner and, therefore, not the discharger of hazardous substances. A lender is not deemed to be involved in management if it responds to an environmental issue and remediates it or directs its borrower to do so, nor is it required to perform an environmental inspection prior to making a loan to avail itself of this safe harbour. In addition, taking title to the property after a foreclosure sale with the intention of selling it in order to realise on the collateral falls within the safe harbour.

3.9 Effects of a Borrower Becoming Insolvent

If the borrower becomes insolvent and is the debtor in a bankruptcy proceeding, any enforcement actions previously commenced will be subject to the automatic stay of the Bankruptcy Code. However, provided that the mortgage was properly recorded and there are no defects in the mortgage itself, the priority of the lender's mortgage will remain intact. Throughout the pendency of the foreclosure action, the property will typically be operated by a receiver, if requested by the lender.

Until the actual sheriff's sale after a foreclosure proceeding, the borrower retains its equity of redemption and can regain control of the property by paying off the then balance of the mortgage loan, together with all costs, attorneys' fees, and interest as calculated in accordance with applicable law. If the borrower files a bankruptcy proceeding after a sheriff's sale, title will nonetheless pass to the successful bidder.

3.10 Taxes on Loans

New Jersey does not currently have any existing, pending, or proposed rules, regulations, or requirements regarding recording taxes in connection with mortgage loans or mezzanine loans related to real estate.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

New Jersey has adopted the Municipal Land Use Law which imposes certain uniform requirements on municipalities with respect to land development. However, New Jersey is a home rule state and, accordingly, controls with respect to design and appearance are primarily local in nature and vary by municipality. Other governmental authorities with jurisdiction over the affected site may impose such obligations (see **4.3 Regulatory Authorities**).

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The method of construction is not customarily different than the Uniform Construction Code, which has been adopted with modifications by New Jersey, but each municipality applies the requisite inspection and approval obligations in its own procedural manner. Unique design and/or construction requirements are routinely imposed with respect to, among others, waterfront properties, properties within flood zones, and properties in or bordering on wetlands areas. In addition, municipalities often have a historic preservation committee which opines on development applications.

4.3 Regulatory Authorities

Generally, municipalities are responsible for regulating the use of real property within their jurisdiction. Counties and other governmental authorities may also regulate development and use of property within their jurisdiction through, for example, various county planning boards and the State Planning Board. All such governmental authorities have the right to designate what uses may be made of real property within designated zones, and they may grant relief from such requirements in appropriate cases (through variances or rezoning).

In addition, depending on the nature and location of the proposed development, the New Jersey Department of Environmental Protection, the Port Authority of New York and New Jersey, the New Jersey Department of Transportation, the Pinelands Commission, the Hackensack Meadowlands Commission, various watershed management agencies, sewerage authorities, affordable housing agencies, storm-water management agencies, and the county in which the property is located may have input into development and, in some instances, have the authority to grant or deny the application or impose conditions at the grant of the application.

4.4 Obtaining Entitlements to Develop a New Project

The nature of the requisite approvals varies depending upon where the property is located and the magnitude of the proposed development. As a general guideline (addressing municipal approvals only), a municipality will require submission of a site plan application to approve a development that is permitted in the applicable zone. Demolition and construction applications will typically be required where an existing structure is not being retained. In the event the use is not one that is approved in the zone, or the structures are non-compliant with the zoning requirements, a property owner would submit a variance application (or a site plan and variance application) to the applicable municipal zoning agency.

Notice of the application must be provided to real property owners within 200 feet of the proposed development, and all members of the

public, and anyone purporting to be affected by the proposed development, may appear and object at the hearing. Objectors also have the right to present evidence and expert testimony. The variance process may take as little as three to six months for a simple application or as long as 12 to 15 months for major variance applications.

Applications involving multiple agencies, particularly those located in sensitive ecological areas, may take up to several years.

4.5 Right of Appeal Against an Authority's Decision

An applicant or other person aggrieved by a municipal zoning decision has the right to file an appeal within 45 days of publication of the decision of the municipality in a newspaper of record. The Superior Court will then schedule a trial and a single judge will determine whether, on the record created before the municipal agency, the zoning decision should be affirmed or reversed. Municipal zoning decisions are given great weight and are upheld unless they are determined to be "arbitrary, capricious or unreasonable".

In the case of a denial of a variance or application for development, the municipality obviously would not issue any permits pending the appeal; in the case of a grant of an application for a variance or development, a municipality may issue such permits pending appeal, typically upon the posting of a bond by the applicant to ensure that in the event the appeal results in a reversal of the grant of the variance or zoning application, the site can be restored. Many municipalities will not issue such permits during an appeal by objectors.

4.6 Agreements With Local or Governmental Authorities

Agreements between developers and municipalities are properly available only in limited circumstances. In the ordinary course, a developer would have to proceed through a request for rezoning or an application for site plan approval (with or without variances) to obtain municipal approvals. However, it is not uncommon for such approvals to be "conditioned", with the developer's agreement, upon the developer addressing appropriate land use issues caused or exacerbated by the proposed development (for example, traffic flow, public safety).

Further, in the case of applications not requiring a use variance, it is typical for the municipality's professionals to meet with the developer's professionals to attempt to reach agreement as to any of the issues presented on the application. In certain other contexts, primarily with respect to blighted or distressed areas, Redevelopment Agreements and PILOT (Payments In Lieu of Taxes) Agreements are commonly used in New Jersey, but their use is not applicable to all properties. For a Redevelopment Agreement, the municipality must first designate the property at issue as an area in need of redevelopment (pursuant to state statutory criteria).

A Redevelopment Agreement can be negotiated, executed, and approved by the municipality's governing body (though it is common for such details to be agreed upon prior to the designation of a site for redevelopment). PILOT programmes similarly incentivise developers to restore distressed or blighted areas and PILOT agreements are often executed in conjunction with a Redevelopment Agreement.

4.7 Enforcement of Restrictions on Development and Designated Use

Municipalities typically employ code enforcement officials who respond to complaints, monitor ongoing construction, and conduct routine town inspections to ensure that unauthorised and/or unlawful developments are identified and appropriate municipal or court action is taken. State and county agencies also employ engineers and inspectors to oversee construction and development within their jurisdictions. In the case of construction (as distinct from unlawful use), a "stop work" order is usually issued by a code enforcement officer with a violation of such order resulting in fines, which can be significant.

In the case of an unlawful use, a notice of violation would be served upon the property owner; again, violations of the permitted uses of a given property would typically result in fines. Each day of non-compliance with the applicable uses in a zone, or with construction that is not permitted, constitutes a separate violation. In addition, municipalities will typically not issue permits until it has first been ascertained that the construction has been authorised and that the use is a permitted one.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

New Jersey recognises various business entities that are available to owners of real estate, including limited liability companies, corporations, and partnerships. The most common entity is the limited liability company, which affords the most flexibility and pass-through taxation, as well as fewer formalities than corporations.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Corporation

A corporation in New Jersey, as elsewhere, provides a separation between the shareholders, directors, and officers. The shareholders are the owners of the corporation and they elect the board of directors. The directors manage the business trajectory and activities of the corporation. The directors appoint officers who manage the day-to-day business and affairs. The main benefit of a corporation is that shareholders have no personal liability for the corporation except for certain specific instances such as a breach of fiduciary duty or a breach of the duty of loyalty.

Limited Liability Company

A New Jersey limited liability company (an LLC) has many of the same benefits of a corporation but is preferred for its flexibility of management while affording liability protection to its members. In addition, unlike corporations, LLCs are not taxed on the entity level but, rather, tax liability passes through to each of the members individually. For that reason, the LLC is the preferred form for structuring the acquisition of real property in New Jersey.

Partnerships

Partnerships have become far less common in recent years, especially with the increased popularity and ease of LLCs. Partnerships in New Jersey are more likely to be limited partnerships which combine a limited partner and a general partner. The limited partner is insulated from unlimited liability, but does not participate in the management or operation of the business. In this structure, the limited partner is only liable for its investment; accordingly, this form was primarily beneficial for a limited partner that sought to avoid unlimited liability and a general partner

who sought investment capital without material interference in the business activities.

5.3 REITs

REITs are available in New Jersey and can be either public or private.

5.4 Minimum Capital Requirement

There are no minimum capital requirements in New Jersey.

5.5 Applicable Governance Requirements

In all instances, annual reports must be filed with the State of New Jersey Division of Revenue and Enterprise Services.

5.6 Annual Entity Maintenance and Accounting Compliance

Many property owners have internal accounting groups or hire outside accounting firms to handle real estate investment entities. At minimum, annual reports will be required for filing for all New Jersey corporations, LLCs, non-profits, LPs, and LLPs. The process is relatively easy and can be completed online. The filing fees associated with annual reports, and which are due at the end of the relevant entity's anniversary month are listed below:

- corporations – foreign and domestic: USD75;
- LLCs – foreign and domestic: USD75;
- non-profits, co-operatives, and religious corporations: USD30;
- LPs – foreign and domestic – foreign and domestic: USD75; and
- LLPs – foreign and domestic: USD75.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

While New Jersey does recognise licences and occupancy agreements, the most prevalent form of arrangement for the use of real estate is a lease. A licence (or occupancy agreement) will not result in the grant of an interest in property for the licensee/occupant but will rather confer a lesser right for limited use that is often terminable and revocable at the will of the property owner.

However, the lease creates a possessory interest in property and affords the tenant greater rights, including exclusivity and assignability (as permitted by the landlord) and is not generally terminable prior to the expiration of the lease term, absent a default by the tenant or other narrowly construed circumstances.

6.2 Types of Commercial Leases

Commercial Leases

Commercial leases in New Jersey can be net leases or gross leases. In gross lease, the landlord typically provides certain building services and charges a fractional share of the costs back to the tenants. In this scenario, the tenant will typically pay rent to the landlord that comprises two parts:

- a base rent payment that is fixed but may increase annually; and
- additional rent payments which would include operating expenses for the property such as taxes, insurance, maintenance, and utilities.

Sometimes, these payments of "additional rent" are structured as payments of increases over a specified base year; other times, especially with

retail leases, it is a flat percentage of the building's square footage.

Typically, gross leases are seen in shopping centres, office buildings, and other properties where there are multiple tenants in a single building.

Conversely, with a net lease, the tenant pays a base rent payment to the landlord and separately contracts for and/or pays other costs and expenses of the property directly to the service provider or other proper payee. In a triple-net lease, for instance, the tenant would pay a fixed rent to the landlord monthly and separately pay all costs and expenses of the real property such as taxes, insurance, maintenance, and utilities.

Ground Leases

Ground leases are another type of lease in New Jersey. Typically, the landlord leases only the land to the tenant for a term of 20 or more years and maintains a reversionary interest where, upon expiration of the lease, the land and all improvements will be owned by the landlord. During the term of the ground lease, the tenant is responsible for constructing improvements and maintaining the property.

6.3 Regulation of Rents or Lease Terms

New Jersey does not regulate commercial rents.

6.4 Typical Terms of a Lease

Leases typically range from five years to 15 years and will often afford the tenant at least one option to renew. The terms vary based on each deal; however, the rent during the renewal term is usually a fixed percentage increase over the rent previously in effect, or based on another calculation such a consumer price index adjustment or a similar mechanism used to determine fair market value. Ground leases have much longer terms, typically 25 years or more.

For space leases, the tenant has all repair and maintenance obligations within the premises; the landlord is responsible for maintaining the structural components of the building, the roof, common areas, and the building systems. Typically, leases provide that if the tenant fails to make its required repairs in a timely manner and following notice and opportunity to cure, the landlord has the right to make such repairs and then charge back the incurred costs to the tenant. In a ground lease, it is common for the tenant to be solely responsible for all repairs and all maintenance.

Rent is typically paid monthly, although ground lease payments may also be made quarterly or annually.

6.5 Rent Variation

Typically, base rent will increase at certain trigger points that are negotiated as part of the economics of the lease deal (such increase could be every three years, five years, or another interval). The amount of the increase varies but is usually a pre-determined percentage. Escalation charges are usually computed annually, with estimated payments until actual expenses are known and reconciled. In a retail context, the tenant will often be required to pay the landlord a "percentage rent" with a computation commonly done on an annual basis and with payments to be made on an estimated basis until actual sales figures are available.

6.6 Determination of New Rent

The amount of the increase is usually known at the time of lease execution and is determined by either a fixed dollar amount, a figure based on cost per square foot, or another fair market valuation calculation or formulation such as the Consumer Price Index.

6.7 Payment of VAT

There is no VAT payable in New Jersey.

6.8 Costs Payable by a Tenant at the Start of a Lease

Other than rent payments, diligence costs, legal fees, and costs associated with posting a security deposit, the tenant may incur costs associated with obtaining permits for its intended use and any construction or fit-out costs associated with constructing or remodelling the premises. Typically, with a gross lease, the landlord will provide the tenant with a broom-swept empty space in a stated condition and provide a monetary sum to be used as a "construction allowance" for the tenant's fit-out. The tenant factors this allowance in its economics and is responsible for any costs exceeding the allowance.

Alternatively, the landlord may agree to a "build-to-suit" lease or provide a "turnkey" space to the tenant where the landlord would handle all construction and deliver a space to the tenant that is substantially complete. Of course, the cost differential is factored into the rent specified in the lease and directly affects the security that the tenant provides to the landlord.

6.9 Payment of Maintenance and Repair

In this jurisdiction, the landlord is generally responsible for all maintenance and repair of common areas such as hallways, lobbies, elevators, parking lots, and gardens. Leases will specify the services that will be provided by the landlord and will often include seasonal services such as landscaping and snow removal. The costs are passed to tenants as either operating expenses or common area maintenance and each tenant pays its pro rata share based on the percentage set forth in the lease.

Often these costs are estimated at the start of the year and billed monthly to tenants but are reconciled when actual costs and expenses are determined. In a ground lease, the tenant is commonly responsible for all maintenance and repair costs.

6.10 Payment of Utilities and Telecommunications

The method of payment for telecommunications and utilities will vary based on the property. For electricity, the cost to the tenant is usually determined by a direct meter or a submeter. The landlord may also reserve the right to charge a flat rate to the tenant. Charges for heating, ventilation, and air conditioning (HVAC) will also depend on each property.

Most commonly, tenants are all served by a single universal HVAC system during business hours (with the expenses to be built into the base rent and escalations) and are typically subject to additional charges for after-hours HVAC service. In some buildings, the HVAC system is designed so that each tenant has its own, with such expenses being charged to the respective tenant. Additionally, tenants may have their own supplemental air conditioning and cooling systems for data and telecom rooms, or to provide after-hours service, the expense of which is borne by each tenant.

6.11 Insurance Issues

The structure of the Global Practice Guides is fixed (for ease of cross-jurisdictional comparison), so every section requires some content, even if only to say that the issues involved do not apply in a given jurisdiction.

The absence of an answer for this this section, however, seemed more like an oversight than a choice. I have therefore added the firm's

response to the equivalent section in the 2023 US Real Estate guide below. The COVID part of the question can, I think, be safely ignored as no longer particularly relevant. We will be removing the COVID-19 questions from the 2025 questionnaire anyway.

In New Jersey, landlord and tenant each maintain their own insurance. Typically, the landlord will impose an obligation on tenants to maintain specific forms of coverage and to include the landlord as an additional insured. Such insurance will usually include general commercial liability and personal injury in certain amounts and limits that will vary depending on the premises and the use. Often, landlords are not required to maintain any insurance but will do so as a matter of business practice and will look to cover the common areas, structures, and roof as well as general commercial liability and personal injury, with such costs to be included in the operating expenses payable by tenants.

6.12 Restrictions on the Use of Real Estate

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6.13 Tenant's Ability to Alter and Improve Real Estate

Tenants must typically request the landlord's prior written consent as to any alterations or changes to be made within its leased premises. This is especially important for a landlord in terms of any potential tenant alterations that could reach beyond the tenant's own premises and potentially affect the structural portions of the building, the building systems, or affect ingress and egress. Often, the lease will provide that a tenant may make alterations without the landlord's consent provided that such alterations are cosmetic in nature, do not exceed a dollar threshold, do not require a building permit, and/or do not affect the structure, the roof, the building systems, or ingress to or egress from the building.

6.14 Specific Regulations

All tenants in New Jersey are entitled to the right of quiet enjoyment. Residential tenants are given greater rights relating to a warranty of habitability.

In addition, case law in New Jersey imposes an obligation on landlords to mitigate damages in the event of a tenant default. This applies in commercial and residential contexts. Accordingly, in the event of a tenant default where the lease is terminated, the landlord must use commercially reasonable efforts to relet the premises.

6.15 Effect of the Tenant's Insolvency

The tenant's insolvency in a lease context is governed by applicable bankruptcy, insolvency, and creditor's rights statutes. When the tenant files for bankruptcy under federal bankruptcy law, an "automatic stay" is imposed which initially restricts the enforcement of remedies or the termination of the lease by the landlord, absent of relief from the bankruptcy courts.

Thereafter, there are specific requirements under bankruptcy law with respect to whether a lease, which is a contractual agreement, is to be assumed or rejected, and which establish methods for calculation and recovery of rents unpaid as of the date of the bankruptcy filing. The lease is an executory contract and bankruptcy law may impose rules and obligations on how this must be treated.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Typically, landlords require a security deposit at the outset of the lease in the form of either cash security or a letter of credit or a guaranty from a well- capitalised parent entity. A letter of credit or a parent guaranty is generally considered more desirable to a landlord than a cash security deposit as such forms of security deposit may place the landlord in a better position in the event of the bankruptcy of the tenant. The amount of the security deposit is negotiated but is often based on monthly rent or a multiple thereof.

In addition, for long-term leases, tenants will often negotiate a "burn-down" where the amount of the security can be reduced over time with good behaviour.

6.17 Right to Occupy After Termination or Expiry of a Lease

New Jersey has a holdover statute which may impose on the tenant the obligation to pay up to 200% of the current rental rate or the actual fair market value of the premises (whichever is greater) in the event of a holdover, but a common provision is for 150% of the current rent. When a tenant remains in possession of the premises after the lease is terminated, the lease may continue as a month-to-month lease and the tenant will be required to continue to comply with the terms of the lease. At that point, the tenant can be evicted by the landlord upon 30 days' notice.

6.18 Right to Assign a Leasehold Interest

Assignment and subletting are extremely sensitive issues that are commonly negotiated in the written lease. Where a lease is silent, the tenant does have a right to assign its leasehold interest in the lease and/or sublet all or a portion of the premises; however, landlords and tenants usually draft language into the lease to ensure there is no misunderstanding as to the terms and potential limitations.

Where a landlord will permit a tenant to assign its lease or sublet a portion of the premises, the landlord often still imposes a requirement to seek prior written consent or, for an affiliate, advance written notice. In addition, any number of the following conditions could be considered in New Jersey when negotiating an assignment and sublease clause:

- both the original tenant and the guarantors must remain liable on the lease;
- the proposed assignee or sublessee is affiliated with the tenant or under common control;
- a net worth covenant must be met by the assignee or sublessee and must demonstrate strength equal to or greater than the tenant;
- the landlord's right of recapture;
- the use of the premises shall not change; and/or
- a percentage profit share in the event that the tenant assigns or subleases the premises and receives rental income that exceeds the rent due under the primary lease.

6.19 Right to Terminate a Lease

In this jurisdiction, both landlord and tenant typically have a right to terminate in the event of a condemnation by a governmental authority and/or a casualty event that either exceeds a dollar amount or requires a stated period for remediation. In addition, landlords reserve the right to terminate a tenant's lease if that tenant defaults on its lease obligations and fails to cure following notice from the landlord. In a retail lease, tenants often seek the right to terminate the lease if they fail to hit certain revenue milestones; all such rights are often referred to as a "kick out".

Recently, early termination clauses have become more prevalent whereby tenants can terminate a lease prior to expiration by giving notice to the landlord together with payment of a termination fee of a fixed amount plus reimbursement of a portion of the landlord's unamortised leasing costs such as its build-out expenses and brokerage commissions paid.

6.20 Registration Requirements

Leases in New Jersey are not required to be registered. A memorandum of lease may be recorded in the land records of the county in which the leased premises are located upon payment of nominal filing fees and costs.

The Flood Hazard Disclosure Law, which applies to leases in New Jersey after 20 March 2024, requires landlords to make detailed flood risk disclosures when renting property to tenants. This new legislation aims to protect prospective tenants in New Jersey from unforeseen damages and financial losses in the face of issues associated with climate change. Accordingly, landlords will be required to provide tenants with a Flood Risk Notice which contains questions about the flood risk of the property based on the landlord's actual knowledge. The notice also contains added information about flood insurance available through FEMA's National Flood Insurance Program and provides information about the effects of climate change on flood risks in New Jersey. Although the new law does not expressly distinguish between residential and commercial leases, it does specify that for residential leases, the notice must be provided as a separate rider to the lease, signed or acknowledged by the tenant.

6.21 Forced Eviction

In New Jersey, a landlord may terminate a lease and force the tenant to vacate its premises in the event of a default under the lease, such as failure to pay rent. Self-help is generally not permitted; the eviction process is pursued in court. The timing of the process varies but in a non-payment or rent case the process, from notice to judgment, should be expected to take no less than three months. Given the eviction moratorium that was in place from 2020 through early 2022, the eviction process may take considerably longer, until the court backlog has been cleared.

After judgment of eviction is obtained, a sheriff is required to enforce the judgment and evict the tenant. The sheriff's eviction may be complicated by the tenant's inventory or machinery located at the premises. In such cases, the landlord may need to arrange for a contractor to remove the tenant's property under guidance of the sheriff.

The timing of this process varies but, from notice to judgment, the process should be expected to take no less than three months. Even if obtaining a judgment of possession is not problematic, it could be a hurdle to having a sheriff remove the tenant, especially if the tenant has an inventory or machinery.

It should be noted that, while commercial eviction and commercial foreclosure proceedings are not, at time of writing, formally stayed under any state governmental orders or court orders, the time to evict a commercial tenant or foreclose a commercial mortgage, etc, has been greatly lengthened due to court closures and the volume of such actions that are being filed as a result of the pandemic.

6.22 Termination by a Third Party

A lease may be terminated by condemnation; a process which is described in **6.19 Right to Terminate Lease**. In the event of a condemnation, the award is given to the property owner, though tenants are often permitted to make separate claims for moving expenses. In addition, a mortgage lender may have rights to foreclose and terminate tenancies.

6.23 Remedies/Damages for Breach

In the commercial context, a landlord's damages are typically identified by category in the lease documents. Generally, a landlord is entitled to back rent, to evict a tenant that has breached the terms of the lease and to enforce any guaranties that were provided in connection with the lease. A commercial landlord is required to attempt to mitigate its damages. In the residential context, a scheme of state laws and regulations governs this area of law, and these should be specifically reviewed for a detailed understanding. Generally, a residential landlord may seek eviction and money damages for back rent, a specific attorneys' fee, damages to the dwelling unit, and future rent until the time the apartment is re-leased. In New Jersey, eviction of a tenant and the money damages actions are separate judicial proceedings. Both residential and commercial landlords have rights as to tenant property left in the leased premises but the rights differ under statute with commercial landlords not bound by the Abandoned Property Act.

Landlords in New Jersey typically hold a security deposit. The form of security differs and may consists of cash, letters of credit, pledges of security interests and similar documentation. Residential landlords have specific statutory obligations as to, among other things, where and how tenant security deposits must be maintained and when the security deposits must be returned to departing tenants.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Common pricing models for construction projects include:

- fixed price (also referred to at times as lump sum or stipulated price); and
- cost plus, either:
  - (a) subject to a guaranteed maximum price; or
  - (b) not subject to a guaranteed maximum price.

Construction engagements are not limited to these approaches, and other project delivery models – such as (i) design-build agreements, (ii) construction management agency/multiple-prime, (iii) engineer, procurement, and construction (EPC) agreements, or (iv) integrated project delivery agreements – are also types of construction agreements that may be used depending on the nature, type and location of the project.

7.2 Assigning Responsibility for the Design and Construction of a Project

The responsibility for design is generally assigned to licensed professional architects or and/or engineers. These disciplines may either be separately engaged or engaged under the responsibility of the designated architect, developer, design-builder, or EPC contractor. Regardless of the approach, there are also commonly other professional disciplines that will be engaged separately, such as those providing geotechnical or environmental site services to assist in the design and engineering considerations for the intended project, among other things.

For construction, management of the project is often assigned to a construction manager who is either "at risk", holding all the contracts for subcontractors, or "not at risk", meaning the owner holds all the trade contracts for the work, with the construction manager administering those contracts as the owner's agent. The responsibilities may also be expanded in the context of a design-build contract or EPC approach; further responsibilities of the construction manager often include certain delegated design-assist and/or limited design-build scope responsibilities, notwithstanding the separate engagement of the architect or other professional disciplines.

Owners that elect to use a general contractor may also elect to engage a project manager or other owner's representative to assist the owner with project oversight and management.

7.3 Management of Construction Risk

Construction risk in this jurisdiction is often managed by, among other things, indemnification, warranties, limitations of liability, delay damage limitations and other waivers of damages, provisions relating to insurance, bonding and subcontractor default insurance, subcontract pass-through provisions, contingency (in the case of a guaranteed maximum price contract) and other economic provisions and controls (such as shared savings or other incentives), as well as liquidated damages. New Jersey law prohibits an owner or other party from requiring contractual indemnity for damages arising out of bodily injury to persons or damage to property caused by, or resulting from, the sole negligence of the owner or such other proposed indemnitees.

Parties should, therefore, be mindful to tailor indemnity clauses appropriately so as not to risk having the provision deemed unenforceable. Owners should be mindful to properly review and tailor insurance programmes to minimise potential uninsured exposures and require, by contract, that the contractor's commercial general liability and excess/umbrella coverage be endorsed to include the owner as an additional insured, assuming the intended primary coverage is provided by the contractor and not an owner's project policy.

There are continued concerns about supply chain disruptions and pricing volatility and, as a result, contractors and suppliers are qualifying pricing and scheduling commitments more so than historically had been the case. Owners should be mindful of such qualifications and consider appropriate contract contingencies.

Relatedly, consideration should be given to practical remedies versus contractual remedies since it is not uncommon to have a contractual recourse or remedy that does not, in practical terms, actually resolve the issue at hand (namely allowing for the construction of the project to maintain pace and/or recover from such events).

Depending Builders' Risk Coverage

Depending builders' risk coverage, which may be provided by either the owner or contractor, will insure property loss to the work in progress and is typically provided with the insurer's waiver of claims for subrogation for such insured losses. In such cases, the parties should consider allocation of deductible responsibilities; in particular for insured losses caused in whole or in part by the contractor or subcontractors, such as water damage where deductible exposures tend to be higher.

Subcontractor Default Insurance

Owners should also consider the limitations of subcontractor default insurance, which is used with greater frequency over the last several years. These policies do not insure the interests of the owner and often include large deductibles and/or self-insured retention. Policy premiums are often paid up front based upon estimated enrolled volume with an accounting true-up at completion. However, the policies typically will not survive a contract termination (other than for contractor insolvency). It is, therefore, important to assess the coverage afforded under a subcontractor default insurance programme and to consider how covered claims are treated under the construction contract.

7.4 Management of Schedule-Related Risk

Contract provisions typically require contractors and subcontractors to adhere to established milestones, with corresponding schedules prepared by the contractor or construction manager. In particular, the contractor's work should be subject to a "time is of the essence" clause, and construction schedules should identify key interim and completion milestones, as well as critical path activities. It is not uncommon for contracts to include liquidated damages for contractor delay and, often, depending on the nature of the project and timing considerations, they may also include early completion bonuses.

Any such bonuses tend to be based on economic terms and, while not uncommon, they are not an industry standard or norm. Delay events should be subject to prompt and timely notice with an obligation to substantiate impact to the critical path of the work. Owners should consider the extent of weather events that may be assumed within the contractor's construction schedule, and clearly define force majeure events.

Also to be considered are economic impacts from delays including potential pricing escalation as a result of such delays. New Jersey law will recognise "no damage for delay" contract limitations (ie, an extension of time being to the exclusive remedy for excused delay) provided that statutes may prohibit such limitations in public works contracts to the extent the delay is caused by a contracting entity's bad faith, active interference, or tortious conduct.

Furthermore, New Jersey courts have permitted recovery for delay damages, notwithstanding any such contractual limitation, when:

- the delay was of a type not contemplated by the parties;
- the delay amounts to abandonment of the project or contract; or
- the delay was caused by active interference or bad faith of the party seeking enforcement.

It is, therefore, essential that any such provisions are carefully drafted to reflect the intent of the parties. Relatedly, unpredictability may increase with respect to the treatment of delay claims and such provisions in the continued wake of the COVID-19 pandemic and surrounding its rip-

ple effects, now more generally referred to "supply chain disruptions", including for example the recent 27 March 2004 Key Bridge collapse in Baltimore, Maryland, which has resulted in a temporary port shutdown. The risk allocation, for both schedule and economic impacts, has gained more focus over the last several years, with concerns related to supply chain disruptions and market volatilities continuing to be a point of emphasis. Parties should consider giving careful attention to bid clarifications and contract terms with respect to potential pricing holds and market fluctuation as a result of delays and independent of delays. Owners can receive compensation for delays, including liquidated damages, if provided for in the contract but these recoveries will not resolve the issue of the project delays. Owners should consider additional monitoring and options, such as providing for clearly developed procurement schedules, early procurement and storage arrangements, and predetermining the availability of alternative supply sources and suitable substitute materials.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

A common form of additional security to guarantee a contractor's performance is a performance bond, which is required for most public projects. In private projects, there may also be completion guarantees provided from parent or related companies, depending on the nature of the transaction and the parties involved.

Subcontractor default insurance programmes are also being implemented to mitigate project performance exposures for contractors. These programmes insure the contractor for losses associated with defaulting subcontractors. Owners should be mindful that such insurance programmes do not include an owner's ability to pursue insured claims and that contractual provisions are needed between an owner and contractor/policy holder to make certain that the intended benefits of such insurance programmes are being realised.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and designers may file liens to encumber property in the event of non-payment pursuant to New Jersey Lien Law. Under New Jersey law, statutory liens for the prime contractor and subcontractors generally must be filed within 90 days of last providing labour or materials (120 days for residential projects) and the action to enforce the lien claim instituted within one year of the last provision of labour or materials to the project. The owner can remove a lien by posting a bond equal to 110% of the lien or by payment of money into court.

A mortgage lien filed prior to a statutory lien being recorded, or a lien claimant's properly filed and served Notice of Unpaid Balance, will generally have priority over such liens, but statutory limitations apply and should be considered. In New Jersey, it is important to note that the New Jersey Prompt Payment Act provides that the contractor's billing shall be deemed approved and certified 20 days after the owner receives it unless the owner provides, before the end of the 20-day period, a written statement of the amount withheld and the reason for withholding payment.

7.7 Requirements Before Use or Inhabitation

Generally, a certificate of occupancy must be obtained before a building may be occupied following new construction. There are certain exceptions and rules that will otherwise govern renovations and improvements, not all of which require a certificate of occupancy.

8. Tax

8.1 VAT and Sales Tax

New Jersey imposes a tax on real property transfers (RTF). The Division of Taxation has released tables showing the combined RTF on real property transfers, plus the fee on new construction. For consideration not more than USD1 million, the RTF is USD6.05 for each USD500 of consideration.

New Jersey also imposes a 1% CITT applicable to transfers of controlling interests of corporations, partnerships, associations, trusts, or other organisations that own real property in New Jersey. The tax is 1% of the consideration paid for the transfer of the controlling interest in an entity that possesses a controlling interest in commercial properties, if the equalised assessed value of the real property exceeds USD1 million. If the entity possesses commercial and other property, the tax is 1% of that percentage of the equalised assessed value of the commercial property that is equal to the percentage of the ownership interest transferred.

The transfer tax is paid by the seller.

Federal and New Jersey corporate tax will be due on the gain from the sale of real property. The New Jersey corporate tax rates range from 6.5% for corporations with entire net income of USD50,000 or less; 7.5% for corporations with entire net income of USD50,001 to USD100,000, and 9% for corporations with entire net income more than USD100,000.

Effective 1 January 2021, a transfer of real property that is an intercompany transfer between combined group members as part of the unitary business is exempt from the transfer tax (New Jersey Statutes Section 46:15-10 (r)).

8.2 Mitigation of Tax Liability

A deed or controlling interest transfer is only subject to tax if consideration exceeds USD100. The New Jersey Tax Court held that where there is no debt on the property and consideration stated is less than USD100, no tax is due.

8.3 Municipal Taxes

The RTF includes a local component.

8.4 Income Tax Withholding for Foreign Investors

See **2.2 Important Jurisdictional Requirements** regarding bulk sales law.

8.5 Tax Benefits

Taxpayers may increase their basis in real estate sold to the extent a New Jersey tax benefit was not received due to limits on depreciation and net operating loss deductions in place for tax years 2002–05. For tax years beginning after 31 December 2013, income is apportioned to New Jersey based upon receipts allocated to New Jersey. Having eliminated a property factor from the apportionment formula, owning real property in New Jersey will not increase the apportionment to the state.

USA - NEW YORK



Law and Practice

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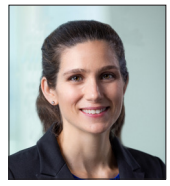
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Phillips Lytle LLP is a preeminent law firm with a highly recognised real estate practice consisting of 50 attorneys with a broad range of expertise. With offices across New York State, as well as offices in Chicago, IL; Washington, DC; and Ontario, Canada, Phillips Lytle has handled many high-profile real estate development projects. The firm has nationally recognised experience across numerous areas, including those involving institutional lenders, corporations, REITs, private developers, public utilities, municipalities, individuals, and others in connection with large and small commercial, industrial, office, professional, retail and residential projects. The practice includes national, high-volume, high-technology representation in the telecommunications, lending and foreclosure areas, as well as nationwide multilocation retail leasing and portfolio sales. Areas of expertise include commercial leasing, construction compliance (including MWBE requirements) and litigation, land use, permitting and zoning, project development, real estate finance, real estate litigation and workouts, tax, and title insurance.

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1. General

1.1 Main Sources of Law

Real estate law encompasses a broad range of skills and practice areas. To adequately represent a client, a real estate attorney must understand the nature of the client's business and the client's willingness to take risks.

A real estate practitioner must understand the myriad of potential issues that may arise for a given real estate project (typically within tax, finance, corporate, securities, environmental, energy and land use, bankruptcy, government relations, insurance, and construction, among others) and have access to the breadth and expertise necessary to effectively represent clients on all relevant issues. To that end, most matters require a team approach, with lawyers who have differing expertise. In addition, practitioners must be resourceful and have the ability to communicate and negotiate effectively. Current trends typically do not impact the skills required to practice real estate law; however, one must remain aware of them to effectively assist clients in moving their real estate projects forward.

1.2 Main Market Trends and Deals

The dominant trend in real estate in 2024 remains rising interest rates and economic uncertainty, especially in an election year. The pipeline of new development projects has slowed significantly as higher rates and somewhat flat demand make it harder for projects to "pencil out." If rates continue to rise, or remain stagnant, there could be significant impacts on over-leveraged commercial owners. Industrial properties continue to grow at a steady rate as the amount of e-commerce grows and federal stimulus targets expansion of US-based manufacturing capabilities. Brick-and-mortar retail is slowly making its comeback post-pandemic. Consumers have adjusted to and embraced online shopping, but a stronger desire from people to make physical connections with brands and products is leading to improvements in in-store experiences for consumers. Developers continue to try to get creative to breathe new life into traditional shopping malls by converting them into mixed-use lifestyle centres with a focus on residential, restaurants, and other experiential features. Similarly, the outlook for dated commercial office space is trending towards residential conversion. Restaurants and hospitality continue to rebound as more and more people are getting back to normal and travel increases. Looking ahead, the big question is how the real estate-related trends that the pandemic accelerated will evolve over time. The "work-from home" model appears to be holding strong, and the impact on the commercial office space and dependent retail/restaurant sectors remains unclear. Employers are either getting creative in order to entice workers back to the office, or simply mandating new rules about required office presence.

1.3 Proposals for Reform

New York State Governor Kathy Hochul recently signed new legislation aimed at ending New York State's dependence on fossil fuels. The state's pending ban on natural gas is one of many steps to achieve the proposed goal of creating zero-emission buildings and reducing greenhouse gas emissions by 40% by 2030 and 85% by 2050 from 1990 levels. The natural gas ban will be effectuated through amendments to the State Energy Conservation Construction Code and the State Uniform Fire Prevention and Building Codes ("Codes"). Specifically, the natural gas ban legislation amends the Codes to prohibit the installation of fossil-fuel equipment and building systems, including plumbing, heating, electrical,

lighting, insulation, ventilation, air conditioning and refrigeration that uses fossil fuels, in:

- new one-family residential buildings of any height beginning 31 December 2025;
- new multi-family residential buildings not more than three stories in height beginning 31 December 2025;
- new multi-family residential buildings more than three stories in height beginning 31 December 2028; and
- new commercial buildings beginning 31 December 2028.

Residential construction will seemingly be most affected by the ban, but how much homeowners and commercial building owners will pay for electrified alternatives will depend in part on the availability of alternative technologies – such as heat pumps to replace fossil-fuelled heating and cooling – and whether the state can remove the existing cost and permitting barriers to promote development of alternative energy sources. Hesitation on future new commercial development projects has already begun, with developers wary of unanticipated utility costs associated with an outdated electrical grid that will need improving to handle the new requirements.

2. Sale and Purchase

2.1 Categories of Property Rights

The most prevalent forms of ownership are individual and joint ownership through legal entities, such as limited liability companies, limited partnerships, corporations, or trusts. Currently, these legal entities remain the primary owners of commercial real estate, especially limited liability companies due to their flexibility with tax treatment and structuring the company. Typically, investors in commercial real estate take title through an entity, or series of entities, owned and controlled by the individual owners.

Residential real estate owned by more than one person may take title as tenants-in-common, joint tenancy with the right of survivorship, or tenancy by the entirety for married couples.

2.2 Laws Applicable to Transfer of Title

Generally, parties are able to buy and sell real estate without complying with any jurisdictional requirements. Only certain types of parties or real property are subjected to state or local regulation; eg, certain charitable corporations must obtain the permission of the Supreme Court of the State of New York or the New York State Attorney General before transferring real property.

Similarly, a party seeking to purchase a residential home that is in default on a mortgage loan must comply with the New York State Home Equity Theft Prevention Act. Properties that are suffering from environmental contamination may require the selling party to notify the New York State Department of Environmental Conservation or subsequent parties in title of the existence of the contamination or any restrictions placed upon the real property.

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title is effectuated by the delivery and acceptance of a deed, in recordable form, to the subject real property. To be in recordable form, a deed must be signed, be acknowledged by a notary, and contain an adequate description of the property. While delivery and acceptance of a deed is sufficient to transfer title to real property, the deed must be recorded in the county clerk's office and the applicable taxes and fees paid to perfect the transfer.

This final step is important because New York State is a "race-notice" jurisdiction. This means a party can simultaneously issue two deeds to two separate parties for the same real property. The party that wins the "race" to the applicable county clerk's office and has their deed recorded first will be the owner of the real property, provided that such party had no knowledge of the other deed.

2.4 Real Estate Due Diligence

Depending on the complexity of the acquisition, purchasers of real estate typically engage third parties such as attorneys, institutional lenders, real estate brokers, appraisers, engineers, surveyors, architects, general contractors, title insurance/search companies, accountants, insurance agents, environmental consultants, zoning research companies, representatives from local municipalities, and other third parties. Sophisticated purchasers often communicate directly with the above-referenced third parties. Contracts for the purchase and sale of real property typically provide the purchaser a specific time period in which to conduct all real estate due diligence.

Purchasers engage attorneys to coordinate with and review the work of the above-referenced third parties. Attorneys are also responsible for examining abstracts of title, instrument surveys, and other title documents to ensure the purchaser is receiving good and marketable title to the property.

Although purchasers are responsible for conducting due diligence and choosing to proceed with the real estate transaction, sophisticated purchasers are increasingly relying on the opinions and expertise of third parties to determine whether various aspects of the real estate are satisfactory for its end use.

2.5 Typical Representations and Warranties

While representations and warranties in a purchase and sale contract can vary greatly, in commercial transactions, the following representations and warranties are common:

- authority and capacity to execute the agreement and perform the obligations under the agreement;
- no pending or threatened lawsuits against the parties or the subject real property;
- no pending or threatened eminent domain or condemnation proceedings against the real property;
- no pending or threatened changes in the assessed valuation or tax rate applicable to the real property;
- no pending or threatened changes in the zoning classification of the real property;
- no known environmental defects with the real property or any actions being taken by any agency with respect to the environmental condition of the real property; and
- the existence and good standing of all permits and certificates necessary for legal use or occupancy of the real property.

In commercial transactions, there are generally no representations or warranties provided for under state or local law. This is not true of residential transactions. For instance, with respect to newly built homes, each sale is subject to certain warranties regarding the quality of construction under the Housing Merchant Implied Warranty.

For pre-built homes, sellers are required to make certain disclosures with respect to the condition of the real property in a Property Condition Disclosure Statement. These forms require the owner to represent certain facts, including gen-

eral historical, environmental, mechanical, and structural information with respect to the property.

There are generally no common representations and warranties driven by the COVID-19 pandemic. One exception is a representation regarding a seller having a loan or other benefits through the federal Paycheck Protection Program (or related program) and whether such loan is still outstanding or has been properly forgiven and/or discharged. However, as time has passed since the COVID-19 pandemic, this type of representation is only of limited relevance.

Remedies and Protections

The remedies against a seller that breaches a representation are typically defined in the contract, including termination of the purchase agreement, specific performance, and monetary damages for out-of-pocket costs incurred by the purchaser owed to attorneys and third parties engaged to assist with purchaser's due diligence. Sellers typically seek to limit their post-closing liability for representations and warranties by negotiating into the contract a "sunset provision" on their survival. The typical "sunset provision" ranges from six months to one year. However, depending on the transaction and relationship of the parties, the "sunset provision" may run significantly longer. In addition, it is not uncommon in a commercial transaction for a seller to limit its liability for a breach of the representations and warranties. Typically, post-closing liability is capped at 1% to 5% of the purchase price. Such limitations on the length and extent of liability allow a seller to distribute closing proceeds and dissolve entities with knowledge of the maximum potential post-closing liability.

The statutory protections that exist in residential transactions also include remedy provisions, such as payment for actual damages if covered by warranty or if the misrepresentations prevented the purchaser from learning the truth before purchasing the real property.

It is not customary to utilise representation and warranty insurance in New York.

2.6 Important Areas of Law for Investors

There are several areas of law that are important for an investor to consider when purchasing real property in New York. Federal and state tax law is important for an investor to consider to determine the tax consequences of any transaction. In addition, it is important for an investor to have an understanding of New York Business Corporation Law, Partnership Law and/or Limited Liability Company Law so that the investor can properly determine which type of entity should be used to acquire title to real property. Finally, to confirm that the property is acceptable for the use contemplated by the investor, it is important for the investor to have an understanding of federal and state environmental law as well as local zoning and land use rules and regulations. If the real property is residential rental property, it is also important for an investor to have an understanding of New York landlord-tenant laws.

2.7 Soil Pollution or Environmental Contamination

As an owner or operator of a real estate asset, the buyer could be held strictly, jointly, and severally liable for preexisting soil pollution or environmental contamination pursuant to state and federal laws. Therefore, typical allocations of environmental risk in purchase and sale agreements are tailored to the intent of the parties, the site conditions, and the actual or potential presence of contaminants of concern.

Under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), current owners and operators of a property are, except in limited circumstances, strictly liable for all response and remediation costs regarding hazardous wastes and substances that were released on a property, unless a statutory defence is established. These include acts of God or war, acts of third parties, and landowner liability protections, such as the innocent landowner defence, bona fide prospective purchaser defence, and contiguous property owner defence.

If the buyer spends money to clean up the contamination caused by others, there are contribution claims available under state and federal laws.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can ascertain the permitted uses of a parcel of real estate by undertaking an analysis of the applicable zoning map and code to identify the zoning district of the parcel in question and the uses permitted by right in that district, as well as the uses permitted upon issuance of a special use permit. In addition, a buyer should review the applicable zoning code to determine the associated bulk requirements. Further background is often available in a municipality's land use/comprehensive plan. See **4.6 Agreements With Local or Governmental Authorities**.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental taking through eminent domain or condemnation is a possible risk in this jurisdiction. While there is only a slight risk that a governmental taking will occur, it appears more prevalent along rights of way to accommodate roadway-widening projects or the installation of public utilities.

The governmental taking process in New York State is codified in the New York Eminent Domain Procedure Law, and allows for condemnation by the filing of an appropriate map with the applicable county clerk (at which time the property set forth in the map vests in the governmental agency), or filing of petition to condemn, which seeks an order allowing the filing of an acquisition map. The title vests in the condemning party upon the filing of the acquisition map.

The condemning party is required to pay just compensation (defined as the fair market value of the property) to the former owner of the property that was acquired through condemnation.

2.10 Taxes Applicable to a Transaction

For the transfer of real estate, a transfer tax is due to the New York State Department of Taxation and Finance, and is paid to the applicable county clerk upon recordation of a deed. In order to record a deed, a transfer tax return (form TP-584) must be presented to the county clerk. The state transfer tax is USD2 for every USD500 of consideration paid or the fair market value of the real property. Local municipalities may also impose a separate transfer tax, which varies by county.

Transfer tax and the cost of filing a form TP-584 are customarily seller expenses, although this can be negotiated. Additionally, the "Mansion Tax" – imposed on the conveyance of residential real property where the consideration is USD1 million or more – has a tax rate of one percent of the consideration paid, customarily paid by the purchaser. Transfers of real property in New York City may be subject to additional taxes.

New York Tax Law was recently amended to provide that when the purchaser fails to pay the tax, the seller is required to pay. When the seller is required to pay the additional tax because the purchaser failed to pay, the additional tax becomes the joint and several liability of the seller and the purchaser.

A transaction of shares in a property-owning company also triggers a transfer tax obligation if the grantee, or a group of grantees acting in concert, acquires a controlling interest (50% or greater) from one or more grantors. Section 1402 of the New York Tax Law regulations provides a safe harbour for acquisitions of a controlling interest completed outside of a three-year period. The transfer tax is calculated by utilising the consideration paid for the shares or the grantor's pro rata share of the fair market value of the real property owned by the property-owning company.

Standard Exemptions

There are certain standard exemptions, including conveyances:

- to the federal or state government, or their agencies or political subdivisions;
- to secure a debt or other obligation;
- to confirm, correct, modify, or supplement a prior conveyance;
- made as gifts;
- that are only intended as a change of identity;
- given in connection with a tax sale;
- by deed of partition;
- made pursuant to the federal Bankruptcy Act;
- that only consist of certain contracts to sell, or options to purchase, real property; or
- not deemed a conveyance within the meaning of New York Tax Law.

2.11 Legal Restrictions on Foreign Investors

Regulations issued since passage of the Foreign Investment Risk Review Modernization Act of 2018 expose even noncontrolling foreign investments to potential CFIUS review if the investment conveys certain minimal rights in property within one of the listed proximities to specified national security installations or infrastructure. In view of the substantial penalties should CFIUS later determine a filing should have been made, as well as CFIUS' authority to block an investment or even order divestiture, filing for such review by simple declaration or more detailed notice, if applicable, would seem advisable.

Investors from "excepted investor states" (currently Australia, Canada, New Zealand, and the United Kingdom) are exempt from filing for noncontrolling investments provided the investor meets the detailed criteria of relationship to the "excepted" state outlined in the regulations. Even for these states, however, the usual rules apply for acquisition of controlling interests.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Commercial real estate acquisitions are typically financed through commercial real estate loans from institutional lenders, customarily secured by a mortgage. In addition, commercial mortgage loans are usually further supported by guarantees of payment from the borrower's individual principals. For new construction, borrowers can apply for a construction loan mortgage.

In addition to mortgage loans, purchasers of commercial real estate may obtain mezzanine financing to finance amounts beyond what is

loaned by the institutional mortgage lender. Mezzanine loans are secured by a pledge of the borrower's equity interest in the entity which owns the property. Developers also raise funds to purchase real estate by selling equity in exchange for cash contributions.

3.2 Typical Security Created by Commercial Investors

Typically, the security interest created in connection with a mortgage loan is a first-in-priority mortgage lien on the real property. If permitted by the lender, one could borrow additional money from the same or a different lender secured by a mortgage, which would be subordinate to the first mortgage. The security interest is created upon recordation.

The mortgage lender may also choose to file a Uniform Commercial Code (UCC) Financing Statement to create a security interest in any fixtures located at the property or to perfect a security interest in other non-real estate assets of the borrower.

With respect to mezzanine financing, the mezzanine lender may perfect its security interest by filing a UCC Financing Statement in the state of formation of the borrower entity. In addition, the mezzanine lender may require the borrower to opt in to Article 8 of the New York UCC, which changes the characterisation of the pledged equity interest to a "security" under Article 8, as opposed to a "general intangible" under Article 9. In order to perfect its security interest in this manner, the mezzanine lender would require the borrower to deliver original certificates of equity interest.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

The Bank Secrecy Act governs the obligation of financial institutions, including lenders, to engage in strict compliance and reporting measures with regard to the prevention of possible money laundering, terrorism finance, or sanctions violations in international funds transfers or guarantees. Institutions must conduct extensive diligence of the parties to such transfers, routinely report all details, and file immediate reports of suspicious activity.

It is worth noting that CFIUS continues to expand and modify its list of installations and infrastructure subject to the special requirements discussed above; moreover, several pending Congressional measures would, if enacted, expand the types of property acquisitions (especially in the agribusiness area) subject to investment review, and even prohibit certain parties from such investments. In addition, in the last year a number of state legislatures have adopted laws restricting such investments by purchasers from certain "adversary" nations and mandating review. Extensive diligence into the then-current state of both federal and state restrictions is recommended for prudent counsel when advising prospective foreign investors in such transactions.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Mortgage recording taxes vary based on the county where the property is located, but generally range between 0.75% and 1.25% of the loan amount. The county clerk will also charge a fee to record the mortgage and accompanying loan documents or the filing of UCC Financing Statements, the costs of which vary widely based on the type of mortgage or other document being recorded, and the length of the document.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Generally, an entity can give a valid security interest over real estate assets provided it owns the real estate and has complied with its charter documents and applicable law. In addition, certain charitable entities may also be required to obtain the permission of the Supreme Court of the State of New York or the New York State Attorney General before granting a security interest in real estate assets.

3.6 Formalities When a Borrower Is in Default

In New York, a mortgage is used to create a security interest in real property. A mortgage is perfected upon its recording in the local county clerk's office.

Prior to enforcement, it is a customary requirement in a commercial mortgage for a lender to be required to send a notice of default and provide the borrower with an opportunity to cure the default. If the mortgage is considered a "home loan" under New York law, then an additional 90-day statutory notice is required to be sent before a foreclosure of a mortgage can commence.

The length of a mortgage foreclosure action may vary greatly depending on the jurisdiction within the State of New York, the type of mortgage involved and the litigiousness of the parties.

Once commenced, a commercial mortgage foreclosure action may take as little as one year to complete. Conversely, in the City of New York, it is estimated that a standard foreclosure of a home loan will take approximately six years.

Generally, the administrative laws and orders that restricted mortgage foreclosure actions during the COVID-19 pandemic have been lifted or removed. As a result, lenders are now routinely exercising their foreclosure rights. However, an administrative order was issued in 2022 that requires mandatory settlement conferences in commercial division cases. Previously, New York law only required settlement conferences in the foreclosure of home loans.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt in any circumstances, but ideally you want to take several steps in your documentation to avoid pitfalls.

3.8 Lenders' Liability Under Environmental Laws

Lenders are generally exempt from liability under federal and State environmental laws as long as the lender does not take title to, or "participate in the management" of, a contaminated property. Requiring a borrower to take action to address contamination, or renegotiating the terms of the secured interest, does not generally equate to "participating in the management" and will not subject a lender to liability. However, decision-making control over day-to-day activities or the environmental compliance of the site (ie, hazardous waste management), controlling expenditures, or taking title to the property may make a lender liable.

3.9 Effects of a Borrower Becoming Insolvent

When a security interest is created and a foreclosure action is commenced prior to the filing of a bankruptcy by the borrower, the mortgage lien is generally secure and will typically survive the bankruptcy unless discharged by payment during bankruptcy. However, attempts to enforce the mortgage or pursue the foreclosure action

are generally stayed unless and until the automatic bankruptcy stay is lifted.

Once a foreclosure sale occurs, the debtor's rights of redemption will expire. If a borrower files bankruptcy after a foreclosure sale, the real property is generally considered to be outside the borrower's bankruptcy estate and the title may be transferred to a winning bidder, notwithstanding the pendency of the bankruptcy and corresponding automatic stay.

3.10 Taxes on Loans

On 22 January 2021, New York State Assembly members reintroduced legislation which would require the recording of, and payment of recording tax on, mezzanine debt and preferred equity investments related to the real property, whenever a mortgage is recorded with respect to the property. This legislation, however, was not enacted.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Governmental authority over planning and zoning is derived from the state's police power to promote the health, safety, and welfare of its citizens. This authority has been delegated to local municipalities through the General City Law, Town Law, and Village Law, which authorise municipalities to exercise control over local zoning pursuant to the police power. The Municipal Home Rule Law and the Statute of Local Governments provide additional independent authority for municipalities to adopt local zoning laws that are not inconsistent with state law. Local zoning laws must also be in accordance with a municipality's comprehensive plan. While there may be regional approaches to particular land use issues, typically, each municipality has its own zoning laws and there is little consistency between differing municipalities.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

A municipality's zoning code sets forth development criteria and regulations with respect to appearance and construction of structures. In addition, there may be supplemental/overlay design guidelines dependent on the parcel's location within a specific neighbourhood or historic district. Compliance with design, appearance, and method of construction is normally handled through the site plan review process with the municipal planning board. This process should be consistent with the applicable zoning enabling law (General City Law, Town Law, and Village Law).

4.3 Regulatory Authorities

The local municipal government is typically responsible for regulating development of individual parcels within the municipality, with input from municipal planning boards. The municipal zoning code provides a framework for decision-making in connection with the development of property, which is based upon the community's preferences. In addition, the municipality's land use plan bridges the municipality's comprehensive plan and zoning code by recommending the appropriate type, intensity, and character of development.

4.4 Obtaining Entitlements to Develop a New Project

New projects or major refurbishments typically require approvals from local municipal boards after a formal filing is made, and a public hearing is held. Compliance with the State Environ-

mental Quality Review Act is often included in this process. Third parties or members of the public may appear at public hearings regarding the proposal, and the municipality may consider the opinions of the public in connection with its determination.

Requests for variances require application to the municipal zoning board of appeals. Rezonings generally require an application to a municipal board for a zoning amendment, which is often referred to the municipal planning board for its review and recommendation.

4.5 Right of Appeal Against an Authority's Decision

Often, a municipality will have a specific section in its municipal code for appealing a relevant authority's decision. An appeal will begin with an adverse determination by a code enforcement officer and is normally heard by the zoning board of appeals. Once all municipal avenues have been exhausted, an aggrieved party is provided the right to appeal further in the State Supreme Court.

4.6 Agreements With Local or Governmental Authorities

Agreements with local governments, authorities, or utility suppliers are not generally necessary to obtain permits or approvals for development projects; however, they can be required in some instances, commonly in cases of incentive zoning agreements and reimbursement agreements. Incentive zoning offers rights to a developer in exchange for public benefits to the community. Rezoning of property is negotiated between the developer and municipality.

Some municipal zoning codes contain provisions for Planned Unit Development that allow municipalities to provide flexibility with respect to underlying code requirements for certain innovative and unique projects. In addition, reimbursement agreements allow a municipality to hire certain professionals/consultants, and require the applicant to cover all fees associated with the same. However, such fees may only be lawfully imposed if they are reasonable, necessary, and not simply for the convenience of the local board.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and designated uses are typically enforced through certain bulk provisions in the zoning code regulating height, density, lot coverage, minimum/maximum parking requirements, setbacks, and similar considerations. Restrictions may also be enforced through conditions to zoning approvals. Proposed development is evaluated by the municipality's planning/zoning department, and existing development is monitored through the municipality's code enforcement officer/building department. Violations can be generated through citizen complaints or permitting and routine inspections, and fines can be assessed.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

There are several types of entities available to investors to acquire and hold real estate, including, but not limited to, limited liability companies, corporations, and partnerships. Limited liability companies are the most commonly used entity type to acquire real estate because they are typically characterised by flexible organisational governance, they offer limited liability protection to all members, and members can define their contractual obligation in the company's operat-

ing agreement to tailor it to reflect their business agreement and financial arrangements.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Corporation

A corporation is an association of shareholders formed under the New York Business Corporation Law that is a legal entity separate and distinct from its shareholders with the capacity for perpetual existence to:

- acquire, hold and dispose of property;
- sue or be sued; and
- have such other powers as may be conferred upon it by law.

Owners of a corporation are shareholders, who typically do not manage the day-to-day affairs of the corporation. Shareholders elect directors and approve extraordinary transactions and activities of the corporation.

The primary benefit of corporations is that the shareholders are generally not personally liable for the debts and obligations of the corporation, and liability is limited to the assets of the corporation. Directors and officers are generally not liable to shareholders or the corporation for their actions or inactions with respect to the corporation, provided that they act in a manner that is consistent with their fiduciary duties of care and loyalty. Corporations may also limit or eliminate the personal liability of directors for their acts and omissions.

However, corporations do not afford the same level of flexibility as do partnerships and LLCs.

Limited Liability Company

An LLC is an unincorporated organisation of one or more persons having limited liability for the contractual obligations and other liabilities of the business. An LLC is a hybrid business organisation that combines the flexibility of governance and economic arrangements of a partnership and a corporation. The primary benefit of an LLC is that it offers its members the limited liability protection akin to shareholders of a corporation, is taxed like a partnership (except for a single-member LLC or unless the owners elect corporate tax treatment), and is governed by contract, whereby the operating agreement is the primary document defining the rights of members, the duties of managers, and the financial arrangements among the LLC's members.

Members and managers are generally not liable for debts, obligations, or liabilities of the LLC solely by reason of being a member or manager.

Partnership

A partnership is a voluntary agreement between at least two persons who bring together their money, property, labour, or skills to conduct a business and share profits and losses. In this jurisdiction, commercial real estate is more often held in limited partnerships than general partnerships due to their liability structures. General partners are jointly liable for the debts and obligations of the partnership, while limited partners are not liable for the contractual obligations of a partnership unless they are also general partners or they participate in the control of the business.

The benefit of real estate acquisition through a limited partnership is material for the limited partner, whose liability is restricted to the amount that the partner has contributed to the partnership plus the partner's share of any undistributed income. Whether a general partnership or limited partnership, the partners do not have a separate interest in the property and are therefore obliged to treat partnership property as joint property.

This is often a deterrent to some commercial real estate owners or investors who value the freedom to deal with their undivided interest in the property as would be permitted under a co-ownership arrangement.

5.3 REITs

Real estate investment trusts (REITs) are available in the United States and New York, although typically they are formed under Maryland law. New York follows the federal income taxation of REITs, but subjects REITs to state corporate franchise tax if the REIT is subject to federal income tax. REITs can be publicly traded or privately held, and are available to foreign investors. There are plenty of advantages of using REITs. They provide investors with the opportunity to invest in a diversified estate portfolio; they may provide for more flexibility in terms of tax-efficient sales of real estate by investors looking to exit a real estate portfolio; and, depending on applicable tax rates, income generated by REITs may be subject to less aggregate federal income tax than real estate held through other types of entities. The requirements for qualifying as a REIT are numerous and complex, but the primary statutory requirements are:

- the REIT is managed by one or more trustees or directors;
- the beneficial ownership of the REIT is evidenced by transferable shares or by transferable certificates of beneficial interest;
- the REIT would be taxable as a domestic corporation but for Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code");
- the REIT is neither a financial institution nor an insurance company subject to specified provisions of the Code;
- the beneficial ownership of the REIT is held by 100 or more persons;
- at all times during the last half of each taxable year, not more than 50% in value of the outstanding shares of the REIT are owned, directly or indirectly, through the application of certain attribution rules, by five or fewer individuals;
- the corporation makes an election to be taxable as a REIT, or has made this election for a previous taxable year that has not been revoked or terminated, and satisfies all relevant filing and other administrative requirements established by the IRS that must be met to elect and maintain REIT status;
- the REIT uses a calendar year for federal income tax purposes and complies with the record-keeping requirements of the Code and Treasury regulations promulgated thereunder;
- at the end of any taxable year, the REIT has any undistributed earnings and profits that are attributable to a non-REIT taxable year; and
- the REIT meets other tests regarding the nature of its income and assets, and the amount of its distributions.

5.4 Minimum Capital Requirement

New York State does not have a minimum capital requirement to start up any type of entity.

5.5 Applicable Governance Requirements

Corporations

The day-to-day management of a corporation's activities is the responsibility of the directors of the corporation, who generally delegate such management to officers. Certain significant matters associated with the governance and operation of the corporation may require the approval of the corporation's shareholders. Corporate governance is dictated by the provisions of the certificate of incorporation, bylaws and statutory law.

Limited Liability Companies

An LLC is presumed to be managed by its members unless the articles of organization provide that the management is carried on by managers. Except as provided in the operating agreement, each member of an LLC is entitled to vote in proportion to the member's share of current profits. The articles of organization of an LLC may provide for classes or groups of members having such relative rights, powers, preferences and limitations as the operating agreement of such LLC may provide. Members in a member-managed LLC, and managers in a manager-managed LLC, who exercise management powers or responsibilities have the duty of care and loyalty.

Limited Partnerships

Limited partnerships are managed by at least one general partner. Limited partnership governance is dictated by the terms of the limited partnership agreement with the limited partnership law setting forth statutory defaults. In order to insulate the limited partners from unlimited liability, the general partner must be solely responsible for the management and operation of the partnership business. The limited partners cannot participate in the management or operation of the business.

A limited partner who does take part in the control, management or operation of the business of the limited partnership, including signing any documents on behalf of the partnership in its own capacity as a limited partner, risks being exposed to unlimited liability.

The Corporate Transparency Act was passed by Congress in 2021 and the law imposes a new beneficial ownership reporting requirement on entities – both newly-formed and ones that are currently in existence. The objective of the legislation is to make it more difficult for bad actors to shield their identity or facilitate illegal transactions through entities which may be opaque to federal governmental authorities in terms of the identity of individuals that own and operate those entities. Unless an exemption for a particular entity is available, effective 1 January 2024, each entity is required to report certain information regarding the entity and individuals that exercise "substantial control" over the particular entity through an information portal maintained by the Financial Crimes Enforcement Network (FinCEN), which is a bureau within the U.S. Treasury Department.

Newly formed entities (ie, entities formed after 1 January 2024) have a limited period of time following formation (90 days in 2024; 30 days in 2025 and thereafter) in which to file their reports if they are not otherwise exempt from the reporting requirements. Existing entities (ie, entities that were formed prior to 1 January 2024) that are not exempt from the requirements have until 31 December 2024 to file their initial beneficial ownership report with FinCEN. More information relating to the reporting requirements, the filing portal, exemptions from reporting (in all, there are 23 exemptions available) and all related information (including the underlying law and regulations) can be found on the FinCEN Beneficial Ownership Information reporting page of its website. On 1 March 2024, in the case of National Small Business United v. Yellen, No. 5:22-cv-01448, a Federal District Court in the Northern District of Alabama ruled the Corporate Transparency Act to be unconstitutional. Subsequent to the ruling, the U.S. Justice Department (on behalf of the U.S. Treasury Department) filed a Notice of Appeal as it relates to the case. FinCEN has essentially taken the position that all other reporting companies (aside from the parties involved in the case) remain obligated

to file beneficial ownership information reports with FinCEN pending the outcome of the case.

5.6 Annual Entity Maintenance and Accounting Compliance

New York corporations and limited liability companies have biennial statement fees of USD9 each. These fees are subject to change.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A lease and a license are two common legal arrangements that allow a person, company, or other organisation to occupy or use real estate that it does not own.

A lease is a contract between a landlord and a tenant whereby the tenant is given the exclusive right to occupy the landlord's property for an agreed-upon time period. A lease is an interest in real property that can be transferred to another, subject to restrictions contained in the lease agreement.

A license is an agreement granting a limited use of a property. A license is not an interest in real property. A license is typically terminable by the licensor, not transferrable, and not exclusive, and may be subject to a right of relocation.

6.2 Types of Commercial Leases

There are several types of commercial leases, as follows.

Net Leases

The tenant pays rent, as well as all or a portion of the operating expenses for the property such as taxes, insurance, maintenance, and utilities. Parties sometimes refer to net leases as single net leases, double net leases or triple net leases. The distinctions are not absolute, but in a triple net lease, the tenant pays all costs and expenses with respect to the real property.

Gross Leases

The landlord provides services and pays the operating expenses for the property, and such expenses are typically factored into the tenant's rent. In addition, the tenant typically pays escalation charges with regard to real property taxes and operating expenses. In Class A office buildings, the tenant typically pays its proportionate share of taxes and operating expenses over the negotiated base year.

In retail leases, the tenant typically pays its proportionate share of such taxes and expenses from the first dollar.

Ground Leases

The landlord leases the land to the tenant. The tenant pays ground rent, covers all costs and expenses, and is responsible for all improvements to the premises. Upon the expiration of the lease, possession of the land and ownership of any improvements revert to the landlord.

6.3 Regulation of Rents or Lease Terms

There is no commercial rent regulation in New York State. The terms of commercial leases are a matter of negotiation between the parties, subject to case law and statutes pertaining to specific issues. For example, statutes provide that a lease cannot contain a waiver of a landlord's responsibility for its negligence.

There are no-going regulations of rents for commercial leases.

Since the COVID-19 pandemic, the definition of force majeure has been scrutinised as to whether or not the provision refers to pandemics such as the COVID-19 pandemic. Landlords and tenants often have differing opinions and practices with regard to the treatment of pandemics and force majeure under a lease.

6.4 Typical Terms of a Lease

The term of a typical commercial lease is five to ten years. However, the term of a typical ground lease is 30 to 100 years.

The tenant is typically responsible for maintaining and repairing the space it occupies, whereas a landlord is typically responsible for repairing and maintaining the common areas, the structure, the exterior of the building and surrounding property.

Rent payments are typically made on a monthly basis, although in a ground lease, rent may be paid annually or quarterly.

6.5 Rent Variation

Rent typically increases either annually or once every three or five years, usually by a predetermined amount, depending on the terms of the lease.

6.6 Determination of New Rent

Increases in rent under a commercial lease are typically determined by negotiation prior to entering into a lease. Increases can be expressed in terms of a fixed dollar amount, a per-square-foot amount or a formula based on, for example, the Consumer Price Index.

6.7 Payment of VAT

Value-added tax, or other taxes or governmental levies, are typically not payable on New York rent. An exception is the New York City Commercial Rent Tax (CRT) that is imposed on the rent paid by tenants of commercial property located south of the centreline of 96th Street in Manhattan. Generally, the CRT applies to tenants whose gross annual rent is at least USD250,000.

The tax rate is 6% of the base rent. However, all taxpayers are given a 35% base rent reduction, effectively reducing the number of taxpayers that are subject to the CRT, as well as reducing the tax rate to 3.9%. In addition, a tax credit is given to those tenants whose annual base rent is between USD250,000 and USD300,000 before the 35% reduction.

6.8 Costs Payable by a Tenant at the Start of a Lease

In a net lease, the tenant is responsible for constructing or remodelling any existing improvements, and for the payment of all associated expenses. In a gross lease, landlords often deliver the space with mechanical services stubbed to the premises, or sheetrocked in “white box” condition, and give the tenant a negotiated allowance for the construction of improvements.

Alternatively, the landlord may be responsible for building out the space to meet the tenant’s needs. This is known as a “turnkey” lease. Such leases may include a cap on the landlord’s construction costs, with the tenant responsible for excess costs.

6.9 Payment of Maintenance and Repair

Landlords are typically responsible for paying for the maintenance and repair of common areas used by several tenants, such as lobbies, elevators, parking lots and gardens. However, tenants are often responsible for reimbursing the landlord for their pro rata share of operating expenses. Sometimes reimbursement commences from the first dollar and sometimes over

a base amount, depending on negotiations and the structure of the lease.

Ground leases are triple net leases whereby the tenant covers all expenses for maintenance and repair obligations.

6.10 Payment of Utilities and Telecommunications

Telecommunications and utilities are typically paid for by the tenants. Each tenant's space is either metered or submetered for electricity, or the tenant reimburses the landlord for electric costs pursuant to a formula.

The charges for heating, ventilation and air conditioning (HVAC) depend on how the property is engineered. Each tenant may have its own cooling system, or the tenants may be served by a building-wide cooling system during business hours and subject to significant charges for after-hours HVAC. Tenants may also control supplemental HVAC systems to provide overnight cooling, typically for IT and telecom installations.

Tenants should determine the availability of telecommunication services and the availability of any particular providers, including distributed antenna systems during the selection of a property to lease.

6.11 Insurance Issues

The landlord and tenant each have to insure their respective interests in the real estate, subject to the terms negotiated and included in the lease. Negotiated issues include whether rent abates because the space becomes unusable, for example, due to a pandemic or other force majeure, and who is required to maintain business interruption insurance.

The COVID-19 pandemic resulted in the renegotiation of many leases. For example, many tenants extended the term of their lease in exchange for a reduction of the rent during the period of the pandemic.

6.12 Restrictions on the Use of Real Estate

A landlord can impose restrictions on a tenant's use of the real estate via the permitted use provision, which typically lists specific permissible and prohibited uses of the space, and allows the landlord to declare a default and exercise available remedies if the tenant engages in an unpermitted use. The tenant's use can also be restricted by local zoning laws, as well as building and health regulations. Retail leases often also grant exclusive uses to tenants, which are limited to the tenant's specific product line.

6.13 Tenant's Ability to Alter and Improve Real Estate

Tenants are typically permitted to alter or improve the real estate during the lease with the landlord's approval, and landlords generally allow cosmetic alterations without prior approval. A lease usually contains a limit on the cost and type of alterations a tenant can make without the landlord's approval.

6.14 Specific Regulations

Commercial Leases

Commercial leases are generally governed by the agreement between the parties. However, there are laws and licensing requirements that are specific to particular uses, such as the operation of hotels, restaurants, banks, etc.

A new issue frequently overlooked by tenant attorneys in New York City is Local Law 97, which was passed as a part of the Climate Mobilization Act in 2019. Local Law 97 requires the

reduction of greenhouse gas emissions in most buildings over 25,000 square feet by 40% in 2030 and 80% by 2050. With its first compliance period in 2024, the law's carbon emission limits become increasingly stringent over a series of compliance periods, with owners facing potential penalties for exceeding limits. While compliance rests with the buildings' owners, emissions from tenants' energy consumption play a part in compliance. At the onset of negotiating a letter of intent, landlords and tenants should discuss the extent to which the tenant has to contribute to the cost of improving the building to meet the new law. During the lease negotiation, landlords and tenants should clearly discuss and understand any building performance standards that the landlord has set or other building rules and requirements applicable to energy efficiency and the reduction of greenhouse gas emissions.

Residential Leases

The regulations and laws that apply to residential leases were overhauled by the Statewide Housing Stability and Tenant Protection Act of 2019 (HSTPA). In addition, some residential tenancies are protected by older rent control laws. The key provisions of the HSTPA include the following:

Rent Regulation

Some residential buildings are subject to rent stabilisation regulations that establish caps on the amount of rent landlords can charge and the amount of increases they can impose. In addition, some residential tenancies are protected by older rent control laws. The HSTPA has made it more difficult for landlords to "deregulate" units subject to such regulations, as follows.

Luxury deregulation and vacancy allowances

Prior to the HSTPA, apartments with rents above a certain threshold could be deregulated upon vacancy or when the tenant's income rose to a certain amount. Also, landlords could increase rent by up to 20% each time a unit became vacant, and earn longevity bonuses, which allowed them to increase rent by 0.6% multiplied by the number of years since the last vacancy. The HSTPA repealed these allowances.

Sunset provision

The HSTPA repealed the sunset provision, which was the date by which the legislature had to renew rent regulation laws to prevent their expiration.

Rent control

Under the HSTPA, rent for rent-controlled units can only be increased by the lesser of 7.5% or the average of the previous five increases approved by the Rent Guidelines Board.

Co-op and condo conversions

Landlords could previously deregulate stabilised apartments as part of the condo or co-op conversion process. The HSTPA imposed significant limitations on this by eliminating the eviction-plan option, and increasing the required purchase percentage for non-eviction plans from a minimum of 15% sales to third parties to a minimum of 51% sales to current occupants.

Capital improvements

Before the HSTPA, landlords could recoup costs of Major Capital Improvements (MCIs) to buildings and Individual Apartment Improvements (IAIs) to apartments through rent increases. These increases have been significantly curtailed.

MCI increases are based on the cost of the improvements and apportioned on a per-unit basis. Before the HSTPA, owners of buildings with 35 or fewer units could recoup their costs over an eight-year amortisation period, while

owners of buildings with 36 or more units had nine years. Annual rent increases were capped at 6% in New York City and 15% in the rest of New York State. The HSTPA imposed a 2% Statewide cap, lengthened the amortisation period to 12 years, and made the rent increases temporary, requiring them to be removed after 30 years.

The HSTPA limited the number and cost of IAIs to no more than three within a 15-year period, at a maximum aggregate cost of USD15,000. As with MCIs, the rent increases are now temporary and must be removed after 30 years.

Duty to mitigate

If a residential tenant vacates before the lease expires, the landlord has a legal duty to find a new tenant before they can seek to collect rent from the vacating tenant. There is no such duty for commercial landlords. Landlords must now take reasonable and customary actions to re-rent vacant units, whether regulated or unregulated, at the lower of fair market value or the rate agreed to in the lease.

In addition, residential tenants are now statutorily entitled by law to a sanitary and safe apartment pursuant to the warranty of habitability.

On 22 December 2021, the HSTPA was modified as to the application of the following to co-operatives:

- the provisions limiting security deposits and advances;
- the requirement for the landlord to give notice if a lease renewal is not offered or if a renewal is offered at an increase to rent equal to or greater than 5%;
- the limitations/prohibitions on fees charged at the beginning of a tenancy;
- the limitations on the payments, fees or charges for the late payment of rent;
- restrictions on what may be sought in a summary proceeding;
- the requirement for an additional five-day notice by certified mail if maintenance is not timely received; and
- the provision prohibiting the collection of attorneys' fees in a summary proceeding.

Tax incentives for residential development

Section 421-a of the Real Property Tax Law has over the years provided certain tax incentives for developers to build "affordable" residential units, in the form of real property tax abatements for a certain number of years following completion of construction. This law is controversial, has been modified several times, and currently is only available to projects that commenced construction between 1 January 2016 and 15 June 2022 that are to be completed on or before 15 June 2026. This law is under continuing discussion and debate. It is unclear if the tax incentives will be renewed, and the form and terms of any such renewal are uncertain.

6.15 Effect of the Tenant's Insolvency

The effect of a tenant's insolvency on its lease obligations is governed by the applicable bankruptcy, insolvency, and creditors' rights statutes.

When the tenant files for bankruptcy, an "automatic stay" is imposed that initially restricts the enforcement of remedies or the termination of the lease by the landlord. Thereafter, there are specific requirements under bankruptcy law with respect to whether a lease is to be assumed or rejected.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Upon the signing of the lease, the landlord typically requires a "security deposit" from the tenant to protect against a default by the tenant.

The amount of the security deposit is a matter of negotiation and may be in the form of cash or a letter of credit. A letter of credit is a document through which the issuing bank promises to pay the security deposit to the landlord.

A letter of credit is generally considered more desirable to a landlord than a cash security deposit because it puts the landlord in a better position in the event of the bankruptcy of the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant typically does not have a right to occupy the relevant real estate after the expiry or termination of a commercial lease. However, commercial leases typically have a "holdover" provision that states that if a tenant continues to occupy the premises after the expiry or termination of the lease, the tenant must pay a multiplier of the rent for the last month of the lease (typically 150% to 200%) and become a month-to-month tenant or a tenant at sufferance. A landlord can only evict a month-to-month tenant upon notice, whereas a tenant at sufferance may be evicted at any time after the expiry or termination of the lease, subject to applicable laws.

In addition, leases may give the landlord the right to impose consequential damages on the tenant for failure to timely vacate.

6.18 Right to Assign a Leasehold Interest

Assignment of leasehold interests are negotiated by landlords and tenants. Typically, tenants are permitted to assign their leasehold interest or sublease all or a portion of the leased premises with the landlord's consent, or to assign to an affiliate or a successor to the tenant by merger, consolidation or acquisition of all or substantially all of the tenant's assets without the landlord's consent. Landlords will want to see financial information regarding the new subtenant and may require tenants to pay the landlord's attorney costs in relation to the consent for the assignment or sublease.

6.19 Right to Terminate a Lease

There are several events that typically give the landlord or the tenant the right to terminate the lease. For example, the lease typically states that if the landlord fails to complete the build-out of the space, the tenant has the right to terminate after a certain date.

The parties typically have a right to terminate in the event of a casualty if the space is not restored within a certain period of time. In addition, a landlord can terminate the lease if the tenant defaults and fails to cure the default, eg, by failing to pay rent.

A tenant may negotiate the right to an early termination of the lease, but such early termination rights are often expensive.

A landlord may negotiate the right to relocate the tenant to other space or even terminate the lease if the landlord wants to redevelop the subject property.

6.20 Registration Requirements

There are no registration requirements to comply with in New York. Memoranda of leases may be recorded in the county's land records. However, not all landlords agree to execute a memorandum of lease because landlords do not want the memorandum of lease encumbering title to the property. Recording fees are paid by a per-page formula and are generally paid by the party requesting and recording the memorandum of lease.

6.21 Forced Eviction

A tenant can be forced to vacate in the event of default or upon the expiration of the lease. For example, a tenant can be evicted for failure to pay rent or for otherwise violating the lease. Such actions are governed by the Real Property Actions and Proceedings Law (RPAPL) of the State of New York.

In residential leases, the HSTPA amended the RPAPL to extend the time periods in non-payment proceedings. The HSTPA eliminated oral demands to vacate and increased the notice period for written demands to 14 days, while also increasing the tenant's time to provide an answer to ten days. In addition, the HSTPA amended RPL Section 235-e to require that tenants be reminded if rent is not received within five days of the due date. Failure to provide such a reminder can be used as an affirmative defence in a non-payment proceeding.

At this point, all rent moratoriums for residential leases have expired.

6.22 Termination by a Third Party

Portions of the leased premises may be taken by the government through eminent domain (condemnation). Condemnation provisions are negotiated by landlords and tenants. Typically, in the event of a condemnation that takes a significant portion of the leased premises such that it is no longer useable for the tenant's purposes, the parties have the option to terminate the lease. Typically, the landlord retains the right to the majority of the claim, and tenants have the right to claim for their fixtures and relocation costs associated with the condemnation. See **2.9 Condemnation, Expropriation, or Compulsory Purchase**.

6.23 Remedies/Damages for Breach

In commercial leases, remedies and damages for a tenant breach and termination of a lease are negotiated between landlords and tenants. There are no statutory or customary limitations on damages a landlord may collect.

Security deposits are negotiated between landlords and tenants. If landlords do hold a security deposit, it can be in cash or letter of credit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are several structures used to price construction projects. First, there is a traditional fixed price or lump sum contract in which the contractor (or a construction manager) bears all of the risk for the job and must complete the job for that cost. On the other hand, in a cost-plus contract, the owner pays the contractor its cost plus a fee, making any cost overruns the owner's responsibility. In a guaranteed maximum price (GMP) arrangement, also referred to as a not-to-exceed price, the owner will reimburse the contractor for costs and fees up to a maximum; this offers the owner more protection than a cost-plus contract because the contractor is responsible for any additional costs that exceed the GMP. Finally, in a unit price contract, the contract price is based

upon the price of individual units of work, for which the contractor provides a specific price. The owner must compensate the contractor for every unit the contractor completes.

7.2 Assigning Responsibility for the Design and Construction of a Project

In New York, the design of a project must be completed by licensed design professionals, which includes Professional Engineers (PE) and Registered Architects (RA).

Traditionally, construction projects consist of a designer for the design phase and a contractor for the construction phase, a process called design-bid-build. Typically, an architect leads the design phase of a project, employing additional professionals as subcontractors. The contractor manages the construction phase of the project.

However, design-build delivery systems are becoming more popular. In this type of project delivery system, the design and construction services are constructed by a single entity using one contract. This arrangement reduces costs in both design and construction, provides a single point of responsibility, and can greatly shorten the delivery schedule by overlapping the design phase and the construction phase. In December 2019, the New York State Legislature passed a law allowing certain New York City departments to use design-build for public projects.

The third type of project delivery system is called a construction manager at risk (CMAR) method, which is a derivative of the design-bid-build process. However, instead of the designer overseeing the design phase and a contractor overseeing the construction phase, a CMAR acts as a consultant to the project owner during the development and design phases, and then acts as general contractor during the construction phase. The CMAR holds all the contracts for the subcontracts and commits to delivering the project within a guaranteed maximum price.

7.3 Management of Construction Risk

Construction risk is managed by indemnification, warranties, limitations of liability, waivers, insurance provisions and retainage.

Indemnification is limited by New York General Obligations Law Section 5-322.1, which prohibits a party involved in the construction, alteration, repair or maintenance of a building from contracting with another to indemnify or hold it harmless for injuries or damage to property caused by its own negligence, though the party may require indemnification for damages caused by the negligence of parties other than itself.

Warranties are almost always limited in duration by express contract provision. New York General Business Law Section 777-a specifically creates warranties applicable to the sales of new construction homes that include a one-year warranty that the home will be free from defects due to poor workmanship and a six-year warranty that the home will be free from material defects.

Limitations of liability and waivers of damages are limited to the extent that the liability or damages were in contemplation of the parties at the time of entering into the contract, but will not be enforced if they purport to protect a party from liability for conduct that constitutes fraud, gross negligence or willful misconduct. The most common limitation of liability in construction contracts is a waiver of consequential damages. Owners and contractors can also limit risk by including a “no damages for delay” clause in a contract with a downstream party, which prohibits a contractor or subcontractor from asserting claims to recover financially for damages caused

by delays, instead limiting relief from delays to time extensions.

Insurance is often used to address the risks occasioned by the limitation on indemnity, and oftentimes owners and contractors will require they be added as an additional insured on the contractor's or subcontractor's commercial general liability policy, respectively.

In addition, an owner may participate in an owner-controlled insurance program (OCIP), which is an insurance policy held by a property owner during the project and covers all liability and losses from the project. Contractors may participate in a contractor-controlled insurance program (CCIP), or wrap-up insurance, which protects the general contractor, its subcontractors and the project owner from liability and losses.

Finally, retainage is used to reduce risk and incentivise contractors or subcontractors to complete a project by withholding a portion of payment until agreed-upon milestones are met. New York recently introduced a new law (New York General Business Law Section 756-c) that reduces the amount of retainage that can be withheld from a contractor or subcontractor on a private construction project to 5% of the contract sum for projects with costs that are equal to or greater than USD150,000. Before this law, parties could agree to withhold "a reasonable amount" of retainage.

7.4 Management of Schedule-Related Risk

Contract provisions require contractors and subcontractors to adhere to schedules prepared by the construction manager or architect on behalf of the owner. Owners can receive compensation for delays if provided for in the contract, most often in the form of liquidated damages. Alternatively, owners can recover actual damages to the extent damages can be proven. While not common, contracts will sometimes provide contractors with cash incentives to exceed scheduling milestones or costs below budget.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common form of additional security to guarantee a contractor's performance is a performance bond. In most, if not all, public projects and in many private projects, the owner will require the general contractor to post a performance bond.

It is becoming popular for general contractors to use a subcontractor default insurance (SDI), often called "subguard", insurance policy in lieu of a subcontractor performance bond for private projects. Such a policy shifts the burden of losses resulting from a subcontractor's default to the insurance company, and provides coverage for losses or damages sustained in the event of a subcontractor's or supplier's default. Further, the subguard policy covers all subcontractors on a given project, or on an annualised basis for all projects combined. However, the insured (general contractor) maintains the responsibility for determining whether or not the subcontractor will be pre-qualified and thus accepted under the subguard programme. Also, the general contractor is responsible for resolving the subcontractor default issues, although the costs of completing the work are covered.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and designers may file liens to encumber property in the event of non-payment pursuant to New York Lien Law. Generally, in New York, a mechanic's lien can be filed at any time during the progress of a project, but no later than

eight months after the completion of the contract or the final furnishing of labour or materials. For single-family dwellings, a mechanic's lien must be filed within four months of completion of the contract or the final furnishing of labour or materials. If the work performed requires a license, the claimant must be licensed in order to file a mechanic's lien. The lien must be recorded in the county in which the project is physically located, and the lien is valid for one year from the date of filing, at which point the claimant must either commence an action to foreclose the lien or file to extend the lien by one year.

Pre-existing mortgages typically have priority over a mechanic's lien claim, but a mechanic's lien has priority over advances made by the construction loan lender after the filing of the mechanic's lien.

The owner can discharge a mechanic's lien by depositing with the county clerk a payment equal to the amount claimed in the lien, with interest to the time of the deposit, or by posting a bond equal to 110% of the lien.

7.7 Requirements Before Use or Inhabitation

An owner must obtain a certificate of occupancy stating a legal use and/or type of permitted occupancy of a building before a building may be occupied. A certificate of occupancy has no expiration date.

8. Tax

8.1 VAT and Sales Tax

New York State does not have a value added tax. New York State sales tax only applies to the sale or lease of tangible personal property and selected services. Sales tax does not apply to the sale or purchase of real estate.

8.2 Mitigation of Tax Liability

Parties occasionally use a Consolidation Extension and Modification Agreement to reduce mortgage recording tax. Provided both the existing lender and the new lender agree, the existing lender assigns its mortgage to the new lender, which will then amend the terms of the mortgage for refinance or purchase of the property. A buyer will then pay mortgage tax on the difference between the outstanding balance of the seller's existing mortgage and the buyer's new mortgage, rather than paying tax on the entire amount of the new mortgage.

8.3 Municipal Taxes

In Upstate New York, municipal taxes are typically not paid on the occupation of business premises or on the payment of rent.

8.4 Income Tax Withholding for Foreign Investors

Foreign investors are generally subject to a 30% withholding tax on certain US source income, including real property rental income. In certain cases, an income tax treaty may reduce the withholding tax rate.

The Foreign Investment in Real Property Tax Act requires the purchaser of real property owned by a foreign investor to withhold a 15% tax on the total amount realised on the purchase. Foreign investors in partnerships are subject to a 15% withholding tax on the sale of their partnership interests. Because real estate in the USA is frequently owned through entities treated as partnerships for US federal income tax purposes, foreign investors will have exposure to this tax if they dispose of the equity in a partnership owning real estate.

8.5 Tax Benefits

Benefits include depreciation deductions for taxpayers with respect to improvements made to real property.

In addition, to the extent that the owner of the real estate used in a trade or business financed the acquisition of, or improvements to, the property with debt, the interest is deductible. Generally, the amount of interest that can be deducted is limited to 30% of the taxpayer's adjusted taxable income, but real estate businesses that meet certain requirements can elect to fully deduct their entire interest expense.

Individuals who own real estate directly or through a pass-through entity pay tax on any long-term capital gain recognised at significantly lower rates than other types of income.

Real property owners who hold property for investment, or for use in a trade or business, may dispose of that property in tax-efficient ways not available to other types of property, such as through Section 1031 of the Internal Revenue Code as discussed above.

Historic Tax Credits

Federal and New York State historic tax credits may be available in connection with the substantial rehabilitation of certain historic buildings. If various requirements are satisfied, a taxpayer that holds title to a rehabilitated historic building (or has an ownership in a pass-through entity that holds the title) may claim a nonrefundable federal tax credit equal to 20% of "qualified rehabilitation expenditures" incurred with respect to the building. The federal tax credit is claimed on a pro rata basis over a five-year period beginning in the tax year in which the rehabilitated building is placed in service.

New York State's historic tax credit is available to a taxpayer that is allowed the federal historic tax credit with respect to a historic building located in New York State, provided that the building is located in a census tract at or below 100% of the state's median family income. The state tax credit is currently equal to 100% of the federal tax credit claimed, but does not need to be claimed over a five-year period. Property owners can receive this enhanced state credit of 100% of the qualified rehabilitation expenditure (QRE) up to USD5 million, if the property placed-in-service date is after 1 January 2010 and before 1 January 2030. A credit of 30% of QRE is available for a property placed-in-service date after 1 January 2030, so long as the total QREs do not exceed USD100,000 per structure.

The Brownfield Cleanup Program

The New York State established the Brownfield Cleanup Program (BCP) in 2003 to encourage private sector cleanup of contaminated property, known as Brownfield sites, and redevelopment and reuse of those sites. The program offers certain legal, financial, and tax incentives to encourage this private sector cleanup, redevelopment, and reuse. Provided that a variety of requirements are met, taxpayers that remediate and redevelop Brownfield sites are eligible to receive refundable tax credits against their New York State income tax liability.

Under the current program, the amount of the credit may be between 10% and 24% of eligible costs paid or incurred to clean up and redevelop the site, with certain components capped. The amount and type of tax credits available vary by individual sites depending on location, type of use, and when the site was accepted into the BCP, amongst other factors.

USA - SOUTH CAROLINA

Law and Practice

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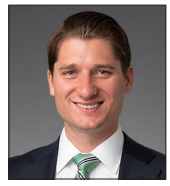
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1. General

1.1 Main Sources of Law

Real estate law is established by federal statutes, state statutes, and common law. General principles of contract and property law govern real estate transfers and ownership, and formalities related to such matters can vary by state and locality.

1.2 Main Market Trends and Deals

The industrial/logistics asset class remained strong in the wake of the COVID-19 pandemic, and the uptick should continue in acquisitions and assemblages of real property for industrial uses, much of which is related to the burgeoning automotive manufacturing and aerospace industry in South Carolina.

Construction, purchase, and sale activity related to multifamily projects continued to be robust, and there continues to be great interest in the acquisition of South Carolina real estate by out-of-state institutional investors. As a result of changing consumer habits, the office and retail sectors continue to be uncertain, and an increased number of restructurings and conveyances are expected as lenders and landlords begin to actively pursue their remedies in distressed settings.

The recent rise in mortgage interest rates and the Federal Reserve's attempt to corral rampant inflation have impacted real estate investors due to increased borrowing costs and reduced cash flow. Higher vacancy rates are seen in commercial buildings, both from the post-pandemic restructuring of the physical workplace and from increases in rent and operating costs.

Many of the industrial sites being acquired are obtained from governmental or quasi-governmental regional or local development authorities; these acquisitions are generally intertwined with governmental incentives, such as real property tax abatements, cash grants, and government-provided or government-financed infrastructure granted as an inducement to site selection in South Carolina. In the financing area, private equity investors and equity fund lenders are becoming a significant source of funding for South Carolina real estate acquisition and development.

1.3 Proposals for Reform

The Biden administration's 2023 proposed limitations to the 1031 like-kind exchange rules were not enacted; however, the Biden administration's budget for fiscal year 2024 again proposes limits on 1031 like-kind exchange deferrals. It can be expected that 1031 like-kind exchanges will continue to be targeted as a "loophole" by Congress.

In 2023, South Carolina reduced its top marginal income tax rate from 6.5% to 6.4%, with a stated goal of reducing such income tax rate annually until such rate is reduced to 6%. Like other states in the southeast, these lower state income taxes are expected to continue to attract retirees from higher income tax states.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights generally fall into three categories – fee interest, leasehold interest, and easement interest. A fee interest generally describes ownership of the land and is often transferred by deed. A leasehold interest generally describes the right to use but not own the land, such as the interest acquired by a tenant when they enter into a lease with a landlord. An easement interest

generally describes the right to access a portion of someone else's land and is generally acquired pursuant to an easement agreement.

2.2 Laws Applicable to Transfer of Title

South Carolina has formal requirements for the validity of conveyancing real estate instruments to be recorded in the real property records located in each county. The parcel or parcels conveyed must have been legally created as separate parcels; any conveyance subdividing a parcel or combining multiple parcels into a single parcel requires an application and government approval for such reconfiguration. There are no special laws or regulations that apply to the transfer of specific types of real estate (although specific uses are always subject to zoning and land-use regulations).

2.3 Effecting Lawful and Proper Transfer of Title

Transfers of ownership of real property in South Carolina are made by deed, which may or may not include warranties of title. A deed must be in proper form and witnessed by two disinterested parties. In addition, a deed must contain an acknowledgment made by the transferor before a notary public or, alternatively, an affidavit of a subscribing witness.

In order to be valid as against third parties, deeds must be recorded in the real property records for the county in which the property is located. There is a transfer tax payable upon recordation of a deed, and each deed must be accompanied by an affidavit as to the actual consideration paid.

South Carolina is a lawyer closing state, meaning that a South Carolina licensed lawyer must undertake or supervise key parts of the real estate transaction, including the title review, drafting of the conveyancing documents, disbursing of funds and recordation of documents. The South Carolina Supreme Court takes these requirements very seriously and, as such, a lack of South Carolina lawyer involvement may affect the enforceability of the underlying documents.

During the COVID-19 pandemic, many counties in South Carolina adopted e-recording to facilitate recording in the real property records while offices were closed, and these counties have generally kept e-recording available on a going-forward basis. An original, wet ink signed and notarised signature is still required to e-record, and when the scanned original is submitted for e-recording, a memorandum of understanding confirming that the original, wet ink signed and notarised document is in hand with the submitter is also submitted.

2.4 Real Estate Due Diligence

Many aspects of real estate transactions are subject to arcane and technical rules and regulations, and, as a result, it is critical to have the assistance of knowledgeable South Carolina counsel. With respect to title due diligence, South Carolina is one of the few states in which law firms act as title insurance agents; most South Carolina law firms are empowered to issue title insurance commitments and policies. This arrangement facilitates the negotiation of title insurance coverage and allows for integration of title insurance coverage with the closing process. For these reasons, due diligence relating to title is generally conducted by purchaser's counsel, and the purchaser or its counsel is responsible for the title examination and obtaining title insurance.

South Carolina is a filed-rate state, meaning that title insurance premiums are largely fixed by state regulation, although there may be some nego-

tiation for the price of endorsements. Although not typical, in some transactions the seller will tender a basic title commitment for review by purchaser's counsel.

Surveys

Purchasers are advised to obtain new surveys meeting the standards set forth by the American Land Title Association (ALTA) and the National Society of Professional Surveyors, Inc (NSPS). These standards contain a number of optional survey coverages and certifications; South Carolina counsel will provide guidance as to the optional provisions appropriate to the specific project. Surveys are necessary to adequately identify and locate encroachments (on or off the property), identify and locate easements and other possible title issues, and specifically locate on the property the exceptions identified in the title commitment.

Zoning and Entitlement

Zoning and entitlement due diligence likewise will be conducted by purchaser's counsel by direct contact with the applicable planning and zoning officials to obtain a "zoning letter"; this due diligence may be supplemented by a zoning report obtained from a national provider.

Environmental

Environmental due diligence will consist at a minimum of a Phase I environmental survey followed by a Phase II environmental survey, as necessary. Properly conducted environmental surveys may provide a purchaser with a defence against unlimited liability for existing contamination on the property, which otherwise attaches to parties in the chain of record title. In order for a purchaser to obtain this defence, there are number of technical requirements that must be complied with in connection with the environmental surveys.

With respect to contaminated properties, purchasers may enter into a voluntary clean-up contract with the state authorities in order to limit environmental claims. The ability of the purchaser to enter into such a voluntary clean-up contract, however, is subject to a number of technical requirements. For example, the clean-up contract must be in place prior to the time the purchaser obtains title; otherwise, the purchaser may have full joint and several liability for environmental contamination on the property. Even if an agreement is reached with the state environmental authorities, this is no guarantee that the protections in the agreement will be recognised by the federal environmental authorities.

Identification of Wetlands

Federal and state regulation precludes development of or damage to many kinds of wetlands and regulates the discharge of stormwater runoff into the wetlands. Wetland regulations are highly technical; the purchaser may be required to restore damaged wetlands (typically at considerable expense) if rules are not fully complied with. Should wetland impairment be necessary for an economically viable development, such impairment may be permitted if the purchaser makes an appropriate investment in a "wetland bank" that ensures the preservation of a comparable amount of wetlands located elsewhere.

Physical Condition

Due diligence as to the physical condition of the property is typically undertaken by engineers or consultants retained by the buyer or by way of a property condition report. If construction is contemplated, geotechnical soil tests will be conducted to determine the suitability of the site for construction.

Real Property Tax

Real property tax matters are a significant part of the purchaser's due diligence. In addition to verifying that all taxes due and payable have been paid, certain transactions may be deemed to be "assessable transfers of interest"; this designation can trigger a reassessment of the property for tax purposes in the year following the transfer, and the resulting increase in value will result in an increase in real property taxes levied.

If the property has been classified as agricultural property, a change to a non-agricultural use may result in a recapture (or "roll back") of tax discounts given in the prior three years on account of the property's agricultural classification.

Under South Carolina law, the state can impose a tax lien on property in the hands of the purchaser for income and other general taxes not paid by the seller. South Carolina law further provides several safe harbours under which this liability can be avoided based on tax compliance affidavits of the seller and a compliance certificate from the South Carolina taxing authorities.

If a seller is an entity, the purchaser's lawyer will verify the existence and good standing of the seller in South Carolina and, if different, its state of formation. The purchaser's lawyer will also confirm that the transaction has been authorised by all necessary resolutions and that any other necessary entity action has been adopted or taken by the seller's governing body.

2.5 Typical Representations and Warranties

There are no legally mandated representations and warranties or disclosures in commercial real estate transactions – the doctrine of caveat emptor prevails. Purchase and sale agreements typically contain customary representations and warranties, although representations as to ownership and the status of title are less common – title matters are left for due diligence by the buyer's counsel, with the buyer's risk further mitigated by title insurance.

Sellers frequently indemnify the purchaser against breaches of representations and warranties; however, the liability of a seller for such breaches is frequently capped monetarily and subject to shortened periods in which claims may be asserted, but even where such indemnities are capped, it may be the case that certain intentional, bad acts of the seller are carved out of the indemnity, such as fraud or willful misconduct. Note that the enforceability of provisions shortening general statutes of limitation may be unenforceable under South Carolina law, and South Carolina counsel should be consulted. It is also common for purchase and sale agreements to preclude recovery for indirect or consequential damages.

Most real estate transaction documents include waivers of jury trial and arbitration requirements. To ensure their enforceability, South Carolina counsel should be consulted during the drafting of such provisions.

2.6 Important Areas of Law for Investors

General principles of contract and property law govern the transfer and ownership of real estate, but an investor would also want to understand the tax implications of investing in real estate. Specifically, real estate investment trusts (REITs) are a common investment vehicle that provide unique tax advantages to their investors.

The South Carolina Local Government Development Agreement Act (S.C. Code Title 6, Chapter 31) is critical for developers in South Carolina. The Act authorises binding agreements between

municipalities and developers, gives developers confidence that they will be able to develop the project, and, among other terms, describes the responsibilities of each party for public infrastructure.

Fee in Lieu of Taxation Agreements (FILOTs) (S.C. Code Title 12, Chapter 44) are another important tool for developers in South Carolina. FILOTs are granted by, and at the discretion of, the county where the project is located, and are available to industries that invest at least USD2.5 million in South Carolina. FILOTs can result in savings of about 40% on property taxes otherwise due for the project.

2.7 Soil Pollution or Environmental Contamination

Purchasers may become liable for environmental contamination simply by acquiring an interest of record in contaminated real property. For this reason, it is critical in South Carolina to conduct environmental assessments of property prior to acquisition. If property is found to be contaminated, a purchaser may enter into a voluntary clean-up contract with the state that limits the exposure of the purchaser to environmental claims asserted by the state; these voluntary clean-up contracts, however, must be entered into prior to the time the purchaser acquires the real property interest and do not necessarily protect a purchaser against claims asserted under federal law.

Generally, purchase and sale agreements provide that the seller is responsible for any clean-up costs and other liabilities arising from contamination occurring prior to the transfer of title, with the purchaser being liable for contamination occurring after the transfer of title. In larger transactions, purchasers are sometimes required to bear all the risk of contamination and may even be required to indemnify the seller against liabilities relating to such contamination.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Purchasers of South Carolina real estate may either verify directly with the appropriate local zoning authorities the zoning classification of the property or obtain a property zoning report from a third-party supplier. Zoning ordinances and maps are publicly available, and the property's zoning classification and the resulting permitted uses and restrictions can be directly determined.

For appropriate projects, most local authorities will enter into development agreements to facilitate development of property deemed desirable by the local authorities. Development agreements may modify or supersede existing zoning provisions and facilitate development in accordance with the peculiarities of the specific project.

2.9 Condemnation, Expropriation or Compulsory Purchase

Condemnation is permitted in South Carolina, and it may be exercised by states, counties, municipalities, and utilities. Property may be taken only for true "public uses", such as roads, airports, ports, and utility facilities; condemnation for the benefit of private enterprise or general redevelopment is not permitted.

2.10 Taxes Applicable to a Transaction

South Carolina imposes a transfer tax on real property conveyances. The amount of the tax is USD1.85 for each USD500, or fractional part thereof, of the value of the property transferred. The calculation of the value of the property transferred, however, is fairly technical and dictated by statute; the value is sometimes (but not always) based on the consideration paid.

The transfer tax is also subject to a number of technical exceptions, and it is sometimes possible to structure the transaction so as to avoid the imposition of the transfer tax entirely.

The transfer tax applies only to transfers conveyed by way of a deed, and it generally does not apply to economic changes in ownership resulting from equity transfers by the title-holding entity. Some local jurisdictions, however, require that notice of an equity transfer be given to the local taxing authorities; this notice may trigger a reassessment of the value of the property in the year following the equity transfer, resulting in an increase in annual taxation.

2.11 Legal Restrictions on Foreign Investors

Foreign investors should be aware of certain laws that affect real estate investors. Under the Foreign Investment in Real Property Tax Act, up to 15% of the proceeds from the sale of real property by a foreign seller may be required to be withheld and applied to the seller's federal income tax liability.

A purchaser of agricultural land may be required to make a filing under the Agriculture Foreign Investment Disclosure Act of 1978.

If the foreign purchaser conducts a US business enterprise in connection with the property, a filing with the US Bureau of Economic Analysis, an agency of the US Department of Commerce, may be required. The purchase of property located near critical infrastructure or sensitive government facilities may require approval from the Committee on Foreign Investment in the United States. Under South Carolina law, a single foreign purchaser may not own more than 500,000 acres of land in the state.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisition of commercial real estate is generally financed by mortgage lenders, who may be either institutional lenders or private equity funds, by way of JV investment or some combination of the foregoing. In addition, mezzanine financing is becoming more common and may be used in conjunction with the more traditional mortgage loan. Many loans of income-producing property are structured to the rating agency requirements for inclusion in a commercial mortgage-backed loan package.

Larger real estate portfolio acquisitions are frequently financed by private equity or multi-lender loans.

3.2 Typical Security Created by Commercial Investors

Most real estate financing is secured by a mortgage, which will grant to the lender a lien on the subject real property. Upon default by the borrower, the lender may institute judicial foreclosure proceedings and cause the public sale by the court of the mortgaged property. The proceeds of that sale will be applied to reduce the borrower's indebtedness secured by mortgage.

Deficiency

Whether the borrower is potentially liable for any deficiency remaining after the sale is determined by the terms of the financing documents. Moreover, South Carolina has an anti-deficiency statute that allows a borrower to use an appraisal process to potentially reduce or eliminate any deficiency judgment. A borrower's rights under this anti-deficiency statute may be waived, but the waiver must meet a number of statutory and procedural requirements, including the giving of

a notice in a prescribed form prior to the transaction and the execution of a waiver in a prescribed form as part of the transaction.

Private Enforcement of Mortgages

South Carolina does not recognise private enforcement of mortgages, such as by way of a power of sale. Further, a lender is not entitled to take possession of the mortgaged property after default – a lender's remedy is limited to judicial foreclosure. In a judicial foreclosure, a receiver may be appointed by the court to take possession of the property and collect rents for the benefit of the lender, but only if the appropriate language is contained in the mortgage loan documents.

Lenders are advised to consult South Carolina counsel to ensure that the financing documents include the necessary receivership provisions.

Assignment

In addition to a mortgage, borrowers are generally required to execute an assignment of the leases, rents, and profits of the property. South Carolina counsel should be consulted to ensure the adequacy of any such intended assignment. To the extent there is significant non-real-estate collateral located on the property (such as machinery and equipment), a borrower may grant a personal property security interest in that non-real-estate collateral.

Finally, security can also be taken at the equity level of the real estate owning entity. This is done by way of a pledge of the equity interests in the real estate owning entity by the owners of those interests.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Foreign banking organisations are subject to regulation at the federal level, with the nature and extent of the regulation depending upon whether the foreign banking operation is chartered in the United States or abroad.

Although there are several potentially applicable exemptions for mortgage lenders, foreign lenders may be required to obtain a certificate of authority to transact business in South Carolina. South Carolina counsel should be consulted as to whether the transaction may be structured so as to avoid the need for a certificate of authority.

There is effectively no usury in South Carolina and no other interest rate regulation with respect to commercial finance.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

There are no mortgage taxes, transfer taxes, or documentary taxes imposed on the granting of mortgages or other security in real estate interests.

3.5 Legal Requirements Before an Entity Can Give Valid Security

South Carolina entities are empowered to do all things necessary or convenient to carry out their business and affairs, including the mortgaging of their properties. Customarily, the governing body of a borrowing entity will adopt a resolution (or act by written consent) making a determination that the granting of the particular security is in the best interest of the entity and in furtherance of the business purposes of the entity.

3.6 Formalities When a Borrower Is in Default

A mortgage lender seeking to enforce its rights after a borrower default first must take any steps required by the loan documents. For example, the lender must give any notice as of right to cure or demand letters as may be required contractually. Once these preliminary matters are accomplished, the mortgage lender must bring a judicial foreclosure action in order to realise upon the mortgaged property.

This foreclosure action will result in a public auction sale by the court of the mortgaged property. The mortgage lender may "credit bid" at the sale. Sale of the mortgaged property under a power of sale is not permitted; a judicial foreclosure proceeding is required. Likewise, a mortgage lender on default by the borrower is not entitled to take possession of the property.

Establishing Priority

In order to establish the priority of the mortgage over interests of competing creditors, the mortgage lender must record the mortgage in the applicable county's real property records. Competing creditors claiming an interest in the mortgaged property must be named as defendant parties in the judicial foreclosure action; the public sale will be free and clear of those junior claims and interests.

Appointing a Receiver

Assuming the loan documents have the necessary provisions, the court may enforce assignments of leases, rent, and profits by the appointment of a receiver in connection with the foreclosure proceedings. The court may authorise the receiver to collect rents and other profits derived from the property and, after deducting costs of operation of the property and the receiver's fees, to disburse the remaining proceeds to the lender to be applied to the secured indebtedness. South Carolina counsel should be consulted at the loan origination stage so that the necessary assignment of rents and receivership provisions are included.

Pledged Security

Where the equity owners of the real estate entity have pledged that equity as security, the lender is authorised under the Uniform Commercial Code to sell such equity at public or private sale after due notice to interested parties; no judicial action is required. The lender may credit bid at a public sale but may not bid at all in a private sale.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing indebtedness may be subordinated to new indebtedness by a contractual subordination agreement. Otherwise, existing secured indebtedness will generally retain its priority. Although advances made in connection with construction financing will generally maintain priority based on the original filing date of the mortgage, advances made after both the filing and the service of a mechanic's lien may lose priority to the mechanic's lien.

These priorities are determined in large part by the South Carolina recording acts, which are not straightforward and leave much to common law doctrine. For example, priority is not necessarily determined by the time of recording.

In addition to general priority questions that are determined by ordinary priority rules, in extraordinary circumstances involving lender misconduct, a court may subordinate existing indebtedness under the legal doctrine of "equitable subordination". Finally, again, in extraordinary circumstances, usually in bankruptcy proceedings, debt may be re-characterised as equity,

with the result that the debt is effectively subordinated to claims of other creditors.

3.8 Lenders' Liability Under Environmental Laws

As a general rule, a lender does not become liable under environmental laws by virtue of holding a mortgage or by virtue of foreclosing the mortgage and taking title to the property for the purpose of reselling it to an ultimate purchaser. A lender may nevertheless become liable if the lender actively participates in the management of the property. "Active participation" by a lender means that the lender exercised decision-making control over environmental compliance with respect to the property or exercised general management control such as that typically exercised by a manager of the facility or property.

A lender may, however, inspect the property, require a borrower to respond to contamination issues, provide the borrower with financial advice, or amend or restructure the mortgage or loan terms – these activities are not deemed to constitute active participation.

3.9 Effects of a Borrower Becoming Insolvent

A filing of bankruptcy proceedings by or against a borrower will result in an automatic stay or injunction against all creditors. This automatic stay will prohibit any acts to enforce the mortgage or collect the mortgage indebtedness. In order to proceed with foreclosure or collection activities, a lender must have this automatic stay modified by the bankruptcy court.

A mortgage lender is deemed to be a secured creditor to the extent of the value of its collateral. As part of the bankruptcy process, the repayment terms of the mortgage indebtedness may be extended for a longer period and the interest rate may be modified, but in theory, the amended repayment terms must grant the lender on a present value basis the equivalent value of its mortgage interest.

Mortgages may be set aside in bankruptcy if the mortgage was granted within the period immediately preceding the bankruptcy filing as security for a pre-existing unsecured debt, if the mortgage lender did not provide reasonably equivalent value to the borrower in exchange for the granting of the mortgage, or if there is a significant delay in the recording of the mortgage. A mortgage may also be set aside in bankruptcy if it is not timely and properly filed and indexed in the real property records so as to cause the mortgage to have priority over competing lien creditors. The most important actions a mortgagor lender may take to protect itself from bankruptcy risks is to ensure that the mortgage is recorded in a timely manner and properly indexed in the appropriate recording office.

3.10 Taxes on Loans

There is no existing or pending legislation in South Carolina that proposes to impose a mortgage recording tax, or tax on a pledge of share, or membership interests in the borrower in connection with a mezzanine loan.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Most jurisdictions have a local planning commission, which undertakes a continued planning programme for the physical and economic growth of the jurisdiction.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Most jurisdictions have adopted building codes, incorporating construction standards such as required building elevation, general structural matters, loadbearing and wind resistance, and electrical and plumbing requirements. Land disturbance and construction permits are required prior to the commencement of construction, and during construction, arrangements must be made for periodic governmental inspections to verify compliance with applicable building codes. Building code compliance is also required in connection with any major refurbishment of existing structures.

Some, but not all, jurisdictions have architectural review boards or equivalent entities with approval rights over the design and exterior appearance of new and renovated structures.

4.3 Regulatory Authorities

Most local governments have planning and zoning departments charged with enforcing zoning and land-use regulations and building inspection departments charged with enforcing construction requirements. These regulations typically include permitted uses, lot coverage, setback requirements, and general construction standards. In some rural areas, however, there is no applicable zoning regulation, although building codes will nevertheless be applicable.

In addition to general planning and zoning and construction regulation, the construction of "curb cuts" granting physical access to existing public roads requires approval of the applicable department of transportation. If there are regulated wetlands on the parcel, approval of the development plans by the US Army Corps of Engineers will generally be required. Approval of water, sewer, and stormwater retention and dispersal requirements is regulated by the South Carolina Department of Health and Environmental Control and local governments.

4.4 Obtaining Entitlements to Develop a New Project

Planning and Zoning Departments

If the proposed use is consistent with existing zoning codes, then the initial step in development of property is to obtain approval from the applicable planning and zoning departments of a site plan setting forth the basic layout of the project. The site plan may include (or will be followed by) civil engineering plans showing regulated wetlands, stormwater retention and dispersal plans, utility plans such as water and sewage, and building footprints. Additional approvals required in connection with the site plan approval process include approval of stormwater containment and dispersal plans, approval of curb cuts for access to public roads obtained from the applicable department of transportation, and approval of wetlands delineation and impairment by the US Army Corps of Engineers.

Architectural Review Board

Architectural plans likewise require approval of the applicable planning and zoning department as well as, if applicable, the governing architectural review board. Appropriate permits must be issued before land disturbance and the commencement of construction. If the project and proposed use of the property conforms to existing zoning requirements, there is generally no formal public input into the permitting process.

To the extent the project or the resulting use of the property requires a variance or a zoning amendment, the property owner must comply with a formal application process, requiring, among other things, one or more public hear-

ings. The public is given the right to object to any requested variances or zoning amendment and to participate in the related public hearings.

4.5 Right of Appeal Against an Authority's Decision

Most state and local authorities have a board of zoning appeals or a functionally equivalent body that is expressly authorised to hear appeals from permitting and zoning actions, including denials of or the imposition of conditions on permits and zoning variances. Aggrieved parties generally have an appeal as a matter of right to the appeals board with respect to any adverse decision made under a zoning or development ordinance, including adverse decisions with respect to the issuance of permits.

4.6 Agreements With Local or Governmental Authorities

The construction or development of projects that are in conformity with applicable zoning and land-use requirements does not require specific agreements with local authorities. Nevertheless, in order to provide certainty to developers prior to the investment of substantial funds, local governments are authorised to enter into development agreements with property owners. The development agreements are intended to allow for pre-approval of the scope and permitting of a proposed project and will typically address zoning and land-use issues, density, infrastructure, and the funding of related public services.

Local governments are required to have one or more public hearings after public notice before entering into development agreements. Development agreements are commonly used in connection with larger projects and where the specific project requires amendments or variances from the current zoning.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and the designated use of property are generally enforced at the permit level; land disturbance and building permits are denied if the proposed project is not consistent with applicable restrictions. Certificates of occupancy may be denied for the same reason. Restrictions on use and the development of property may also be enforced by both the local governmental authorities and the public by way of legal proceedings seeking to enjoin the unauthorised use or development of the property.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Title real estate can be held by any legally recognised entity having a separate legal existence, including partnerships, LPs, LLCs, corporations, and statutory trusts. Title can also be held by trustees under common law trusts. The type of entity most frequently used to hold title to real estate is the LLC. LPs are also frequently used.

The use of corporations and partnerships as title-holding vehicles is less common.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Limited Liability Companies (LLCs)

LLCs provide limited liability protections – members and managers are not liable for debts of the LLC. LLCs have great flexibility with respect to:

- management and control options;
- allocations of profits, losses, and other tax attributes among the members;
- distributions among the members; and

- limitation of duties owed by members to each other and to the LLC.

In some states, creditors of individual members may only reach the distributional interest of that member and not the member's actual limited liability interest; to this extent, an LLC may provide limited asset protection benefits.

Single-member LLCs are generally ignored for income tax purposes, with taxation occurring at the parent/owner level. Multiple-member LLCs are typically taxed as partnerships. As a result, the LLC is a pass-through entity for tax purposes – taxation is at the member level and not the entity level. LLCs may, however, elect to be taxed as C corporations under the Internal Revenue Code, such that tax is also levied at the entity level.

Partnerships

Partnerships are similar to LLCs, but they have a significant disadvantage: the individual partners are jointly, or jointly and severally, personally liable for the debts and obligations of the partnership – there is no limited liability. Thus, a partner in a partnership may have liability greatly exceeding the amount of the partner's investment in the partnership.

Limited Partnerships (LPs)

An LP is similar to a partnership, but it must have at least one general partner and one or more limited partners. Although the general partner is fully liable for the debts and obligations of the LP, the limited partners' liability is limited to their investment in the LP. As an LP is able to offer limited liability to its partners, it is a commonly used vehicle when there are multiple third-party investors.

Partnerships and LPs

Partnerships and LPs are pass-through entities for tax purposes, with taxation at the partner level and not the partnership level.

Corporations

Corporations are also established methods of holding title and provide limited liability to their shareholders. The use of corporations as title-holding entities is less common than the use of LLCs and LPs because corporations are considered less tax-efficient real property investment vehicles.

Corporations are taxed at the entity level, and distributions of property and cash may also be subject to taxation at the shareholder level; because of this double taxation, and less favourable tax consequences on liquidation, corporations are generally viewed as less favourable vehicles from a tax perspective for the ownership of real property.

5.3 REITs

Both public and private REITs are common investment vehicles used in South Carolina, although they are typically organised outside of the state. REITs receive beneficial tax treatment and South Carolina has adopted the federal income tax treatment of REITs as established by the Internal Revenue Code. Among additional requirements, to qualify as a REIT, a company must invest at least 75% of its total assets in real estate, derive at least 75% of its gross income from real property rents, real property mortgage interest or from real property sales, and pay out at least 90% of its taxable income as shareholder dividends.

5.4 Minimum Capital Requirement

Although South Carolina imposes minimal capital requirements on certain banking and financial

institutions, and de minimis organisation fees are owed to the South Carolina Secretary of State for an entity to organise or register to conduct business in South Carolina, South Carolina does not otherwise impose minimal capital requirements on the investment entities discussed in **5. Investment Vehicles**.

5.5 Applicable Governance Requirements

LLCs are usually governed either by the members or by appointing managers, although they can also be governed by a board of directors. Partnerships and LPs are governed by their general partners. Corporations are usually governed by a board of directors. In each case, the applicable members of the governing bodies approve proposed transactions by way of resolutions or actions by written consent.

The Corporate Transparency Act has increased disclosure requirements for the beneficial owners of LLCs. Historically, it would have been common for a real estate attorney to co-ordinate organisation of an LLC, but in response to the Corporate Transparency Act, it is recommended that organisers consult with corporate counsel or third-party servicers to ensure compliance with the Corporate Transparency Act.

5.6 Annual Entity Maintenance and Accounting Compliance

The annual entity maintenance and accounting compliance cost for each type of entity used to invest in real estate can vary dramatically from a few hundred dollars to several thousand dollars depending on the amount of assets owned or the volume of transactions by the entity.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The granting of the right to possess real property without the transfer of title is usually accomplished by a lease. Leases grant a right of possession, typically for a term of years.

A limited right of possession or use may also be granted by way of a license; typically, however, a license is for a very short, transitory period and for a limited, specific purpose. Moreover, leases granting an exclusive right of possession are considered an interest in real property; licenses do not grant an exclusive right of possession and are not considered an interest in real property.

The right to use another's property for a specific purpose may also be granted by way of an easement. Easements may be perpetual or for a specified term and may be classified as appurtenant, meaning that the easement benefits transfer with the benefited property, or personal, meaning that the easement benefits are not transferable. Personal easements are frequently for a limited term. Easements are considered an interest in real property.

6.2 Types of Commercial Leases

Commercial leases are generally classified based on the nature of the property leased. A commercial lease that grants the right to possession to unimproved land only is commonly referred to as a ground lease and is typically used where the lessee intends to construct and own title to the buildings, with title to the ground remaining with the lessor. Commercial leases may also grant the right to possession of an entire facility or property – both land and improvements. Like-

wise, leases may grant the right to possession of a portion of existing improvements, such as in office buildings. These leases of only a portion of property are frequently referred to as "space leases".

6.3 Regulation of Rents or Lease Terms

Rents and lease terms in commercial leases are, generally, not regulated. For certain property tax regulatory purposes, however, ground leases having terms of 90 years or more may be deemed to be full transfers of title to the lessee.

There is statutory regulation of residential leases, limiting remedies, providing for rights to cure defaults, requiring the provision of essential services and regulating security deposits. There is, however, no direct rental amount regulation, except with respect to certain federally subsidised housing.

6.4 Typical Terms of a Lease

Lease terms vary based on the nature of the lease and the nature of the property subject to the lease. Typically, commercial leases have a term of between 10 and 30 years, with provisions for multiple optional extension terms that may double the initial lease term. Ground leases usually have much longer terms, ranging from 30 years to 99 years. Space leases typically have terms in the range of five years to 20 years.

It is typical for a tenant to be responsible for repair and maintenance obligations for all matters within their leased premises, while the landlord remains responsible for structural components of the building within which the leased premises sit, as well as facilities up to the point of connection with the leased premises.

Rent obligations are typically quoted in annual terms but payable monthly in equal instalments. In response to the COVID-19 pandemic, construction build-out terms have become more favourable to tenants, as landlords are willing to contribute larger sums toward tenant build-out plans in an effort to attract tenants while maintaining base rent values. It is much more common for "pandemics" to be included in the definition of force majeure, which has the consequence of excusing late performance of maintenance obligations by the landlord (and sometimes even the tenant), but it is less likely that a pandemic will excuse timely payment of rent or trigger a right of the tenant to abate rent.

6.5 Rent Variation

Most leases provide for periodic, automatic increases in rent during the lease term. The adjustments may occur each lease year or in some multiple thereof (eg, every five years). If the lease provides for renewal or extension terms, the rent will typically increase at the inception of each such additional term.

Leases for large retail businesses have traditionally included an "override", meaning that the tenant will, in addition to scheduled rent, owe additional rent calculated as a fixed percentage of its gross sales in excess of an agreed-upon baseline amount.

6.6 Determination of New Rent

Changes in rent are frequently based on negotiated fixed increases set forth in the lease at inception. Changes in rent may also be based upon changes in one or more measures of the consumer price index or other governmental indices of inflation.

6.7 Payment of VAT

There are no taxes or governmental levies payable with respect to rent in South Carolina, except that rent received by an owner will be included

in the gross income of the owner for general income tax purposes.

6.8 Costs Payable by a Tenant at the Start of a Lease

Tenants typically pay a security deposit equal to one or more months' rent at the inception of the lease. Alternatively, the landlord may require a letter of credit to serve as a security deposit. Tenants are also generally required to pay the first month's rent upon signing the lease.

6.9 Payment of Maintenance and Repair

Where there are multiple tenants in a property, the cost of maintenance and repair of the common areas (CAM charges) is divided among the tenants. Generally, each lease will specify a fixed, specified proportionate share of the CAM charges attributable to that tenant.

6.10 Payment of Utilities and Telecommunications

In most cases, utilities are directly metered to the separate tenant spaces and paid for by the tenant. Otherwise, where there are multiple tenants, each tenant is typically charged a percentage of the total utility bill based upon an agreed-upon percentage set forth in the lease at inception.

6.11 Insurance Issues

In most commercial leases, the tenant pays directly the cost of insurance on the leased premises. When there are multiple tenants, each tenant will pay its pro rata share based on its proportionate share as set forth in its lease. Alternatively, the landlord may pay the cost of insurance and be reimbursed on a monthly or annual basis by the tenants. With respect to ground leases, where the tenant typically owns the improvements, the tenant will pay the cost of insurance.

Most leased properties are insured against fire and other casualty. In larger projects, terrorism insurance may be included. In certain geographic regions, insurance will include one or more of earthquake, ground subsidence, windstorm and hail, and flood insurance. In addition, many owners of a leased property will carry rent loss and business interruption insurance.

6.12 Restrictions on the Use of Real Estate

Landlords are free to restrict the use of leased premises by way of restrictive provisions in the leases. In addition, the permitted uses of leased premises will always be subject to general zoning and use limitations applicable to the location of the leased premises irrespective of the provisions of the lease.

6.13 Tenant's Ability to Alter and Improve Real Estate

Whether a tenant may alter or improve the lease premises is governed by the terms of the lease. Typically, a lease will expressly prohibit alteration or improvement of the lease premises without the prior written consent of the landlord. If alteration or improvement is allowed, the landlord will require indemnity against mechanic's liens and other liability from the tenant and require the payment of any additional insurance premiums resulting from the alteration or improvement. The construction or alteration of leased premises will also be subject to the general construction and permitting requirements of the jurisdiction.

6.14 Specific Regulations

There are safety regulations applicable to high-density uses, such as multifamily properties, hotels, and office buildings, including requirements for smoke detectors, sprinkler systems, isolated stairwells, firewalls, and general resistance.

High-risk uses may be subject to special regulation by the US Department of Homeland Security. For example, chemical manufacturing facilities may be subject to the Chemical Facilities Anti-Terrorism Standards regulations promulgated by the US Department of Homeland Security. These requirements typically include fencing and screening adequate to limit access and sightlines onto the property.

Commercial real property that is to be used for the sale or consumption of alcoholic beverages is subject to regulation under state law as to whether such sale or consumption is permitted on the property. Otherwise, except for generally applicable zoning and land-use regulations, there are no specific regulations or laws that apply to particular categories of commercial real property leases.

6.15 Effect of the Tenant's Insolvency

Insolvency

An insolvent tenant who fails to pay rent when due may be evicted from the property, and the landlord may terminate the lease. A landlord may also recover past-due rent and damages arising from the tenant's failure to pay future rent.

Bankruptcy

A tenant in bankruptcy, however, will generally have the right to reject any lease determined to be burdensome to the tenant, and as a result of such rejection, the lease will terminate. Further, a tenant's bankruptcy will result in an automatic stay prohibiting acts to enforce the lease or evict the tenant without prior bankruptcy court approval.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Typical protections obtained by a landlord against the defaulting tenant include the taking of a security deposit or obtaining a letter of credit at the inception of the lease and requiring that a solvent third party execute a guaranty of the tenant's obligations under the lease.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant has no right to possession after termination of the lease and may be evicted by appropriate court procedures. If the lease so provides, a tenant holding over beyond the expiration of the term may be liable for rent during the holdover period at some multiple of the original rental amount.

6.18 Right to Assign a Leasehold Interest

Assignment and sublease provisions are generally included in leases, but where they are omitted, the majority rule is that the lease can be freely assigned or sublet; however, South Carolina takes a minority position for subletting, requiring consent from the landlord for a tenant to sublease where the lease is silent (S.C. Code Title 27, Chapter 35). It is common for leases to restrict assignment and subleasing but carve out limited exceptions in the event of an assignment or sublease to a related entity (eg, in connection with a reorganisation of the tenant entity) or in the event of an assignment to a successor entity (eg, the tenant entity is acquired by a third party). Where assignment or subletting is permitted in the lease, it would be typical for the landlord to require evidence of adequate net worth from the proposed assignee or sublessee, and the landlord may not agree to release the assignor from backstopping the assignee if the

assignee fails to satisfy their lease obligations after assignment.

6.19 Right to Terminate a Lease

A landlord has a statutory right to terminate the lease upon non-payment of rent. Most commercial leases also contain a detailed list of defaults that will allow the landlord to terminate the lease and evict the tenant. These defaults frequently include the non-payment of rent, the failure to maintain the premises, the unauthorised use of the premises, the unauthorised assignment of the lease, the unauthorised subleasing of the premises, a violation of environmental laws with respect to the premises, abandonment of the premises, and the insolvency of the tenant.

Investors should consult with South Carolina counsel to verify that the list of defaults in a commercial lease is appropriate and sufficient.

6.20 Registration Requirements

South Carolina does not require that the lease itself be notarised, but a memorandum of lease requires notarisation to be recorded. If the lease permits the recordation of a memorandum of lease, the tenant typically bears the cost of the de minimis recording fees, and it would be worthwhile for the tenant to co-ordinate same, as recording the memorandum of lease puts third parties on notice of tenant's occupancy rights and can be used to provide notice of special lease terms such as a purchase option.

6.21 Forced Eviction

If the lease contains appropriate language, a tenant in default under a lease may be evicted prior to the expiration of the lease by way of a summary eviction proceeding. Eviction proceedings typically take between several weeks and several months to complete.

6.22 Termination by a Third Party

Condemnation of property that is subject to a lease will result in termination of the lease. As between the property owner and any tenant, a condemnation award is divided in accordance with the terms of the lease. Absent a governing provision in the lease, the allocation of the award between landlord and tenant will be decided by the courts.

6.23 Remedies/Damages for Breach

In the event of a tenant breach that results in termination of the lease, a residential landlord is obligated to mitigate damages in South Carolina (S.C. Code Title 27, Chapter 40), which in general, means that the landlord must try to replace the tenant instead of simply collecting rent from the breaching tenant. If, despite efforts to mitigate, the landlord is unable to replace the tenant, the tenant would still be liable for the rent owed, and may also owe the landlord for its costs incurred in seeking to have the tenant replaced. It is typical for a landlord to hold a security deposit, usually equal to one month's rent, and although letters of credit are sometimes used, cash deposits are more common.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The most common form of construction contract pricing is the use of a fixed-price contract. Also used are cost-plus contracts, with general contractor compensation based either on a percentage of total costs or a negotiated fixed-fee basis.

7.2 Assigning Responsibility for the Design and Construction of a Project

In most projects, design responsibilities are separated from construction responsibilities

– commonly referred to as "design-bid-build". Typically, the design function is assigned to third-party architects. Less frequently, a design-build contract is used, in which the contractor itself provides the design services.

7.3 Management of Construction Risk

Management of construction risk is largely through the use of third-party inspectors; ie, architects or other construction professionals. These inspectors make periodic inspections – typically coincident with each construction loan draw or advance – and assess the percentage of completion and verify that the improvements on the ground are consistent with the amount of funds disbursed to date. The use of fixed-price contracts with appropriate delay penalties is another method of addressing construction risk.

Another common approach for the management of construction risk by lenders is to require a guaranty of completion from a parent or other affiliate of the owner entity. Lenders also typically require a substantial equity investment either prior to or coincident with advances of construction loan proceeds. The equity investment may or may not be segregated and pledged to a lender.

Additional equity deposits are frequently required by lenders in the event a construction loan becomes "out of balance".

7.4 Management of Schedule-Related Risk

Schedule-related risk in construction projects is managed by use of third-party inspectors and the inclusion in the underlying construction contract of substantial penalties for delays in meeting intermediate milestone dates and the completion date. In addition, lenders frequently incorporate construction milestones into the financing documents.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Owners frequently seek additional assurance as to performance by contractors by way of a payment and performance bond issued by surety. The use of letters of credit in construction projects in South Carolina is not common.

7.6 Liens or Encumbrances in the Event of Non-payment

Persons performing work or providing materials with respect to construction and development of property who are not paid for such work or materials are entitled to file a lien on the property as security for the amounts owed. In addition, liens may be filed by persons providing security services, by surveyors, by leasing (but not selling) real estate brokers, by persons providing landscaping services, and by persons providing design services (architects and engineers).

Mechanic's liens may be discharged from the real property by the posting of a bond; the lien then attaches to the bond and is released from the real property. Further, in a proper circumstance a court may order the removal of a mechanic's lien.

7.7 Requirements Before Use or Inhabitation

Buildings may not be occupied until a certificate of occupancy has been issued. The requirements for obtaining a certificate of occupancy include the inspection of the major functional portions of the building (including electrical and plumbing) during the construction process and verification that construction was done in accordance with the approved plans and specifications.

8. Tax

8.1 VAT and Sales Tax

The gain on the sale of real estate is taxed as income under general state and federal income tax laws. In addition, there is a transfer tax levied on transfers of ownership of real estate evidenced by deeds, which is typically paid by seller, and the rate is USD1.85 per USD500 of the sales price, subject to limited statutory exemptions. There is no sales tax on the sale of corporate real estate.

8.2 Mitigation of Tax Liability

In some cases, transfer tax (deed recording fee) may be avoided or reduced by structuring the transaction appropriately. For example, the deed recording fee may be avoided by contributing the property to be sold to a single-member LLC and then selling the equity in that single-member LLC to the economic purchaser of the property.

8.3 Municipal Taxes

Although in most jurisdictions there is a business license tax assessed against businesses at the county and city level, this tax is based on gross revenues of the business in the jurisdiction and not on the property per se. The ownership and operation of real property would constitute a business subject to this business license tax.

In addition, commercial properties may be subject to solid waste disposal, stormwater, and other user fees. South Carolina law also allows for special assessments of property for adjacent improvements (such as street paving). There are no specific occupancy taxes or taxes on rent other than ordinary state and federal income taxes.

8.4 Income Tax Withholding for Foreign Investors

Foreign purchasers of real estate should review whether applicable treaties exempt such purchaser from the imposition of general income tax withholding requirements by the state of South Carolina or the United States on income from the property purchased or on proceeds from the resale of such property. Absent such a treaty-based exemption, it may be possible to use appropriate transaction structures, such as “blocker” corporations, to limit the tax liability and withholding obligations with respect to foreign investors.

Under the federal Foreign Investment in Real Property Tax Act, up to 15% of the proceeds from the sale of real property by a foreign seller may be required to be withheld from the foreign seller to be applied to federal income taxes.

In addition, under South Carolina law, foreign investors that are deemed “non-resident sellers” may be subject to withholding with respect to the proceeds of the sale of South Carolina real property to the extent of the gain recognised by the investor under the income tax laws. South Carolina law provides that “non-resident sellers” include individual residents outside of the state, entities organised outside of the state, and trusts administered outside of the state. An entity formed under the laws of South Carolina is considered a resident; accordingly, taking title to South Carolina property in a South Carolina-organised subsidiary may avoid any otherwise applicable requirement for the withholding of a portion of the proceeds of the sale of the property. There are limited exceptions to this withholding requirement for foreign investors who qualify as “deemed residents”.

8.5 Tax Benefits

South Carolina is known for taking an aggressive approach to economic incentives for businesses opening and conducting operations in the state. These incentives include both tax credits and the reduction of property taxes and are typically based on the size and scope of the operation, the number of jobs created, and the wages those jobs command, as well as the facility's geographic location within the state. South Carolina counsel working in this area should be consulted to assist in structuring incentive packages, which may include fee-in-lieu-of-tax agreements, job tax credits, payroll tax rebates, tax abatements, capital credit agreements, tax increment financing, and various types of infrastructure grants.

The owner of real property is generally entitled to take deductions for depreciation with respect to buildings and improvements located on the land. In addition, investors in real property who are not dealers in that property and have met the requisite holding periods may be entitled to defer the recognition of gain on the sale of real property by entering into a like-kind exchange pursuant to Section 1031 of the Internal Revenue Code. Finally, property owners who invest the capital gain proceeds from the sale of real property into an opportunity zone project may defer or reduce the amount of gain ultimately recognised.

Developers can also benefit from South Carolina-specific tax credits related to historic building rehabilitation and abandoned building revitalisation. Real property owners who develop solar farms on their property may be entitled to state and federal tax credits.

USA - TEXAS



Law and Practice

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Haynes and Boone, LLP is a top-ranked international law firm, with nearly 700 lawyers in 19 offices spanning Texas, New York, California, Charlotte, Chicago, Denver, Virginia, Washington DC, London, Mexico City, and Shanghai, providing a full spectrum of legal services in energy, technology, financial services and private equity. The more than 50 lawyers in Haynes Boone's real estate practice group understand the dynamics of today's real estate market both locally and nationally. Its lawyers maintain a strong track record representing clients on acquisitions, dispositions, joint venturing, financing and development of properties and real estate portfolios in Texas and throughout the United States. The group also advises developers and institutional investors in joint ventures, with a particular focus on projects that include both taxable and tax-exempt ventures. Examples of representative clients include Hillwood Development Company, Harwood International Incorporated, The Howard Hughes Corporation, Trive Capital, Trammell Crow Residential, and Comerica Bank.

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HAYNES BOONE

1. General

1.1 Main Sources of Law

In Texas, the main sources of real estate law include state statutes, case law (ie, court decisions), and administrative regulations. Key statutes include the Texas Property Code, which addresses a wide range of property issues including ownership, land use, and landlord-tenant relationships. These laws are supplemented by common law principles that have evolved through case law over time. Additionally, Texas real estate practices are influenced by federal laws in areas such as fair housing, and financing and federal and state laws on environmental regulation. Local ordinances also play a significant role, particularly in zoning, building codes, and property taxes.

1.2 Main Market Trends and Deals

The Texas commercial real estate market in 2024 has demonstrated a mix of resilience and challenges influenced by various economic factors and regional differences.

Market Stability and Performance

The market has shown stability, particularly in industrial and multi-family properties. Industrial real estate remains robust, supported by e-commerce demand, with significant construction activities, especially in the Dallas-Fort Worth area. This region saw about 67 million square feet of industrial properties under construction, indicating a strong market with stable rental rates and land prices.

Office Space

The office market presents mixed signals with a general trend towards stabilisation. North Texas, in particular, shows resilience with a healthy pace of leasing, especially in smaller and Class B office spaces. The return-to-work movement has helped stabilise this sector.

Economic and Policy Influences

The market faces potential pressures from high inflation and interest rates, influencing investment and refinancing activities across real estate sectors. The Texas legislature passed an act to cut property taxes resulting in a projection of over USD18 billion saved by taxpayers, aiming to keep home ownership attainable and sustainable.

1.3 Proposals for Reform

Recent proposals for reform in Texas's real estate sector have focused on providing tax relief to homeowners and businesses. The Texas Legislature passed an act to cut property taxes resulting in a projection of over USD18 billion saved by taxpayers, aiming to keep home ownership attainable and sustainable. Key components of the reform include:

- a homestead exemption to more than double the current exemption, aiming to lower the taxable value of homes and thereby reduce property taxes for homeowners;
- a temporary, heightened appraisal cap for commercial, mineral, and residential properties not otherwise eligible for a homestead exemption, intended to limit the annual taxable value increase for the next three years, with the programme slated to end in 2026 unless extended; and
- franchise tax exemptions are part of the package, intending to substantially increase the revenue threshold for businesses required to pay franchise tax.

2. Sale and Purchase

2.1 Categories of Property Rights

In Texas, various categories of property rights can be acquired, including the following.

- Fee Simple Absolute – this is the highest form of ownership interest and grants the owner complete control and rights over the property for an indefinite period.
- Life Estate – in this type of ownership, the owner holds rights to the property only for the duration of their life or the life of another person.
- Leasehold Estate – this involves possessing the property for a specific period under a lease agreement. The rights are limited to the terms outlined in the lease.
- Mineral Rights – these rights pertain to the ownership of minerals or resources beneath the surface of the property.
- Easements – these are rights to use or access someone else's property for specific purposes, such as utilities, access, or drainage.
- Licences – similar to easements, licences grant permission to use another person's property for a specific purpose, but they are revocable at any time.
- Air Rights – these rights allow the owner to use the space above the property, often for construction or airspace leasing.

2.2 Laws Applicable to Transfer of Title

In Texas, the transfer of real estate title is governed primarily by state laws, which include the Texas Property Code. These laws cover a broad range of real estate transactions, including the sale and purchase of residential, industrial, office, retail, and hotel properties. While the general legal framework for transferring title applies to all types of real estate, there may be specific considerations or additional regulations for certain types of properties, such as zoning laws for commercial properties or residential housing standards.

Formatting requirements for real estate documents to be recorded in the real property records, the documents required for transfers, and enforcement of statewide rules can also vary on a county-by-county basis in Texas. Special laws or ordinances at the local level may also impact the transfer of certain types of real estate, addressing issues like land use, building codes, and environmental assessments.

2.3 Effecting Lawful and Proper Transfer of Title

In Texas, a lawful and proper transfer of title to real estate is effectuated through the execution of a deed, which must be delivered and accepted. Deeds are recorded in the county real property records in which the property is located to provide public notice and protect the interests of both parties. Title insurance is common in Texas to protect against defects in the title. During the COVID-19 pandemic, Texas implemented new procedures, including remote notarisation and electronic recording of documents, to accommodate restrictions on in-person transactions, and many of these processes remain in use.

2.4 Real Estate Due Diligence

Commercial real estate due diligence for Texas properties typically involves a comprehensive evaluation of the property, including its legal, financial, and physical aspects. This process usually includes title search and title insurance to verify ownership and check for liens or encumbrances, property and environmental inspections to assess the condition and identify potential issues, review of local zoning and land use regulations to ensure compliance and understand permissible uses, and financial analysis of

income-producing properties. One example of routine environmental due diligence in Texas is that many purchasers will often conduct a Phase I environmental site assessment.

2.5 Typical Representations and Warranties

In Texas, as in other jurisdictions, typical representations and warranties in a commercial real estate transaction might include the legal authority to sell, the absence of liens or encumbrances, compliance with laws (including zoning and environmental laws), and the condition of the property. A seller's warranties provided under statutes may include disclosures about the property's condition, but these vary.

A buyer's remedies for misrepresentation typically include rescission of the sale, damages, or specific performance. Caps on liability vary and are subject to negotiation. Representation and warranty insurance is increasingly used to mitigate risks associated with potential breaches of representations and warranties. Pursuant to Section 16.070(a) of the Texas Civil Practice & Remedies Code, any representation or warranty made in an agreement must survive for a minimum period of two years. To satisfy statutory requirements, purchase agreements will commonly state explicitly that all representations and warranties have a survival period of at least two years and a day. During the COVID-19 pandemic, there might have been new representations and warranties regarding the health and safety measures taken at the property or the impact of the pandemic on the property's use and occupancy on case-by-case basis, but substantial shifts in the market arising from the pandemic have so far failed to materialise.

2.6 Important Areas of Law for Investors

In Texas, key areas of law for a real estate investor to consider include property law (covering aspects like title, ownership types, and property rights), contract law (for sale and lease agreements), zoning and land use regulations (determining how property can be developed or used), environmental laws (addressing potential contamination and liability issues as well as conditions that could restrict development such as endangered species), and tax law (including property taxes and implications for investment structures).

2.7 Soil Pollution or Environmental Contamination

In Texas, as in many jurisdictions, buyers can potentially be held responsible for existing environmental contamination on a property they purchase, even if they did not cause the pollution. This is due to laws that aim to ensure contaminated sites are cleaned up, regardless of the current owner's role in causing the contamination. While defences to this type of liability are limited and the state defences differ somewhat from the federal defences, many of the available defences turn on performing appropriate due diligence, such as a Phase I, prior to purchase (or in the case of a tenant, lease). Further, the Texas Commission on Environmental Quality administers the Voluntary Cleanup Program, which can provide protection to a prospective purchaser who enters the programme prior to purchase, and the Innocent Landowner Program, which provides protection to owners of land contaminated by contamination migrating from an unaffiliated adjacent parcel of land.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

In Texas, buyers can ascertain the permitted uses of a parcel of real estate under applicable

zoning or planning law by consulting with local municipal or county zoning offices, where they can access zoning maps and ordinances. It's also possible to request zoning verification letters for specific properties. Moreover, buyers can enter into specific development agreements with relevant public authorities to facilitate a project. These agreements can outline the development conditions, infrastructure improvements, and other project specifics, and they often require approval from local government bodies.

2.9 Condemnation, Expropriation or Compulsory Purchase

In Texas, governmental entities and quasi-governmental entities (eg, municipal utility districts (MUDs) and school districts) have the power to take land through condemnation, expropriation, or compulsory purchase for public use, known as eminent domain. The process typically involves the government entity providing notice to the property owner, making an offer to purchase the property and, if necessary, filing a condemnation lawsuit. The owner is entitled to receive just compensation for the property taken.

2.10 Taxes Applicable to a Transaction

Generally, in Texas, real estate transactions do not incur transfer, recordation, stamp, or similar taxes that are common in other states. The sharing of transaction costs between buyer and seller, including title insurance, escrow fees, and others, is typically negotiated in the purchase agreement. In the case of share deals or transfers of interest in property-owning entities, these transactions are subject to federal and state capital gains taxes, not specific transfer taxes. Typically, sellers of a property will pay for the base policy premium of the owner's policy of title insurance, buyers for any desired endorsements (which are limited in scope in Texas compared to many other states), and escrow fees will be split among the parties.

2.11 Legal Restrictions on Foreign Investors

In Texas, there are no specific legal restrictions on foreign investors acquiring real estate purely based on their nationality. However, foreign investors must comply with applicable US federal laws.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Generally, acquisitions of commercial real estate in Texas can be financed through a variety of methods including traditional bank loans, commercial mortgage-backed securities, life insurance companies, private lenders, and seller financing. For large real estate portfolios or companies holding real estate, financing options may also include syndicated loans from multiple lenders, mezzanine financing, and equity financing from investment funds. Each financing method comes with its own set of terms, conditions, and costs, which can vary based on the size of the transaction, the risk profile of the investment, and the financial standing of the borrower.

3.2 Typical Security Created by Commercial Investors

Generally, in Texas, commercial real estate investors often secure financing through mortgage loans, where the real estate itself serves as collateral. This involves creating a lien on the property in favour of the lender. The grant of a secured interest in the property to the lender is typically memorialised in a deed of trust. Pursuant to the Texas Assignment of Rents Act, codified as Section 64.052(b) of the Texas Property

Code, lenders do not need to file a separate assignment of rents in addition to the deed of trust to perfect a security interest in the rents for a given property as recordation of the deed of trust automatically perfects such an interest.

Other common securities include mezzanine financing, which is secured by equity interests in the entity that owns the real estate. Developers might also use construction loans for development projects, which are disbursed in stages based on construction progress and in addition to collateral assignments of agreements related to the design and construction of the projects are secured by a deed of trust.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

Generally, in the United States, including Texas, there are not significant restrictions on granting security over real estate to foreign lenders compared to domestic lenders. Both foreign and domestic lenders can take security interests in real estate.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

In general, when securing real estate with a deed of trust or other security instruments in Texas, parties might incur certain costs such as recording fees for the deed of trust in county records to perfect the lien, and notary fees for the execution of documents. Texas does not impose a documentary stamp tax on mortgages or deeds of trust, which differentiates it from other states. Similar to recording fees generally, fees imposed for granting or enforcing a secured interest in real property will vary by county.

3.5 Legal Requirements Before an Entity Can Give Valid Security

In Texas, the main legal requirements before an entity can provide valid security over its real estate assets involve ensuring the security agreement is in writing, signed by the party granting the security interest (debtor), and reasonably identifies the secured property. The security interest is typically "perfected" through filing a financing statement with the appropriate government office to put third parties on notice. While Texas does not specifically enforce "financial assistance" rules as known in other jurisdictions, the transaction must not violate any statutes, including without limitation any provision of the Texas Business Organizations Code or prohibitions on usurious interest in the Texas Finance Code.

3.6 Formalities When a Borrower Is in Default

When a borrower defaults on a mortgage loan for property in Texas, the foreclosure process typically involves non-judicial means. The foreclosure process starts with the borrower signing a promissory note and a deed of trust, which includes a power of sale clause allowing the lender to sell the property non-judicially if the borrower fails to make payments. Upon default, the lender must send a notice of default and intent to accelerate, giving the borrower at least 20 days to cure the default. After this period, a Notice of Sale must be mailed to the borrower at least 21 days before the foreclosure sale, also being posted at the courthouse door and filed with the county clerk.

The foreclosure sale itself is public, with the highest bidder becoming the new owner of the property. Texas law does not provide a right to redeem the property after a foreclosure sale. However, borrowers have specific rights, includ-

ing the possibility to reinstate the loan within 20 days after receiving the notice of default and intent to accelerate. Also, lenders may seek a deficiency judgment if the sale does not cover the total debt, but borrowers can challenge the deficiency amount by proving the fair market value of the property. Federal and state laws offer protections and options for loss mitigation, such as loan modifications, forbearances, or repayment agreements.

Foreclosure activity in Texas, along with other states, has seen a significant uptick in the wake of the COVID-19 pandemic. This uptick represents a continuation of the rising trend in foreclosure activities, gradually moving towards pre-pandemic levels. Despite this increase, the foreclosure activity remains below the historical norms observed before the Great Recession, signalling that while there is a rise, it has not reached the peak levels of the past.

3.7 Subordinating Existing Debt to Newly Created Debt

In Texas, it is possible for existing secured debt to voluntarily become subordinated to newly created debt. This process is typically managed through a subordination agreement, which is a legal document that establishes a hierarchy of debt and priority of repayment for multiple creditors. This kind of agreement is particularly used when there are multiple loans secured by the same property, and the parties involved want to establish the order in which their claims will be satisfied in the event of default or foreclosure.

3.8 Lenders' Liability Under Environmental Laws

In Texas, a lender holding security interests in real estate are generally exempt from liability for environmental contamination on the property as long as they do not participate in the management of the facility or worsen the contamination, as well as take certain steps with respect to divesting itself of the property after a foreclosure. At the federal level, the Comprehensive Environmental Response, Compensation and Liability Act outlines this exemption, focusing on the lender's role as not being an "operator" or actively managing environmental aspects of the property. This allows lenders to minimise risks associated with loans secured by properties that may have environmental challenges. Texas environmental law offers similar lender liability protections.

3.9 Effects of a Borrower Becoming Insolvent

In Texas, security interests created by a borrower in favour of a lender generally remain valid even if the borrower becomes insolvent. The filing of bankruptcy by a borrower can introduce complexities, such as the automatic stay on collection activities, but it does not automatically void existing security interests. Lenders may need to seek relief from the bankruptcy court to enforce their security interests in such situations.

3.10 Taxes on Loans

Texas does not impose a mortgage tax on the recording of mortgages or deeds of trust. Recording fees are typically required for the recording of mortgages and deeds of trust in the county where the property is located. These fees vary by county and are intended to cover the cost of entering the document into the public record, ensuring it is accessible for public inspection.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

In Texas, planning and zoning laws are generally governed by Title 7 of the Texas Local Government Code, which grants municipalities and counties the authority to enact zoning and planning regulations. These local entities have the power to regulate land use to promote public health, safety, and general welfare. Specific controls may include zoning ordinances, comprehensive plans, subdivision regulations, and other development standards.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

In Texas, the design, appearance, and construction methods of new buildings or the refurbishment of existing buildings are regulated by various state laws and local ordinances. These regulations often include zoning ordinances and regulations and building codes, which set minimum standards for construction to ensure safety, health, and sometimes even aesthetic conformity. Local municipalities may have specific ordinances regarding the architectural style, height restrictions, and materials used in construction to preserve historical character or maintain a certain community aesthetic.

4.3 Regulatory Authorities

The development and use of Texas real estate are primarily regulated by local governments through zoning ordinances and development codes. These local regulations determine how land can be used, the types of buildings allowed, their sizes, and their placement on a lot. The Texas Local Government Code provides the statutory framework for these local regulations. Planning and zoning commissions, city councils, and county commissioners' courts typically oversee these regulations.

4.4 Obtaining Entitlements to Develop a New Project

In Texas, obtaining entitlements for new developments or major refurbishments typically involves submitting detailed plans and applications to local planning or development departments. These applications are reviewed against zoning regulations, building codes, and other local ordinances. Public hearings and meetings may be part of the process, allowing for community input and objections. Approval from planning commissions, city councils, or other regulatory bodies may be required, and conditions or modifications might be imposed to address planning concerns or public feedback.

4.5 Right of Appeal Against an Authority's Decision

The Texas government generally recognises a right of appeal against decisions made by local or state authorities regarding applications for development or land use. This can include decisions on zoning, permits, and other regulatory approvals.

4.6 Agreements With Local or Governmental Authorities

It is common for developers operating in Texas to enter into agreements with local, governmental, or quasi-governmental authorities to facilitate development projects. These agreements, such as development agreements and public improvement agreements, can address infrastructure improvements, utility services, and compliance with zoning and planning requirements. For larger projects or planned unit developments, agreements might also involve land dedication for public use, transfers of devel-

opment rights, or concessions regarding density and design standards to ensure the project aligns with local development goals and community needs.

4.7 Enforcement of Restrictions on Development and Designated Use

In Texas, enforcement of restrictions on development and designated use is typically carried out by local government agencies through zoning and planning regulations. These agencies have the authority to review and approve development projects, ensuring compliance with local zoning laws, land use plans, and building codes. Violations can lead to penalties, including fines, stop-work orders, or requirements to modify or demolish non-compliant construction.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The types of entities available to investors for holding real estate assets in Texas include corporations, limited liability companies (LLCs), partnerships (including general partnerships, limited partnerships, and limited liability partnerships), tenancies in common (TICs), Delaware statutory trusts (DSTs), condominiums, and professional entities. Each type offers different benefits, operational structures, and tax implications.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

When it comes to investing in real estate in Texas, various entities are available that each offer specific benefits, especially concerning tax implications and liability protection.

C-Corporations and S-Corporations

These are popular choices, with S-Corps being particularly beneficial for developers because they can reduce self-employment tax liability by distinguishing between W-2 wages and distributions. However, S-Corps have limitations on the number and type of shareholders they can have and strict protocols for payroll and profit distribution must be followed to avoid double taxation common in C-Corps.

LLCs

LLCs are often a preferred choice due to their flexibility in management and favourable pass-through tax treatment, which avoids the double taxation that corporations may face. The LLC structure allows profits and losses to pass directly to the members, avoiding corporate taxes, while still providing liability protection.

Partnerships

Partnerships are also available as options. In general partnerships, all partners are considered equal owners and share responsibility for managing the business. Limited partnerships, on the other hand, consist of at least one general partner, who manages the partnership and has unlimited liability, and one or more limited partners, who contribute capital and have liability limited to the extent of their investment. Both entities benefit from pass-through taxation, avoiding corporate tax levels and allowing profits to be taxed at the individual partner level. Both partnership types have their place in real estate investment, with the choice largely depending on the level of involvement and liability the partners are willing to assume.

TICs

TICs allow two or more parties to hold title to real estate. Each tenant in common holds an individual, undivided ownership interest in the property

that can be sold, transferred, or bequeathed to heirs. Each tenant in common can independently control their share of the property without the need for consent from the other owners, subject to any agreements made among the co-owners. Income and expenses from the property are reported based on each owner's respective share. If the property generates rental income, each co-owner reports their share of the income on their personal tax returns.

DSTs

DSTs are separate legal entities created as a trust under Delaware statutory law, which allows for fractional ownership of property by investors. DSTs are treated as grantor trusts for tax purposes, meaning the DST itself is not taxed. Instead, all income and deductions flow through to the investors, who report these on their individual tax returns. DSTs are often used in 1031 exchanges because they qualify as like-kind property. This allows investors to defer capital gains taxes by reinvesting the proceeds from the sale of a property into a DST.

Condominiums

Condominiums involve ownership of a specific unit within a larger property. The owner has title to the interior space of the unit but not to the land or common areas, which are owned collectively with the other condo owners. Condominium owners pay property taxes on their individual unit(s) and will typically also pay a fee to any homeowner's association formed to manage the larger property.

5.3 REITs

REITs are recognised in Texas as a popular investment vehicle, offering both public and private forms. These vehicles are accessible to foreign investors and provide a structured way to invest in real estate assets without directly managing properties. REITs in Texas, like elsewhere in the United States, must adhere to specific federal tax requirements to qualify and maintain their REIT status, including being organised as a corporation, trust, or association, and meeting income distribution and asset investment thresholds related to real estate. The benefits of REIT status include significant tax advantages, as a qualifying REIT can deduct dividends paid to its shareholders, potentially avoiding corporate tax. This allows REITs to attract both tax-exempt and foreign investors.

5.4 Minimum Capital Requirement

In Texas, the minimum capital required to set up each type of entity used for real estate investment varies depending on the specific entity structure chosen. For instance, the formation of a corporation, LLC, or partnership does not have a specified minimum capital requirement by law.

5.5 Applicable Governance Requirements

Entities used for Texas real estate investment, including without limitation general partnerships and limited partnerships, need to comply with governance requirements as stipulated in the Texas Business Organizations Code, in addition to federal specifications.

5.6 Annual Entity Maintenance and Accounting Compliance

Operating both domestic and foreign, or out-of-state, entities in Texas for the purpose of investing in real estate involves various accounting and compliance costs. Each taxable entity formed or organised in Texas or doing business in the state is subject to the franchise tax. Tax rates vary based on entity type and income, and entities below a certain income threshold need not pay the franchise tax but still must file a "no tax due" report. Entities organised in Texas must

pay a nominal fee, usually several hundred dollars, upon formation, while foreign entities doing business in Texas must pay a fee of similar size to register.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Texas law recognises several types of arrangements for the use of real estate without outright purchase. These arrangements include leases, which can be for residential or commercial properties, and licence agreements that permit the use of property for specific purposes without transferring ownership. Additionally, easements grant the right to use a portion of another's property for a particular function, such as access or utility placement, and are another form of recognised arrangement.

6.2 Types of Commercial Leases

There are several types of leases applicable in Texas, including without limitation the following.

Gross Lease

This type of lease involves a tenant paying an annual flat fee that covers both the rent and yearly operating expenses like utilities, cleaning services, and taxes. A variation, known as a modified gross lease, may see tenants responsible for some building operational costs not included in the annual fee.

Percentage Lease

Commonly used for retail spaces, this lease type includes base rent and operating expenses, with the addition of a percentage of the business's monthly gross sales. This structure aligns the landlord's interests with the tenant's sales performance.

Net Lease

This is particularly prevalent in commercial properties. Tenants pay base rent plus a share of operating costs, with the specifics varying by the lease type. Net leases can be single net (tenant pays base rent and property taxes), double net (tenant also pays insurance), or triple net (tenant pays base rent, property taxes, insurance, and possibly other expenses like utilities and maintenance).

6.3 Regulation of Rents or Lease Terms

In Texas, rents and lease terms are generally freely negotiable between landlords and tenants without widespread state-level rent control or regulation. However, local ordinances may impose specific regulations, and any adjustments or protections introduced during the COVID-19 pandemic would be subject to local jurisdiction decisions. For the most part, commercial and residential rental agreements in Texas are determined by the lease terms agreed upon by the parties involved.

6.4 Typical Terms of a Lease

Commercial lease terms, including rent, are generally freely negotiable between the landlord and tenant without extensive regulation by the Texas state government. While there are laws protecting against discrimination and ensuring basic contractual fairness, the specific terms, including rent amounts and lease durations, are largely determined by the parties involved and market conditions. Regarding the COVID-19 pandemic, there have been temporary measures and moratoriums on evictions in various jurisdictions, but these are temporary and vary locally rather than being permanent or state-wide regulations.

6.5 Rent Variation

The rent payable under a lease can remain the same or change, depending on the lease terms agreed upon by the landlord and tenant of Texas properties. Fixed leases keep the rent the same throughout the lease term and are less common in practice, while most leases include escalation mechanisms for rent increases at specified intervals or based on certain criteria, such as inflation rates or operational costs.

6.6 Determination of New Rent

The determination of new rent after an increase depends on the terms specified in the lease agreement. Common methods include fixed percentage increases, adjustments based on inflation or consumer price index (CPI), or market rent reviews where the new rent is aligned with current market rates. Leases also include predetermined incremental increases at specified intervals. The exact method and criteria for rent adjustments should be clearly outlined in the lease documentation.

6.7 Payment of VAT

Texas does not impose a VAT (or equivalent tax) on the sale or purchase of real estate.

6.8 Costs Payable by a Tenant at the Start of a Lease

At the start of a lease in Texas, tenants typically face various costs beyond just the rent. These costs can include a security deposit, which the landlord holds as a form of "insurance" against damage or non-payment by the tenant. Under Texas law, security deposit must be refunded within 60 days of vacating the premises under a commercial lease (30 days under a residential lease), provided the tenant has not caused damage beyond normal wear and tear and has paid all amounts due and payable pursuant to the lease.

6.9 Payment of Maintenance and Repair

In Texas, the maintenance and repair responsibilities in a commercial lease vary, but generally, landlords are responsible for maintaining the property's structural integrity, while tenants are expected to take care of interior maintenance and repairs. This delineation ensures the property remains habitable and safe for tenants, while also outlining that tenants are responsible for keeping their specific leased space in good condition. This standard is quite common in commercial leases and helps to prevent legal disputes by making it clear who is responsible for what types of maintenance and repair work.

6.10 Payment of Utilities and Telecommunications

A common practice for Texas properties with a single tenant is for the tenant to contract directly for utility and telecommunications services and pay the cost for those services. For multi-tenant properties with common utilities, landlords often give tenants the right to install separate meters (but it is often negotiable whether the landlord or tenant pays for utilities or telecommunications).

6.11 Insurance Issues

In Texas, the responsibility for insuring real estate subject to a lease typically falls on both the landlord and the tenant, with each party having specific obligations. Landlords generally require tenants to carry commercial rental insurance, including liability insurance, to protect against accidents or injuries occurring within the leased space. This requirement helps ensure that landlords are not financially responsible for incidents arising out of the tenant's business operations.

The COVID-19 pandemic's unprecedented nature means there is little existing legal precedent for such scenarios. Tenants and landlords are still navigating this complex territory,

with tenants seeking relief under doctrines like "impracticability" and "frustration of purpose" in the absence of specific force majeure provisions that mention pandemics. The outcome of these legal challenges is still pending in many cases and may set important precedents for business interruption coverage and force majeure applicability in future pandemics.

6.12 Restrictions on the Use of Real Estate

Landlords have broad authority to impose restrictions on how a tenant may use real estate under a lease in Texas. For example, in the use provision of a lease for a commercial property, the landlord may stipulate the types of business for which a tenant may use the property and allow the landlord to declare the tenant to be in default under the lease for any violation of the use provision by the tenant. Local zoning and land use laws comprise another layer of restrictions limiting how real estate may be used.

6.13 Tenant's Ability to Alter and Improve Real Estate

In Texas, the ability of a tenant to alter or improve leased real estate largely depends on the terms agreed upon in the rental agreement. Any modifications to the lease, including those allowing alterations or improvements by the tenant, should be discussed with the landlord and incorporated into the agreement. While Texas law does provide broad rights around health, safety, and security, including the repair of conditions materially affecting these areas, specific rights or obligations related to property alterations or improvements are not explicitly covered in the general tenants' rights overview provided by the Texas Attorney General's Office. For detailed guidelines on alterations or improvements, tenants should refer to their specific lease agreements and negotiate terms directly with their landlords.

6.14 Specific Regulations

In Texas, regulations and laws governing leases vary by the category of real estate, such as residential, commercial (which includes industrial, offices, and retail), and others like hotels. What follows is an overview of how laws and regulations apply to different types of real estate leases and any distinctions related to COVID-19 legislation.

Commercial Tenancies

For commercial properties, including industrial, offices, and retail spaces, Chapter 93 of the Texas Property Code specifically addresses commercial tenancies. It outlines requirements for security deposits, the obligations for refunding these deposits within 60 days of termination, and how damages and charges should be accounted for upon the termination of the lease. This section of the law ensures that commercial landlords maintain accurate records of all security deposits and that tenants are provided with an itemised list of deductions upon moving out. Furthermore, if a landlord's interest in the property ceases, the new owner becomes responsible for the security deposit from the date title to the premises is acquired.

Residential Leases

Residential leases are governed by Chapter 92 of the Texas Property Code, which focuses on the protection of renters' rights and the obligations of landlords. Important aspects include lease violation notices, the process for returning security deposits, lease termination, and landlord retaliation laws. For example, landlords must return security deposits within 30 days after the tenant has moved out and provide an itemised list of deductions for any damages

that go beyond normal wear and tear. Texas law prohibits landlords from retaliating against tenants who exercise their rights, such as reporting health or safety violations.

COVID-19 Legislation

During the COVID-19 pandemic, there were various temporary measures and moratoriums put in place to protect tenants from eviction and provide relief to property owners. However, specific asset class distinctions related to COVID-19 legislation would have been part of broader federal and state-level emergency orders and not necessarily permanent changes to property law. These measures were typically designed to address the immediate impacts of the pandemic, such as financial hardship due to unemployment or health-related issues. It's important to consult current state resources or legal advice for the most up-to-date information on any remaining COVID-19-related regulations affecting real estate leases.

Local Laws and Regulations

It is crucial to note that many cities in Texas might have their own landlord-tenant laws that provide additional protections or regulations beyond state law. Cities like Dallas, Austin, San Antonio, and Houston may have specific ordinances that address rent control, eviction procedures, or other rental-related matters. Therefore, both landlords and tenants should be aware of the local laws that might affect their rights and responsibilities.

6.15 Effect of the Tenant's Insolvency

In Texas, the impact of a tenant's insolvency on their lease depends significantly on whether bankruptcy proceedings are initiated. Under the United States Bankruptcy Code, a tenant's insolvency or bankruptcy does not automatically terminate an unexpired lease of real property. This is because clauses in leases that allow for termination due to insolvency or bankruptcy are generally unenforceable. When a tenant files for bankruptcy, an automatic stay is put into place, preventing landlords from evicting the tenant or taking other actions like serving a notice to quit or prosecuting a pending unlawful detainer. This automatic stay is designed to halt all judgments and actions against the debtor's property immediately upon the filing of a bankruptcy petition.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

In Texas, landlords have several options for securing protection against a tenant's failure to meet their obligations under a lease agreement. These measures are designed to mitigate risks such as non-payment of rent, damages to the property, or other breaches of the lease terms.

Security Deposits

Texas law does not impose a limit on the amount that can be charged for a security deposit, but it requires landlords to return the deposit minus any amounts used for cleaning and repairs within 30 days of lease termination for residential leases and within 60 days for commercial leases. The security deposit can cover damages incurred because of lease breaches, unpaid rent, cleaning fees at the end of the lease, and other specified damages not considered normal wear and tear.

Insurance Requirements

The lease agreement may require tenants to obtain renter's insurance. This insurance can provide coverage for the tenant's personal property, liability in case of accidents within the rented premises, and possibly loss-of-use coverage, which can help both parties in case the property becomes uninhabitable due to covered

damages. The landlord may also have its own insurance responsibilities specified in the lease.

Lease Provisions for Termination

Texas lease agreements can include specific provisions outlining how and when a lease may be terminated by either party. This might include conditions for early termination, required notice periods, and potential penalties for early termination.

Lockouts

Section 93.002 of the Texas Property Code permits landlords to change the locks of a premises in the event a tenant is delinquent in paying all or a part of the rent due under the lease. Landlords may prevent a tenant from accessing the premises, resulting in a "lockout" without court action.

6.17 Right to Occupy After Termination or Expiry of a Lease

In Texas, a tenant's right to continue occupying commercial real estate after the expiration or termination of a lease depends on several factors and the specific terms of the lease agreement. There is no automatic right for a tenant to remain in the premises without the landlord's consent after the lease has expired. If the original lease isn't renewed or a new lease isn't signed, the tenant may enter into a tenancy at will if the landlord allows them to stay and continue paying rent. Alternatively, without the landlord's permission, the tenant may find themselves in a tenancy at sufferance, which is less secure and can lead to eviction proceedings.

6.18 Right to Assign a Leasehold Interest

In Texas, a tenant's ability to assign a leasehold interest or sublease the leased premises largely depends on the terms of the original lease agreement. Generally, a landlord can prohibit a tenant from assigning a lease agreement or subleasing the leased premises if such a prohibition is expressly included in the lease agreement. However, if the landlord permits assignment or subleasing, the lease agreement must specify the conditions under which the tenant may enter into an assignment or sublease agreement.

6.19 Right to Terminate a Lease

In Texas, the rights to terminate a lease by both the landlord and the tenant are primarily governed by the terms of the lease agreement, state laws, and specific conditions under which the lease can be terminated. For general circumstances, leases can be terminated by mutual agreement or due to lease violations such as failure to pay rent or breach of lease terms. Specific conditions include the following.

Termination by Tenant

Tenants can terminate residential leases early under certain conditions, such as military service deployment, major damage to the property making it uninhabitable, and situations involving family violence. For example, residential tenants have the right to vacate and avoid liability following family violence under certain conditions outlined in Texas Property Code Section 92.016. This does not affect a residential tenant's liability for unpaid rent before the lease termination, unless specified in the lease.

Month-to-Month Arrangements

After a lease expires, if no new lease is signed, it might automatically renew on a month-to-month basis, depending on the original lease terms or the landlord's acceptance of rent payments, allowing either party to terminate the lease with proper notice, typically equal to the rent payment period.

Landlord's Right to Terminate

Landlords may terminate the lease due to lease violations by the tenant, such as non-payment of rent or engaging in prohibited activities. The eviction process is formal and requires court involvement if the tenant disputes the termination.

Health Reasons

Landlords are required to consider tenant health issues reasonably, which might include allowing early termination if the home poses a health risk to the tenant.

6.20 Registration Requirements

In Texas, leases and rental agreements are subject to specific state regulations but don't generally require formal registration with government authorities for validity. These agreements are binding contracts between landlords and tenants, detailing the conditions under which a property may be occupied. For residential leases, Texas law mandates certain disclosures such as the landlord's name and address, parking and towing rules, lead-based paint disclosures for older properties, and rights related to repairs.

6.21 Forced Eviction

In Texas, a tenant can be forced to leave (evicted) prior to the originally agreed date in the event of default (beyond any applicable cure and notice periods), such as failing to pay rent or violating lease terms. The eviction process typically unfolds over several steps and can take anywhere from 23 to 30 days if no appeal is filed, but the duration may vary depending on whether the eviction is contested, the days courts are in session, and other potential delays.

The process starts with the landlord serving a three-day notice to vacate, followed by filing an eviction suit if the tenant does not comply. The tenant is then served with a citation, and a court hearing is scheduled within six to ten days after the citation is served. If the court rules in favour of the landlord, a writ of possession can be issued, allowing for the eviction to be executed by a constable. The timeline from serving the initial notice to vacate to executing the writ of possession and forcibly removing the tenant can span one to three months, depending on various factors.

6.22 Termination by a Third Party

A lease may be terminated by the governmental or quasi-governmental entity through eminent domain (condemnation). See **2.9 Condemnation, Expropriation, or Compulsory Purchase**.

6.23 Remedies/Damages for Breach

In Texas, landlords can pursue damages for breach of lease, including unpaid rent and costs for property damage. Texas law requires landlords to mitigate damages by attempting to release the property. Security deposits are typically held in cash or as a letter of credit to cover potential damages or unpaid rent.

Landlords typically require security deposits to cover potential damages or unpaid rent, often held in cash or as a letter of credit. The form and conditions for holding and returning these deposits are usually dictated by state law and specified within the lease agreement.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Common pricing structures for construction projects in Texas include fixed price and cost-plus contracts. A fixed price contract sets a specific, agreed-upon amount for the entire project, pro-

viding a clear budget but placing the risk of cost overruns on the contractor. The cost-plus contract reimburses the contractor for actual costs plus a fee or percentage of the costs, offering flexibility but potentially leading to higher overall costs for the owner. Each method has its advantages, depending on the project's scope and complexity.

7.2 Assigning Responsibility for the Design and Construction of a Project

A few of the common methods for assigning responsibility for the design and construction of a project include design-bid-build, design-build, and construction manager at risk approaches. Responsibilities are typically allocated based on the chosen method: design-bid-build involves separate entities for design and construction; design-build assigns both design and construction to a single entity to streamline the process; and construction manager at risk involves a construction manager overseeing the project from start to finish, acting as a consultant during the design phase and as the general contractor during construction.

7.3 Management of Construction Risk

Construction contract risk management in Texas transactions is influenced by specific anti-indemnity laws. These laws restrict the extent to which parties can transfer risk between each other in commercial construction contracts. The Texas Anti-Indemnity Act particularly limits broad-form and intermediate-form indemnities, except for specific scenarios like action-over claims. This leads to a hybrid form of indemnity, mixing limited and broad forms depending on the situation.

7.4 Management of Schedule-Related Risk

In Texas and elsewhere in the US, schedule-related risks in construction projects are often managed through contract terms. These contracts can include provisions for liquidated damages, where the parties agree in advance that the owner will receive a specified amount of money as compensation for delays if the contractor fails to meet agreed-upon milestones or completion dates. This arrangement aims to incentivise timely performance and compensate the owner for losses due to delays.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for owners of Texas real estate to seek additional forms of security to guarantee a contractor's performance on construction projects. This can include requiring performance bonds, letters of credit, parent guarantees, escrow accounts, or third-party sureties. Typically, both private and public owners will require a general contractor to post a performance bond to guarantee completion of a given project.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and designers on projects in Texas can place a mechanic's lien on a property if they have not been paid for their work. To remove a lien, the property owner must ensure the contractor is paid the owed amount. The process involves filling out specific forms and meeting statutory requirements, including sending notices and possibly court involvement if disputes arise.

7.7 Requirements Before Use or Inhabitation

The requirements for a Certificate of Occupancy (CO) (or jurisdictional equivalent) before a com-

mercial building or an individual lease space within a commercial building in Texas can be occupied, or if there are changes to an existing occupancy classification, are specific and regulated by local jurisdictions. For instance, in Fort Worth, any building or structure that is to be used or occupied must have a CO, as stated by the Fort Worth Administrative Building Code. This includes when there's a change in the existing occupancy classification of a building, structure, or portion thereof.

8. Tax

8.1 VAT and Sales Tax

Texas does not impose a VAT on the sale or purchase of corporate real estate. However, Texas does have a state sales and use tax on most goods and taxable services. Real estate transactions, particularly the sale of commercial real estate, are not subject to this sales and use tax.

8.2 Mitigation of Tax Liability

Common practices include but are not limited to structuring deals in a tax-efficient manner, utilising 1031 exchanges for investment properties to defer capital gains tax, and taking advantage of available deductions and credits.

8.3 Municipal Taxes

Municipal taxes in Texas can include property taxes, which vary significantly across different counties and municipalities. These taxes are based on the assessed value of the property and are used to fund local services like schools, fire departments, and infrastructure. A common feature of transactions which include real estate in Texas are agreements under Chapters 380 and 381 of the Texas Local Government Code, which permit government and quasi-governmental entities, including without limitation counties and school districts, to waive collection of assessed taxes on real and personal property held by contracting businesses in exchange for building projects within the given locality for the purpose of creating jobs or expanding infrastructure.

8.4 Income Tax Withholding for Foreign Investors

Texas does not have a state income tax, which means there is no state income tax withholding for foreign investors on real estate transactions. However, foreign investors are subject to federal FIRPTA requirements, which can include withholding of taxes on the income generated from real estate investments and capital gains on the sale of property.

8.5 Tax Benefits

In Texas, real estate owners can benefit from several tax deductions and exemptions. For homeowners, this includes the homestead exemption, which can reduce the taxable value of their primary residence. Real estate investors can benefit from deductions for mortgage interest, property taxes, operating expenses, depreciation, and potentially qualifying for a 1031 exchange which allows deferring capital gains taxes when investing proceeds into another property.

Trends and Developments

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Haynes and Boone, LLP is a top-ranked international law firm, with nearly 700 lawyers in 19 offices spanning Texas, New York, California, Charlotte, Chicago, Denver, Virginia, Washington DC, London, Mexico City, and Shanghai, providing a full spectrum of legal services in energy, technology, financial services and private equity. The more than 50 lawyers in Haynes Boone's real estate practice group understand the dynamics of today's real estate market both locally and nationally. Its lawyers maintain a strong track record representing clients on acquisitions, dispositions, joint venturing, financing and development of properties and real estate portfolios in Texas and throughout the United States. The group also advises developers and institutional investors in joint ventures, with a particular focus on projects that include both taxable and tax-exempt ventures. Examples of representative clients include Hillwood Development Company, Harwood International Incorporated, The Howard Hughes Corporation, Trive Capital, Trammell Crow Residential, and Comerica Bank.

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Over the past 12 months, Texas cities like Dallas, Houston, and Austin have continued to showcase significant urban growth, while also observing dynamics of population and business dispersal in various neighbourhoods. This multi-faceted urban development scenario reflects broader trends impacting Texas's major metropolitan areas, influenced by factors such as migration patterns, economic policies, and housing market dynamics.

Urban Growth and Migration Patterns

In recent years, Texas has seen a significant influx of new residents from coastal states like New York and California, particularly in its largest metropolitan areas, driven by a blend of economic opportunities, a friendly business environment, and a (relatively) low cost of living. This relocation trend was notably influenced by the COVID-19 pandemic, which accelerated the movement of people and businesses from more densely populated and higher-cost areas to places like Texas that offer more space and affordability. The Dallas-Fort Worth metroplex (ie, the North Texas metropolitan area including Dallas, Fort Worth, and surrounding cities) led the state in net in-migration, followed by Austin, which not only attracted a large number of new residents but also saw an increase in migration rates relative to its population size. Smaller Texas metropolitan areas also witnessed increased migration, reversing previous trends of net outflow.

This migration pattern is part of a broader national trend observed during the pandemic, where outmigration from large urban areas in the Northeast and elsewhere accelerated, while a few rural counties saw gains in population for the first time in years. The shift in population diffusion to states like Texas represents a continuation and magnification of pre-pandemic migration patterns, with populous areas like Dallas County experiencing historic levels of growth on top of several decades of steady expansion.

A closer examination of the nation's 56 major metropolitan areas between 2019-20 and 2020-21 reveals a marked shift in demographic trends, with a significant number experiencing either slower growth, greater declines, or a switch from growth to decline. Major metropolitan areas across the country, particularly those in coastal areas and the industrial Midwest, saw population losses, with the largest numeric losses occurring in New York, Los Angeles, San Francisco, and Chicago. In contrast, metropolitan areas in the Sun Belt, particularly Texas cities like Dallas, Houston, and Austin, saw the greatest gains, highlighting the significant role of domestic migration as the primary driver of demographic change during the prime pandemic year.

Migration trends observed over this period of time reflect a complex interplay of factors, including the widespread adoption of remote work, which has made it easier for people to relocate to more affordable and desirable locations. The movement from high-cost coastal cities to Texas metropolitan areas has brought considerable talent and investment to the state, fuelling sustained economic growth. A booming economy spurs further in-migration to Texas, perpetuating the cycle of growth both fiscally and demographically. Real estate owners in particular have benefited from Texas's growth as new residents drive appreciation of residential properties and a confluence of business factors insulate Texas's commercial real estate sector from the substantial headwinds persisting in other parts of the country.

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Economic Policies and Business Climate

Over the past 12 months, Texas has solidified its reputation as a leading destination for businesses, driven by its favourable economic policies and business climate. Recent developments provide insight into how Texas cities have become attractive hubs for economic growth and enterprise.

Texas has been recognised nationally for its prime business climate, a testament to the state's strategic approach to fostering economic growth. The state's economic policies, particularly its business-amenable tax and regulatory environment, have played a pivotal role in attracting businesses from across the country and around the world. Texas offers a competitive advantage with no personal or corporate income tax at the state level, which stands out as one of the most tax-favourable environments in the United States.

The state has experienced significant job growth, adding the most jobs in the nation over the last 12 months. This growth is not only a reflection of the state's robust business environment but also its diverse economy, which spans various sectors from technology to manufacturing. The expansion of the labour force to historic highs underscores Texas's capacity to attract and retain talent, further fuelling its economic dynamism.

Texas's economic strength is bolstered by strategic incentives aimed at business development, including the Texas Enterprise Fund. The Texas Enterprise Fund is a programme which awards grants to businesses which select a site in Texas for a project or series of projects when the sites initially under consideration included at least one Texas site and one site outside of Texas. Recipient businesses receive a "deal-closing" cash grant calculated according to a uniform analytical model applied to each applicant upon deciding to pursue a project in Texas as well as fulfilling other financial and job-creation requirements. Additionally, Texas's commitment to infrastructure development ensures businesses have the necessary support to thrive, from transportation to utilities. These incentives, combined with a highly skilled workforce and an internationally competitive higher education system, create fertile ground for businesses to grow and prosper.

The state's welcoming business climate, combined with its quality of life, has made it an attractive destination for both talent and investment. Texas cities have seen an influx of skilled professionals and major corporations seeking to leverage the state's economic advantages. This trend is exemplified by the relocation of companies from more regulated and higher-tax states to Texas, seeking economic freedom and opportunity.

Texas local governments extensively utilise tax incentive agreements to stimulate economic growth, attract, and retain businesses. These agreements, primarily governed under Chapter 380 of the Texas Local Government Code for cities and Chapter 381 of the Texas Local Government Code for counties, enable municipalities and counties to abate taxes and disburse grants or services at minimal to no cost to promote state and local economic development and stimulate business and commercial activity. These provisions grant local governments significant flexibility in negotiating directly with developers and businesses, allowing for a broad spectrum of incentives to encourage development within their jurisdictions.

The use of these incentive agreements has become a preferred economic development tool across Texas, with over 4,500 executed deals aiming to boost local economies as of 1 April 2024. This approach by local governments is not free of its critics who observe that many of these agreements lack governmental oversight and there are no caps on each deal's value, raising concerns about accountability and the burden on taxpayers. Notably, these laws do not mandate job creation or penalties for non-compliance, and before recent legislation requiring reporting to the state comptroller's office, there was no central repository of information on these agreements, making comprehensive analysis challenging.

Local officials defend the use of agreements under Chapter 380 and 381 as vital for attracting and retaining employers, illustrating their importance with significant agreements like Round Rock's multi-year deal with Dell Technologies. Local governments wield substantial authority in drafting these agreements and will usually premise any grant or tax waiver on completion of a project or creation of a certain number of jobs by a business, which will often provide a substantial windfall to a locality's tax revenue both before and after the term of the given agreement expires. Any agreement under either Chapter 380 or 381 executed since 1 September 2021, must be filed with the Texas Comptroller, whose office operates a website making each agreement freely accessible to any member of the public, boosting transparency and accountability. Without statutory requirements mandating either creation of a set number of jobs or instituting penalties for non-compliance (beyond losing any grant or tax abatement under an agreement), local governments have a freedom to contract with businesses, which has managed so far to balance economic growth with fiscal responsibility and is one of several factors behind Texas's recent success.

As Texas moves forward, the conversation around tax incentive agreements and their role in economic development is likely to continue, with residents new and old expressing the need for a programme that balances competitiveness with fiscal responsibility and transparency. This evolving dialogue underscores the importance of creating policies that not only attract businesses and stimulate economic growth but also ensure equitable benefits for the communities involved and sustainably use public resources.

The economic policies and business climate in Texas over the past 12 months have set the stage for continued growth and prosperity. The state's approach to fostering a business-friendly environment, coupled with strategic investments in infrastructure and workforce development, positions Texas cities as leading destinations for businesses looking to expand or relocate. As Texas continues to attract talent and investment, it will likely maintain its role as a bright star in the national economy, driving innovation and economic development well into the future.

Rising to the Occasion

Positive changes in Texas's overall economic outlook have been a boon to real estate owners and developers, particularly in booming metropolitan areas like Austin, which has experienced significant appreciation and expansion of its housing supply in recent years. Balancing growth with affordability remains a critical issue for policymakers and residents across the state. Moreover, the evolving dynamics of remote work, demographic shifts, and economic policies will continue to influence Texas's real estate landscape, presenting both opportunities

and evolving conditions for the market's long-term trajectory.

The cities of Dallas, Austin, and Houston, prominent urban centres in Texas, have been experiencing dynamic changes over the past 12 months, particularly in terms of urban growth, economic expansion, and new construction. Each city, with its unique set of strengths, faces a different environment calling for discrete and nimble policies to perpetuate Texas's good fortune at both the metropolitan level and statewide.

As discussed above, Texas cities have been magnets for migration, driven by economic opportunities and a relatively lower cost of living compared to other major US metropolitan areas. However, this influx has contributed to a rising cost of living, particularly in housing markets (great news for sellers, bad news for buyers). Austin, known as a high-tech hub for the past couple of decades, has faced circumstances including chronic labour shortages and soaring house prices, which have contributed to Austin's status as an attractive destination for opportunity-seeking skilled workers and real estate investment, both nationally and globally. As a result, the city's population has grown substantially, expanding at about five times the national average from 2010 to 2021, while still maintaining its low unemployment rate. Despite generally rising prices in residential real estate in recent years, the past year has cooled Austin's housing market, delivering a decrease in the median cost of a house in the city, likely arising from increased construction contributing to a higher supply and higher interest rates nationally.

Additionally, Texas's traditional (relatively) cheaper housing edge is slipping away as resilient demand outpaces supply, exacerbated by the COVID-19 pandemic. Texas home prices have increased steadily, with significant implications for housing affordability. This surge in housing demand has been particularly notable in Dallas-Fort Worth and Austin, drawing many new residents from expensive coastal cities. Despite record highs in building permits for single-family homes, inventories have generally dwindled, and prices have surged, suggesting that supply increases have fallen short of demand. Regardless, Texas still compares favourably to many of the states its new residents are coming from, where housing shortages remain acute and new construction can prove difficult.

Issues for all growing cities and which have the potential to impact Texas cities in the future include homelessness and urban decay, galvanising Texans to rise to the occasion. Houston in particular has made notable strides in addressing housing shortages, focusing initially on military veterans and then expanding efforts, resulting in the housing of approximately several thousand formerly homeless people since 2012. This success has been attributed to strong co-ordination among both public and private actors to raise and distribute resources throughout the community and signals a strong civic engagement even as Houston continues to grow and thrive. On the other hand, despite its geographic position and the viability of brand-new construction far into its hinterlands, Dallas has been experiencing a rapid redevelopment of its urban core, replacing aging apartment units with ultra-modern residences and anchoring a substantial number of the city's new residents in its very heart. These re-development projects often necessitate both substantial building improvement and governmental re-zoning, emphasising Dallas' co-ordination of an entrepreneurial spirit with a receptive city administration.

As Texas cities continue to enjoy dynamic growth and economic development and attract diverse populations, addressing the dual challenges of rising cost of living and urban blight will be crucial. The experiences of Houston and Dallas show the importance of strategic planning, civic engagement, and collaborative governance in managing urban growth and ensuring that all residents can benefit from a city's prosperity. Addressing the rising cost of living and combating urban blight through effective governance, community collaboration, and strategic investment will be essential in shaping the future of these urban centres.

In addition to the growth in major metropolitan areas, smaller communities have experienced even more impressive growth in Texas recently, among them counties like Kaufman (outside Dallas), Hays (between Austin and San Antonio), and Liberty (adjacent to Houston). Solving potential challenges faced by counties like Kaufman, Hays, and Liberty due to sudden, large increases in population involves considering various aspects of urban and regional planning, infrastructure, social services, and environmental sustainability. While these counties might have distinct characteristics, they share common challenges associated with rapid population growth.

Rapid population growth puts a significant strain on existing infrastructure. Counties like Kaufman, Hays, and Liberty will need to scale up their infrastructure – roads, water supply, sewage treatment facilities, and power generation – to accommodate the growing demands. The sudden influx can lead to traffic congestion, water shortages, and increased waste, requiring deliberate attention and long-term planning to ensure sustainability. As populations swell, so does the demand for public services, including schools, healthcare, and emergency services. Counties experiencing rapid growth must ensure that these services expand in tandem with population increases to maintain quality of life. This might involve building new schools, expanding hospitals and clinics, and increasing the number and capacity of emergency service providers. Similarly, ensuring that there are enough jobs to support new residents is essential. Counties may need to attract diverse industries and invest in education and training programmes to build a skilled workforce. As mentioned above, agreements under Chapter 380 and 381 of the Texas Local Government Code offer a means for smaller cities and counties to attract new businesses which can then construct much of the additional infrastructure required while bringing new jobs to the locality in question.

Population growth anywhere can exert a strong pressure on the housing market, especially when the growth is so sudden, as in the case of Kaufman, Hays, Liberty, and other counties like them. Demand for housing can lead to skyrocketing property values and rental rates, pushing longtime residents out and exacerbating issues of affordability but also attracting further investment and development. This scenario could necessitate the development of more affordable housing options and policies to ensure that growth benefits all residents, while also providing a source of increased revenue which can then fund novel governmental programmes to address any inequities. Many counties in Texas like Kaufman have the potential of translating short-term population growth into long-term urban development and investment while boosting governmental revenue to meet increasing demands.

Effective governance is key to managing the challenges of rapid population growth but is an area in which Texas communities have, again

and again, risen to the occasion. Comprehensive planning, community engagement, and the development of policies that encourage sustainable growth are important aspects and should continue to be top of mind in all Texas cities, regardless of size. Counties must continue to be proactive in planning for future growth, ensuring that infrastructure, housing, environmental protection, and public services evolve to meet the needs of population growth. Kaufman, Hays, Liberty, and other counties like them facing sudden population increases must navigate a complex set of challenges to ensure that growth is beneficial, sustainable, and inclusive. Strategic planning, investment in infrastructure and services, environmental stewardship, and community engagement are crucial components of successfully managing rapid population growth. Balancing these elements requires a concerted effort from local governments, businesses, community organisations, and residents to ensure that these counties remain vibrant, sustainable, and welcoming places to live.

In summary, Texas's real estate market has experienced and is positioned to continue experiencing substantial growth, influenced by economic strength, regional differentiation, and evolving housing needs. The future continues to look bright for Texas, and while the potential for challenges remains, the Lone Star State is poised to rise to the occasion as it has done many times before.

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