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REAL ESTATE GAZETTE

ETHIOPIA
LAND ACQUISITION FOR REAL ESTATE DEVELOPMENT IN URBAN AREAS OF ETHIOPIA

GHANA
CONSTITUTIONAL LIMITATIONS ON LAND OWNERSHIP IN GHANA: LIFTING THE CORPORATE VEIL

MIDDLE EAST
HOTEL INVESTMENT IN AFRICA—THE "BIG FIVE" LEGAL ISSUES

SOUTH AFRICA
ON SAFARI: SOUTH AFRICA HUNTS DEALS IN CEE AND SEE

UNITED STATES
PROJECT FINANCING IN SUB-SAHARAN AFRICA

HUNGARY
THE COMMERCIAL REAL ESTATE MARKET IN HUNGARY

ITALY
EVEN THE SUPREME COURT MAKES MISTAKES SOMETIMES

SPAIN
CHOOSING THE RIGHT MORTGAGE IN SPAIN

FOCUS ON: AFRICA

CONSIDERING AFRICA'S BURGEONING REAL ESTATE SECTOR, INVESTMENT OPPORTUNITIES AND RELATED LEGAL DEVELOPMENTS

ISSUE 26

CONTRIBUTORS

Luis Filipe Carvalho – ADCA Advogados Angola, Luanda +244 926 61 25 25 lf.carvalho@adca-angola.com
Ariana Silva – ADCA Advogados Angola, Luanda +244 926 61 25 25 a.silva@adca-angola.com
Getu Deme – Mehrteab Leul & Associates Ethopia, Addis Adaba +251 115547938 getu@mehrteableul.com
Nana Takyiwa Ewool – Reindorf Chambers Ghana, Accra +233 302 225674 Takyiwa.Ewool@reindorfchambers.com
Edinam Cofie – Reindorf Chambers Ghana, Accra +233 302 225674 edinam.cofie@reindorfchambers.com
Norah Mutuku – IKM Kenya, Nairobi +254 20 2773 000 Nmutuku@ikm.co.ke
Lydia Owuor – IKM Kenya, Nairobi +254 20 2773 000 lowuor@ikm.co.ke
Khemila Narraidoo – Juristconsult Chambers Mauritius, Port Louis +(230) 208 5526 knarraidoo@juristconsult.com
Marc Hein – Juristconsult Chambers Mauritius, Port Louis +(230) 208 5526 mhein@juristconsult.com
Helen Hangari – Dubai +97144386326 helen.hangari@dlapiper.com
Sean Cope – Dubai +97144386389 Sean.Cope@dlapiper.com
Myriam Mejdoubi – Paris, Casablanca +33140152496 Myriam.Mejdoubi@dlapiper.com
Vanessa Chiponde – SAL & Caldeira Advogados Lda Mozambique, Maputo +258 21 24 1400 vchiponde@salcaldeira.com
Denise R. Hamer – London +44 20 7796 6466; Prague +420 222 817 111; Vienna +43 1 531 78 1452 denise.hamer@dlapiper.com
Joseph A. Tato – New York +1 212.335.4975 Joseph.Tato@dlapiper.com
Paolo S. Boado – New York +1 212.335.4712 Paolo.Boado@dlapiper.com
Jabulani Nhongo – Manokore Attorneys Zimbabwe, Harare +263 4 746787 jnhongo@manokore.com
Bridget Mafusire-Kamanga – Manokore Attorneys Zimbabwe, Harare +263 4 746787 bmafusire@corporatecounsel.co.zw
Michael Neumann – Horten, Copenhagen +45 33344267 mn@horten.dk
Antoine Mercier – Paris +33140152409 Antoine.Mercier@dlapiper.com
Szilard Kui – Budapest +3615101144 Szilard.Kui@dlapiper.com
Carlotta Benigni – Milan +390280618631 Carlotta.Benigni@dlapiper.com
Aleksandra Kozlowska – Warsaw +48225407407 Aleksandra.Kozlowska@dlapiper.com
Florina Toma – Romania +40372155865 Florina.Toma@dlapiper.com
Natalia Zumarraga – Madrid +34917887321 Natalia.Zumarraga@dlapiper.com
Fatima Rico-Villademoros – Madrid +34917901713 Fatima.Rico-Villademoros@dlapiper.com
Jan Råssjö – Stockholm T: +46 8 701 78 88 jan.rassjo@dlapiper.com
Emanuel Sköld – Stockholm T: +46 8 701 78 38 emanuel.skold@dlapiper.com

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A NOTE FROM THE EDITOR

The twenty-sixth issue of the DLA Piper Real Estate Gazette highlights issues relating to real estate in Africa.

We would like to welcome all our readers to Issue 26 of DLA Piper's *Real Estate Gazette*.

Think of Africa and chances are you will be transported to a sun-blushed savannah, where beautiful wild elephants roam across the plains. Or you may think of the monolithic churches of Ethiopia, the reggae and hip hop sounds of Sub-Saharan Africa, or South Africa's achievement as the first African country to host a World Cup football tournament. Chances are you will not immediately think of a burgeoning real estate sector, investment opportunities and related legal developments. However, as the articles in this issue show, the world's second continent may offer real opportunities to foreign investors in real estate.

Amongst others, contributions discussing Angola (page 6), Ethiopia (page 8) and Mozambique (page 20), all report increased demand in the real estate sector. Indeed, in Ethiopia the sector has contributed 12.5 per cent to domestic growth in the past 10 years, whilst the recent discovery of natural resources in Mozambique has led to increased demand there in several sectors, including real estate, which is regarded as one of the best investment opportunities in the country. Of course, it is not all plain sailing and limitations on land ownership by foreigners (Ghana, page 10); issues surrounding commercial lease agreements (Morocco, page 18); and legal issues facing potential investors into the African hotel sector (UAE, page 16) are all placed under the spotlight in this issue.

In general real estate matters, we consider a number of wide-ranging topics, including changes to the French Civil Code and their impact on contractual practices (page 30); the various mortgage types available in Spain (page 42); and tenants' right to claim compensation on termination of leases in Sweden (page 44).

We do hope you will enjoy reading our views.

Olaf Schmidt, Co-Chair of the Global Cross-Practice Real Estate sector

> "The world's second continent may offer real opportunities to foreign investors in real estate."

CONTENTS

ISSUE 26, 2016

AFRICA

ANGOLA

06 ANGOLAN SHOPPING MALLS AND LEASE REQUIREMENTS

ETHIOPIA

08 LAND ACQUISITION FOR REAL ESTATE DEVELOPMENT IN URBAN AREAS OF ETHIOPIA

GHANA

10 CONSTITUTIONAL LIMITATIONS ON LAND OWNERSHIP IN GHANA: LIFTING THE CORPORATE VEIL

KENYA

12 RECENT DEVELOPMENTS IN THE REAL ESTATE AND BANKING SECTORS IN KENYA

MAURITIUS

14 UPDATE ON PROPERTY DEVELOPMENT IN MAURITIUS

MIDDLE EAST

16 HOTEL INVESTMENT IN AFRICA—THE "BIG FIVE" LEGAL ISSUES

MOROCCO

18 COMMERCIAL LEASE AGREEMENTS IN MOROCCO: RECENT DEVELOPMENTS

MOZAMBIQUE

20 FINANCING FOR REAL ESTATE PROJECTS IN MOZAMBIQUE—THE PROVISION OF LAND RIGHTS AS SECURITIES

SOUTH AFRICA

22 ON SAFARI: SOUTH AFRICA HUNTS DEALS IN CEE AND SEE

UNITED STATES

24 PROJECT FINANCING IN SUB-SAHARAN AFRICA

ZIMBABWE

26 FOREIGN REAL ESTATE INVESTMENT OPPORTUNITIES AND INVESTMENT PROTECTION IN ZIMBABWE

GENERAL REAL ESTATE

DENMARK

28 SALE AND LEASE BACK TRANSACTIONS GAINING GROUND IN THE DANISH PROPERTY MARKET

FRANCE

30 CHANGES TO THE FRENCH CIVIL CODE AND THEIR IMPACT ON CONTRACTUAL PRACTICES IN REAL ESTATE

HUNGARY

32 THE COMMERCIAL REAL ESTATE MARKET IN HUNGARY

ITALY

36 EVEN THE SUPREME COURT MAKES MISTAKES SOMETIMES

POLAND

38 TAX CHANGES IN POLAND: IMPACT ON THE REAL ESTATE SECTOR

ROMANIA

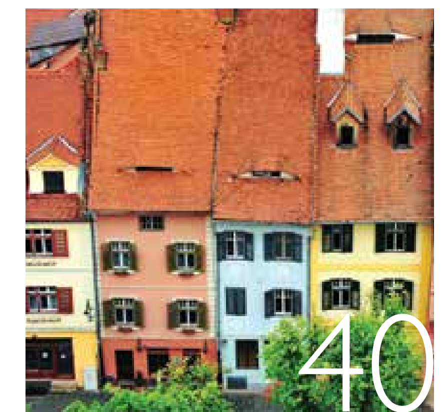
40 RECENT LEGISLATIVE CHANGES AFFECTING THE REAL ESTATE MARKET IN ROMANIA

SPAIN

42 CHOOSING THE RIGHT MORTGAGE IN SPAIN

SWEDEN

44 TENANTS' RIGHT TO COMPENSATION ON TERMINATION OF A LEASE: RECENT DEVELOPMENTS



ANGOLAN SHOPPING MALLS AND LEASE REQUIREMENTS

LUÍS FILIPE CARVALHO AND ARIANA SILVA, LUANDA

"Contracts governing stores in shopping malls must have flexible provisions."

Luanda currently has five shopping malls, with four others under construction at the time of writing and due to open during 2017.

The Angolan real estate market has blossomed in the last couple of years, necessitating more new housing and commercial spaces. At the same time, diverse factors such as inbound investment and an increase in the Luanda-based population (due both to immigration and migration) have led to the development of large shopping malls and other types of retail outlets. Due to the particular nature of these enterprises, their lease requirements differ from typical leases.

The new Urban Lease Law came into force in January 2016, bringing greater transparency to commercial lease contracts, but excluding the regulation of shopping malls.

The Urban Lease Law does not permit tenants and landlords the flexibility that contracts for the use of stores in shopping malls require. The main concern from a developer and landlord's perspective is the creation of a set of standard terms that will allow each store to function both individually and jointly with the others in the mall. It is this requirement that has triggered the need to rethink the legal framework, towards more dynamic legislation which focuses on the business needs of both the landlord and the tenant. The latter, of course, benefits from a system that allows it to promote its individual business, whilst taking advantage of their proximity to other stores, and other service providers in the mall, such as supermarkets, restaurants and cinemas, amongst others.

Despite this new Urban Lease Law, shopping mall contracts remain atypical contracts. These contracts in Angola are very similar to the draft contracts used in shopping malls in Brazil and in Portugal. Both parties to the contract are free to define the terms and conditions in a way that leaves no ambiguity as to the parties' intentions. The contract must be clear and fully comprehensible by the parties, leaving no ground for misinterpretation. In most cases it will be for the landlord to define the essential conditions of the contract, in particular to ensure uniformity across retailers in a particular commercial outlet.

This market is growing in Angola, creating the need for a set of standard terms to form the basis of the atypical contracts that will be used to govern the position of stores in shopping malls. As has been noted above, the Angolan shopping mall market is vibrant, and increasing use is being made of contracts already in use abroad. The lack of foreign currency in the last two years has reduced travel and consumer purchases abroad, which has in turn led to the increase in consumption in shopping malls in Angola.

From a legal perspective, shopping malls must be viewed as important commercial hubs, with the need for uniform treatment across all tenants and driven by the specific needs of the landlord. The management guidelines, such as type of business activities, opening and closing times, configuration of stores and their maintenance, decoration, etc, are to be defined by the landlord, with the ultimate aim that all stores (and thus all tenants) work together in an integrated way. This will result in an enhanced shopping experience for the consumer. In short, if a structural perspective directs a certain approach, then this should also be reflected by the legal system governing the relevant contracts.

Contracts governing stores in shopping malls must have flexible provisions and must consider both the single contract perspective (ie, for each store) but also the joint contract perspective, assuming that all contracts benefit from others and from a common structure for marketing and promotion, giving the landlord or any third party to whom such a role is assigned, powers and obligations that go beyond those of the typical landlord. The nature of these duties means a new approach to the rent component is necessary, allocating a proportion for marketing and promotion and imposing an obligation on each tenant to contribute to the overall management of the property.

Additionally, the concept of tenant mix applies to the market, allowing these contracts to be executed for fixed periods to allow the landlord to choose tenants based not only on their capacity to fully comply with the agreed terms, but also to be part of a blended concept, delivering the best shopping experience to the consumer in terms of the products, services and goods that can be made available.

Shopping malls in Angola are currently in a period of great development, with a large number of investors, tenants, consumers and international brands winning market share from the informal trading that has typified the Angolan economy in recent decades.

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AFRICA | **ETHIOPIA**

LAND ACQUISITION FOR REAL ESTATE DEVELOPMENT IN URBAN AREAS OF ETHIOPIA

GETU DEME, ADDIS ABABA

> "A recent report on real estate by Access Capital indicates that there are both challenges and opportunities in the real estate sector in Ethiopia."

Introduction

The real estate sector has been one of the fastest growing segments of the Ethiopian economy. The sector has contributed 12.5 per cent to domestic growth in the past 10 years. The residential real estate market in Addis Ababa (the capital city and seat of the African Union, with a population of more than 3 million) is evolving into a varied mix of extensive government-built condominiums (supposedly for low-income groups), mid-market developments by housing cooperatives, and largely high-end homes built by real estate developers and/or homeowners themselves. The Government initiated an urban housing project in 2004 and it has constructed and transferred about 200,000 houses to homeowners so far. Currently, there are around 800,000 registered persons on the waiting list for the condominium houses. The Government's focus is on meeting the housing demands of those on low income, whilst the private real estate companies aim to attract mainly high-income home buyers. However, a huge gap remains in the housing market, and the needs of the middle-income urban population in particular still require to be met.

Investment opportunity

Ethiopia's investment policy encourages foreign investment in the real estate sector, and there has indeed been an increasing number of foreign investors in this sector. Chinese developers are at the forefront of this trend. For instance, Tsehay Real Estate's Poli Lotus International Centre and Sinomark Real Estate's 21-tower Royal Garden developments can be given as examples of Ethiopia's biggest real estate schemes. It remains the case, however, that most of the private real estate developers in Ethiopia are local investors.

Private investment in the real estate sector is expected to grow in the coming years. There are a number of factors driving this. These include (i) overall economic growth (as real GDP has grown by an average of 10.8 per cent per annum in the last 10 years); (ii) demographics (the urban population continues to rise and the population of Addis Ababa is expected to more than double by 2040 to reach around 8 million); (iii) a long history of unmet housing demand; (iv) the expansion of city roads and infrastructure (such as the construction of the Addis Ababa Ring Road and other major roadways, Addis Ababa's urban metro system which is the first in Sub-Saharan Africa, the improvement of numerous regional roads, and the wider reach of electricity and water services to the edges of the city); and (v) tax and investment incentive schemes, involving a broadening of investment areas, extended lease periods, and reduced income tax.

Supply and price of land

Ethiopia has a federal system of government constituted by nine regional states and two city administrations, with a dual land tenure system (for urban and rural land). Land in Ethiopia is the property of the public and can generally be acquired only on the basis of a lease. Private ownership of land is prohibited. In many residential urban areas, there are freehold plots owned by private individuals outside of the lease system, but even for these plots of land, the owners technically own only the buildings on the land and not the land itself (which remains public property). Transfer of any freehold with or without a property on it triggers the immediate conversion into the lease system. This means that the transferee is required by law to enter into a lease agreement with the relevant government authority. Once acquired through a lease, the land cannot be mortgaged or sold, but the lease value of the land (the down payment and annuity paid) and the fixed assets on that land may be mortgaged or transferred to third parties.

Land administration is delegated under the constitution to the regions (for rural land) and to city governments and municipalities (for urban land). Accordingly, regional governments and municipal administrations are authorized to lease rural and urban land under their respective laws. In the city suburbs, the Government reserves what it calls a land bank for investors, which, having compensated the landholders, it provides to investors engaging in real estate development. An investor who acquires land under a lease has to enter into a land lease agreement with the Government and obtain a lease-holding certificate issued in its name. The minimum lease down payment is 10 per cent of the total lease payment. The remaining balance of the lease amount is to be paid in equal annual instalments over the payment term. Interest is to be paid on the remaining balance, in line with the prevailing interest rate on loans offered by the Commercial Bank of Ethiopia.

The lease contracts normally include provisions to regulate when construction will start, how long it will take to completion, the payment schedule, grace period, rights and obligations of the parties, as well as other relevant details. The down payment of the lease price must be paid prior to signing the contract. The duration of an urban land lease for real estate development is 60 years for Addis Ababa (the capital city) and 70 years for other cities and towns in Ethiopia.

Except for investments in the manufacturing industries and commercial agriculture and government projects, investors can only access land through a tender-based lease system. Accordingly, real estate developers have to participate in an open and competitive tender process to acquire the land they need. However, regions and city administrations are required by law to prepare in advance plots of urban land, to be assigned by tender, for "mega" real estate developments, to be undertaken by the private sector. Mega real estate is a housing development involving the construction of at least 1,000 residential units, for sale or to rent, with the purpose of alleviating the housing shortage in urban areas. Every plot of urban land must have a benchmark lease price that serves as a floor price for the tender process.

A recent report on real estate by Access Capital indicates that there are both challenges and opportunities in the real estate sector in Ethiopia. The key obstacles facing the sector include land policies, the scarcity and cost of construction materials, infrastructure, and financing. In terms of opportunities, the report highlights the potential of four segments of the real estate market: city-centre commercial developments; residential developments, including apartments, focused on middle-income groups; new developments based on innovative and cheaper construction materials; and commercial parking developments.

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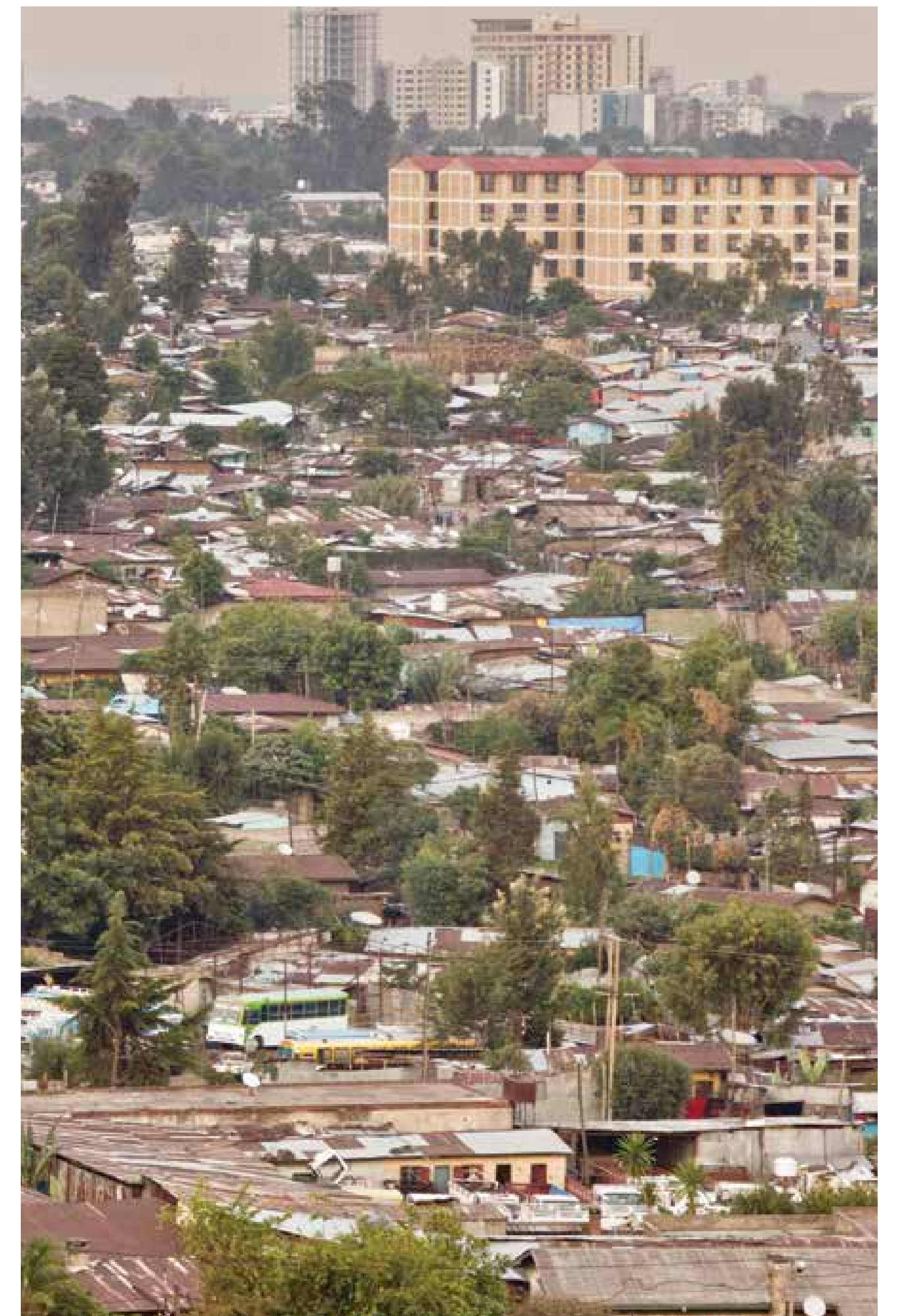

AFRICA | **GHANA**

CONSTITUTIONAL LIMITATIONS ON LAND OWNERSHIP IN GHANA: LIFTING THE CORPORATE VEIL

NANA TAKYIWA EWOOL AND EDINAM COFIE, ACCRA

> "Would a company with 50:50 or 30:70 per cent Ghanaian and foreign ownership be regarded as Ghanaian?"

Foreign investors looking to invest in the Ghanaian economy, especially in the real estate market, have to consider, amongst other things, the type of property title that non-Ghanaians may hold for the purpose of commercial developments and whether non-Ghanaians may lease property in Ghana. It is essential to have this information before investing.

The 1992 Constitution of Ghana limits the ownership of interest in real estate by non-Ghanaians to a leasehold interest of 50 years at any one time. Article 266(1) of the Constitution forbids a non-Ghanaian from obtaining a freehold interest in land in Ghana while any conveyance of a freehold interest in land to a non-Ghanaian is void under article 266(2). These provisions are not new, and indeed have been in effect since the 1969 Constitution.

The 1969 Constitution converted foreign-held freehold interests predating 22 August 1969 into a 50-year leasehold interest at a peppercorn rent. The freehold reversionary interest was vested in the President on behalf of, and in trust for, the people of Ghana. Foreign-held unexpired leasehold interests of more than 50 years were also converted into a 50-year leasehold from 22 August 1969. This has remained the legal position to date.

The right of corporate bodies with foreign shareholders to hold freehold interests in land in Ghana was recently addressed in the case of *Blue Sky Products Ghana Limited v Attorney General & Lands Commission*. Blue Sky Products Ghana Limited ("the company") was a wholly foreign-owned agro processing company incorporated in Ghana. The sole shareholder of the company was Blue Sky Products (UK) Ltd. The company had acquired several acres of land in various locations in Ghana for the purpose of growing fruit. The company also sold some of the land it acquired. The Lands Commission had, however, refused to register land purchased by the company, in which they held a freehold interest. The Lands Commission further threatened to convert all freehold interests in land registered in the name of the company into a 50-year leasehold.

The company commenced an action against the Attorney-General and the Lands Commission, seeking amongst other things, an order directed at all administrative bodies or the Lands Commission to register its interests for its benefit and the benefit of transferees, assignees and lessees. The company contended that as a Ghanaian company, it was entitled to enjoy all the privileges and rights bestowed on Ghanaians by the 1992 Constitution. It was further argued by the company that the Lands Commission's refusal to register their freehold interests as well as threats to convert their freeholds already registered to a 50-year leasehold constituted discrimination. The company also took the view that as a legal person and a Ghanaian, it was entitled to the inalienable right to own and enjoy its real estate and that the Lands Commission's conduct violated this right.

The respondents argued that the company was not a Ghanaian company in the real sense despite its incorporation under Ghanaian law, and thus it could not have an interest in land beyond 50 years. Further, the freehold interests the company had acquired in land, in fact, infringed article 266(1) of the Constitution which prohibits the grant of freehold interests in land to non-citizens of Ghana.

The court held that the company was not Ghanaian in the relevant sense and was consequently not eligible to hold a freehold interest in land in Ghana. It further held that the company could not sell land as if it were registered to carry on that business but had the power to mortgage its real estate to raise capital.

In arriving at this decision, the court observed that, apart from the company's incorporation in Ghana and the fact that it carried on its business in Ghana, there was really nothing Ghanaian about the company. It was evident that Blue Sky Products (UK) Ltd was the dominant entity behind the company, controlling it through its nominees.

In this case, the question of whether the company could acquire a freehold interest in land in Ghana was made less complicated by the fact that, on lifting the corporate veil, it was found that the sole shareholder was a foreigner. The issue may however be more complicated where there is Ghanaian and foreign ownership in the corporate vehicle. For example a 50:50 per cent ownership structure or perhaps a 30:70 per cent ownership structure, where the majority shareholder is a foreigner. Would such a company be regarded as Ghanaian and therefore eligible to a freehold interest? Would a company become eligible to acquire a freehold interest in land in Ghana merely because Ghanaians held some of its shares?

The approach it seems, is to evaluate whether the corporate vehicle is in substance controlled by non-citizens, whether through shareholding or by its directors. Therefore, in the case of a company with both Ghanaian and non-Ghanaian shareholders, where there is evidence of substantial control of the company by citizens of Ghana, it would appear that such a company would be eligible to acquire leasehold interest of more than 50 years at any one time, as well as a freehold interest in land.

Perhaps the best way to clarify the situation would be to adopt the approach taken under section 111(1) of the Minerals and Mining Act, 2006 (Act 703) in determining the citizenship of a corporate body for the purposes of that Act. This involves considering whether a company's membership, directorship and control are composed exclusively of Ghanaian citizens. Alternatively, a provision under which a company is regarded as a citizen only if it is is wholly owned by one or more citizens, such as provided for by article 65(3)(a) of Kenya's Constitution, may be considered.

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RECENT DEVELOPMENTS IN THE REAL ESTATE AND BANKING SECTORS IN KENYA

NORAH MUTUKU AND LYDIA OWUOR, NAIROBI

Strong real estate markets are driven by a combination of factors, the most important of which is land security. The integrity of any land tenure system is achieved through an authoritative legal regime and effective implementation. The impact of these two factors on both local and foreign investor confidence cannot be downplayed. They are essential elements in assuring investors of the integrity of a country's markets.

Kenya has recently made strenuous efforts to improve real estate development in the country through land transparency. There have also been other significant projects in the country which are expected to transform the real estate business climate. Already, the real estate market has begun responding positively to these improvements. Some of the major developments are discussed in this article.

The move to electronic land registration

There has been a transformation of the country's land registries from manual and paper-based methods to a proficient automated system. Upgrading the registries has resulted in greater efficiency in the storage and retrieval of land records, screening property records, processing land transactions and resolving anomalies related to land titles. The process has also made the land registries more accessible to the public. As well as providing a less cumbersome system, the electronic registries will improve oversight of the various stages of property transactions and coordination between the land departments which will in turn eradicate the possibility of corruption in these processes.

Reform of Land Control Boards

Certain plots of land in Kenya are classified as agricultural land and transactions involving them are controlled in order to facilitate an efficient and sustainable use of land.

The Cabinet Secretary for the Lands and Physical Planning Ministry announced the Ministry's plans to disband all the Land Control Boards in an effort to curb corruption. This was actioned through a notice in the *Kenya Gazette*, published on 29 April 2016, and the Cabinet Secretary is currently in the process of restructuring the Boards.

Land law reforms

In May 2012, Kenya overhauled its land law regime and enacted new land statutes which introduced radical changes to land ownership and dealings in land. The most fundamental reform was the introduction of a system of registration of titles only (registration of deeds was abolished) which is more orderly, progressive and intended to inspire confidence in title ownership. In addition, the National Land Commission was created to manage public land, among other related functions. The Land Laws (Amendment) Act 2016 (LLA) and the Community Land Act 2016 (CLA) both came into effect on 21 September 2016. The LLA amends the Land Act 2012, the Land Registration Act 2012 and National Land Commission Act 2012, although some of the sections amending the last-named Act are not yet in force. The CLA provides for the recognition, protection and registration of community land rights and the management and administration of community land.

Infrastructure—construction of the standard gauge railway

The Government of Kenya is currently developing a high capacity standard gauge railway (SGR) transport system, to carry both freight and passengers. The railway line starts at the port city of Mombasa and will run along the Northern corridor through Nairobi, Kisumu to Malaba. The SGR is expected to act as a catalyst for economic growth in the towns along the railway line. There are positive indications that there will be an upsurge of real estate developments in these towns with good price levels and demand. The SGR is also expected to contribute 5 per cent to Kenya's GDP.

Capped interest rates

Another major legal reform in Kenya is the Banking (Amendment) Act 2016 which came into effect on 14 September 2016. The Act capped the maximum interest rate chargeable on a credit facility at not more than 4 per cent of the base rate set by the Central Bank of Kenya. The Act also set the minimum interest rate granted on a deposit held in interest-earning accounts to at least 70 per cent.

The main objectives for capping interest rates are to protect borrowers from high and arbitrary interest rates and to increase access to finance by making loans affordable. Although there is an ongoing debate on whether capping interest rates is a good move, capping proponents see this intervention as a way of providing predictability to borrowers which will in turn boost the capacity to invest in Kenya, and also expand the target market for investors since those in the target market will now be in a position to access loan facilities at more affordable rates.

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"The main objectives for capping interest rates are to protect borrowers from high and arbitrary interest rates and to increase access to finance by making loans affordable."

AFRICA | **MAURITIUS**

UPDATE ON PROPERTY DEVELOPMENT IN MAURITIUS

KHEMILA NARRAIDOO AND MARC HEIN, PORT LUIS

Introduction

Property development has reached a tipping point in Mauritius. Since December 2014, we have seen the Government's introduction of the Property Development Scheme (PDS), as the successor to the previous schemes, namely, the Integrated Resort Scheme (IRS) and Residential Estate Scheme (RES).

This has led to a situation where the previous IRS and RES continue to benefit from the advantages granted to them under the old schemes. The Investment Promotion Act 2000 (IPA 2000) was amended to cater for the new PDS which was set up after consultation between the Government and various stakeholders at the beginning of 2015. Under the powers conferred by the IPA 2000 to the Minister of Finance and Economic Development, the latter enacted the Investment Promotion (Property Development) Scheme Regulations 2015 which provide the framework for the development of the new PDS.

Background

The figures show that about 1,500 residential units were sold by January 2015 through the previous IRS and RES schemes. As a reminder, the RES was introduced after the success of the IRS when it was felt that smaller landowners should also benefit from property development and bring in foreign direct investment (FDI) to the island. Numerous criticisms were made of those two schemes, however, the main one being that they were creating ghettos for rich foreigners who were living in their own communities and isolating themselves from Mauritian life. New solutions, therefore, had to be found.

After the global financial crisis and the slowdown of the property market, together with the desire to better integrate those foreigners who were investing in real estate, it was felt that a new scheme was needed and so the PDS was born in May 2015. The Investment Promotion (PDS) Regulations 2015 are designed to govern the new arrangements.

The objects and legal basis of the PDS

The objects of the PDS are to promote inclusive development and provide for residential, employment and leisure opportunities for Mauritians, members of the Mauritian Diaspora and foreigners. The PDS also aims to ensure that the development accrues to the nearby communities and to small, individual entrepreneurs. The Regulations define who can be a PDS developer, what a PDS certificate is and the obligations and responsibilities of the PDS company. It provides the legal framework for the implementation of the PDS project and the administration for the PDS Social Fund. Finally, the Regulations govern the process for the acquisition and resale of property, both residential and non-residential.

The idea of the PDS is to develop luxury residences on areas ranging from one to 50 arpents and restricted to freehold land. Each project is to develop at least six high-spec residential properties and also to provide public and green spaces. The PDS needs to provide leisure and commercial facilities and daily management services to look after these after completion.

Finally, social contributions are required whereby the PDS company will provide 200,000 Mauritian rupees per each residential property built. Registration duty has been simplified and is now charged at a flat rate of 5 per cent.

The PDS Guidelines

The PDS Guidelines have been published by the Board of Investment (BOI) and are available on its website at www.investmauritius.com. The Guidelines cover the whole framework starting with the application for a PDS up to the issue of the PDS Certificate. They provide for the type and extent of residential property to be acquired and the procedure required to acquire the PDS Certificate. Although it is a 27-page technical document, nonetheless the keen promoter or buyer will certainly find his way whilst reading through it. It also covers the duties and taxes which are payable and the steps to be followed when the contract is governed by provisions of the VEFA (*Vente en l'Etat Futur d'Achevement*) and the GFA (*Garantie Financière d'Achèvement*).

It is clear that many of the previous procedures relating to IRS and RES have been streamlined and promoters are largely supportive of the new rules. However, an outstanding headache for the PDS promoter, until recently, was the obligation to sell 25 per cent of a development to a Mauritian resident or member of the Mauritian Diaspora. Whilst the original idea was probably laudable in its aim to mix both Mauritian and foreign buyers, in practice, it has proved unworkable. No one may start a project if he has not secured the sale of 25 per cent of properties on offer to Mauritians and the obvious question was why would Mauritians pay more to buy within the PDS Scheme when they could buy land for development anywhere in Mauritius. Representations were made to the Government and the BOI to amend the law or to make these provisions more flexible.

Legislative updates

As the property market in Mauritius has matured, the Government has facilitated access to the PDS in its 2016 Budget by removing the stringent requirement on promoters to sell at least 25 per cent of residential units to Mauritian buyers. Likewise, the maximum permissible land size for a villa has been reviewed from half of an acre, which is approximately 2,110 sq. m., to 1.25 acres which is approximately 5,276 sq. m. The maximum limit of 50 acres has also been abolished.

To date, 19 PDS project promoters have received their Letter of Approval and two of these have been issued with their PDS certificates. Recent developments in the property sector in Mauritius have helped to establish more reliable structures for investors. The improved legislative framework shows a commitment from the Government to really use the PDS scheme and to cater for a wide range of buyers with different construction projects. This greatly aids Mauritius in its goal to secure a place on the global property market.

Juristconsult Chambers is a member of the DLA Piper Africa Group, an alliance of leading independent law firms working together in association with DLA Piper across Africa.

> "Many of the previous procedures relating to IRS and RES have been streamlined and promoters are largely supportive of the new rules."

HOTEL INVESTMENT IN AFRICA—THE "BIG FIVE" LEGAL ISSUES

HELEN HANGARI AND SEAN COPE, DUBAI

Safari enthusiasts typically focus on spotting the big five game animals. For potential investors into the African hotel sector, we discuss in this article the big five legal issues to spot.

Africa is a vast continent comprising 54 legal systems, so robust local law advice for each country within the continent is a necessity. This article is intended to highlight headline issues to prospective investors and should not be considered exhaustive.

Land ownership

An international hotel developer will quickly need to establish the types of land ownership it is entitled to hold under local law. Foreign ownership restrictions are common in Africa with international investors often restricted to holding leasehold interests or other kinds of interests limited in time. For example, in Nigeria and Ethiopia all land is state-owned and foreign ownership is restricted to 99-year leases. In Angola, only Angola's citizens may hold freehold title, however foreigners are permitted to hold long-term leases of up to 60 years in designated areas, subject to the proviso that they must then hold the interest for at least five years before disposal.

Due diligence challenges, including lack of property registration, remain a barrier to investment. However, there are examples of steps being taken in some countries to address this. For instance, in Kenya land rights were enshrined in the 2010 Constitution and the Unified Land Acts of 2012 while Botswana, Zambia and Ethiopia recently featured in Jones Lang LaSalle's "global top 10 improvers' list" for real estate transparency. As land due diligence is essential to any real estate investment, potential investors should be aware of any constraints on this. Although markets and land registration systems continue to mature, accessibility of title information and an absence of state guarantees may delay or frustrate title investigations, particularly in the less developed African jurisdictions.

Local partner

The majority of hotel owners in Africa are local or regional investors. International hotel investment has typically been deterred by the perceived risk, and international investors have also encountered difficulties with developing scale in Africa. In contrast, local or regional investors often concentrate on developing a single hotel for diversification of already successful businesses. Moreover, local or regional investors have benefited from being able to price risk lower than international investors and have been willing to develop a hotel at a lower return than their international competitors.

The importance of strong local relationships must therefore not be underestimated. However, it is imperative that investors and operators demonstrate a robust compliance framework in accordance with Know Your Client (KYC) and anti-money laundering regulatory requirements, at both local and global levels. This is particularly true for investors and operators subject to extra-territorial laws of their home state such as those from the US or EU member states. A lack of transparency about the identity of contracting parties should be resolved at the outset with continuous monitoring systems put in place alongside suitable contractual protections.

Tax and exchange rate risk

A degree of tax certainty may be gained by investing from a location which has a Double Tax Agreement (DTA) with the hotel jurisdiction. Mauritius and South Africa have attractive DTA networks and have historically been popular holding countries for investment into Sub-Saharan Africa. For example, both nations have concluded DTAs with numerous states including Rwanda and Uganda. In addition, Mauritius has concluded DTAs with Namibia and Senegal, and South Africa has DTAs with Ethiopia and Nigeria. However, in a bid to attract more capital from investors, a coordinated approach to taxation has also been on the agenda for the East African Community (EAC) following the introduction of the EA Common Markets in July 2010. Once ratified, the EAC's DTA is intended to lower corporate taxes and increase cross-border investments between the member states (namely, the Republics of Kenya, Uganda, Burundi, Rwanda and the United Republic of Tanzania).

International operators often denominate management fees in US dollars. This may cause complications for owners where, as often happens in volatile commodity exporting economies, the state wishes to reinforce the primacy of its domestic currency. Risks associated with foreign exchange restrictions therefore require careful consideration. For example, earlier this year the Tanzanian Government declared it unlawful to price goods and services for Tanzanians in US dollars. There is also a history of nations taking measures to prohibit all transactions in US dollars; with recent examples including Zambia and Ghana (though both prohibitions have since been lifted).

Devaluation of local currency is a primary concern for owners required to make US dollar-denominated payments to operators. Where hotels generate earnings in local currency, owners will be exposed to exchange rate gap risk where the local currency depreciates against the US dollar. Contractually, it is important that a particular exchange rate is specified and provisions are included for the use of an alternative exchange rate if the selected one ceases to exist. Commercially, financial institutions are becoming more skilled in providing hedging solutions; which, when coupled with a longer term view in assessing the impact of foreign exchange rates, can reduce, but not eliminate, the perceived currency risks. Furthermore, hotels can provide a natural hedge against currency fluctuation where revenues are in US dollars but operational costs are in the local currency.

Dispute resolution

Concerns regarding, amongst other things, the ability of local courts to resolve complex commercial issues in a timely and cost-effective manner, together with the relative ease of enforcement of arbitral awards internationally under the New York Convention (of which more than half of African states are signatories), have made arbitration the preferred dispute resolution method for international parties in Africa. A number of African states have made efforts to support arbitration in a bid to attract investment. For example, a Uniform Act on Arbitration Law, enacted in the OHADA grouping of 17 mainly francophone states in West and Central Africa, provides a single commonly applicable law governing the recognition and enforcement of awards. In addition, a number of African states, including Nigeria, Rwanda and Uganda, have adopted legislation incorporating the UNCITRAL Model Arbitration Law.

Nevertheless, arbitration should not be viewed as straightforward and consideration of a number of practical matters is required. Due diligence must be undertaken to identify the location of a counterparty's assets, including an assessment of the availability of measures to enforce an award against such assets. Consideration should also to be given to the relative merits of selecting an African jurisdiction as the seat of arbitration versus the traditional hubs of London or Paris or emerging locations such as the Dubai International Finance Centre or Abu Dhabi Global Markets.

Extra-territorial laws

Failure to comply with anti-corruption laws or trade sanctions could result in significant liabilities including civil and criminal penalties and reputational damage. International operations and investments of US companies are subject to restrictions imposed by the US Foreign Corrupt Practices Act. Anti-corruption laws and regulations of other countries also have extra-territorial reach, such as the UK Bribery Act and UK Modern Slavery Act. Anti-corruption laws and regulations generally prohibit companies and their intermediaries from making improper payments to government officials or other persons (eg to secure development rights in violation of public procurement rules or unlawful facilitation payments). Liability can even extend to a failure to put in place adequate procedures designed to prevent business partners, contractors or agents from acting in ways prohibited by these laws and regulations. The consequences of non-compliance render effective risk management procedures; contractual protections; KYC checks and an understanding of how to respond to allegations, a necessary cost of doing business.

COMMERCIAL LEASE AGREEMENTS IN MOROCCO: RECENT DEVELOPMENTS

MYRIAM MEJDOUBI, PARIS AND CASABLANCA

As part of a series of reforms by the Moroccan authorities affecting the real estate sector in particular, the *Dahir* of 24 May 1955 which introduced the mandatory regime for commercial leases, has been significantly amended by Law No 49-16 published in the *Official Journal* on 11 August 2016.

This law is due to come into force on 11 February 2017 and will apply to all commercial lease agreements in force on that date.

The Moroccan system of governing commercial leases bears many similarities to the French system, although it is less developed. In practice, business leases entered into in Morocco incorporate the characteristics of triple net leases, that is, fixed terms, costs being recharged to tenants, maintenance obligations on tenants, etc.

The purpose of this article is to provide a brief overview of the main changes introduced and what real estate actors need to know in order to effectively negotiate commercial lease agreements in Morocco.

Scope of commercial lease status

Law No 49-16 applies to leases over buildings or premises in which a business is operated. The new law also applies to buildings or premises rented by cooperatives, private educational institutions, private clinics, pharmaceutical laboratories and assimilated entities, among others.

One of the major aspects of this law relates to what seems to be the exclusion of the commercial lease status of lease agreements entered into on premises located in shopping malls. This provision, owing to the active lobbying of major retailers in Morocco, applies to shopping malls composed of premises owned, fitted out and operated the same way directly by its owner or by any other entity appointed by the owner.

Rent and service charges

Rent and service charges are freely negotiated between the parties. The commercial lease status does not include any limitations to the services charges that can be recharged to the tenant. Moroccan law only notes that the service charges are deemed to be included in the amount of rent if not expressly mentioned. In practice, Moroccan lease agreements are often triple net leases under which service charges incurred on the buildings (repairs, insurance premiums, management fees, etc) including taxes incumbent upon the landlord (such as "*taxe sur les service communaux*", or TSC tax) are contractually borne by the tenant.

Article 5 of the new law maintains the provisions of a previous law enacted in 2007 which restricts the right to revise the rent before the expiry of a three-year period as from entry into effect of the lease, and then every three years, and which limits each rent increase to 10 per cent of the amount of rent.

Renewal of the lease—security of tenure

The Moroccan system grants security of tenure to tenants. Specifically, the tenant benefits from a right of renewal of its lease if it occupies the premises for more than two years. This two-year occupancy obligation is excluded if the tenant paid an amount known as "key money" upon entry into possession, duly evidenced in the lease agreement or by separate deed. Key money is legally recognized and constitutes the minimum amount of eviction indemnity to be paid by the landlord should it refuse to renew the lease agreement.

The law specifies that the eviction indemnity shall be assessed in terms of the market value of the tenant's business based on its tax return of the last four years, the costs and expenses borne by the tenant for the repair and improvements of the premises, and for its relocation. It is, however, open to the landlord to prove that the loss suffered by the tenant is less than the sum the latter is claiming.

The landlord can refuse to renew the lease without paying the tenant compensation for eviction in a few narrowly defined cases, in particular where there has been a serious breach of the terms of the lease by the tenant (including, eg, non-payment of the rent 15 days after a written reminder from the landlord, change of activity without landlord's prior consent, etc).

Any provision of the lease restricting the tenant's right of renewal is null and void.

Assignment and sublease

Pursuant to article 25 of the new law, the tenant benefits from the right to assign its leasehold right together or not with its business, with the prior landlord's consent, despite any contrary provision in the lease agreement.

The landlord is only able to challenge the assignation after it is notified by the assignor and the assignee. As there is no joint legal liability between the assignor and the assignee on the tenant's obligation under the lease, in practice the lease agreement usually notes that the assignor remains jointly liable with its assignee of the payment of the rent and fulfilment of its obligations during the remaining term of the lease.

Article 25 also refers to a potential pre-emption right of the landlord on the tenant's leasehold right, without however providing any further details. It is assumed that as soon as this law comes into effect, the tenant must inform the landlord of its intention to sell the leasehold right, setting out the sale price and other terms and conditions of sale. The notification from the tenant will constitute a priority offer to sell to the landlord. The mechanism of the pre-emption right is still unclear, and how it will work in practice remains to be seen.

Article 24 of the new law states that unless the lease provides to the contrary, any subletting whether of the whole or parts of the premises, is authorized. As stated expressly in most leases in practice, the law reiterates that the subtenant cannot claim any direct rights against the landlord and the main tenant is liable to the landlord for the payment of rent and for all obligations under the lease.

When the rent of the sublease exceeds the rent of the main lease agreement, the landlord has the right to revise the rent under the main lease (either in agreement with the tenant, or before the courts).

Termination clause

Article 33 of the new law provides that the lease agreement may include a termination clause under which the landlord has the right to request termination of the lease following the tenant's failure to pay three months' rent, and 15 days after a reminder that payment is due has been sent.

In practice, the termination clause also covers the tenant's failure to pay service charges or taxes, and its failure to perform any of the obligations, charges or conditions arising under the lease.

The tenant may then be evicted by an order granted by the competent tribunal. This order will state merely that the termination clause has taken effect, and may be requested by the landlord within six months as from the expiry of the time granted to the tenant to cure the default in the initial summons.

In principle, the landlord is free to sell the leased premises, no specific pre-emption right having been implemented by law in favour of the tenant. Such a sale will not affect the lease and the tenant will become liable to the new landlord for compliance with the terms of the lease.

Conclusion

It is fair to say that the provisions of the new law are not self-explanatory, and the various debates which resulted in its enactment have not been made available to the public, making it even more difficult to interpret some of the less clear provisions of the new law.

Given the remaining ambiguities in the legal system governing commercial leases in Morocco, investors may anticipate more developments in this area in the near future.

"It is fair to say that the provisions of the new law are not self-explanatory."

FINANCING FOR REAL ESTATE PROJECTS IN MOZAMBIQUE—THE PROVISION OF LAND RIGHTS AS SECURITIES

VANESSA CHIPONDE, MAPUTO

The recent discovery of natural resources in Mozambique has led to increased demand there in several sectors, including real estate, which is regarded as one of the best investment opportunities in the country. This includes commercial and residential buildings, hotels, and logistics and warehousing.

Real estate developers often have to raise large sums through acquisition of loans to finance their proposed projects and lenders will mitigate the risk of default by borrowers by requesting securities. Before undertaking a real estate investment in Mozambique, investors should be aware of the relevant provisions under Mozambican law in respect to encumbrance of land rights, especially for the purposes of acquiring financing.

Rights over land in Mozambique

In Mozambique land is the property of the state. Consequently, land may not be sold, alienated, mortgaged or pledged. However, Mozambicans and foreigners may obtain the right to use and enjoy the land (*direito de uso e aproveitamento da terra*—commonly referred to as "DUAT"). A definitive DUAT granted for economic activities is guaranteed up to 50 years and may be renewed for a similar period (unlike a DUAT for residential purposes which is not subject to any fixed term).

The holder of a DUAT is free to develop the land for which it has obtained the DUAT and, provided all obligations of the DUAT holder are met, its rights are protected against any acts of third parties, or even the state itself. The holder of a DUAT has ownership over the buildings constructed on the land and is entitled to provide guarantees on such buildings and to conduct relevant business there.

There are several steps involved in acquiring a DUAT, particularly in rural areas, including consultation with local communities. If an application is approved, a provisional authorization of DUAT is granted, for a period of two years for foreigners and five years for nationals. During this time, the developments outlined in the usage plan submitted with the original request must be completed. Failure to comply with these obligations may result in revocation of the provisional authorization.

The holder of a provisional authorization must request a site inspection so as to confirm compliance with the usage plan and if the outcome of the inspection is favourable, the competent authority then commences the process for issuing the definitive DUAT.

Acquiring financing for a project in Mozambique

In Mozambique, the land and the DUAT acquired by private parties cannot be encumbered. What may be encumbered, however, are the improvements made (ie any construction work) on the land for which a developer has obtained a DUAT. The only form of security over immovable property permitted under the Mozambican law is a mortgage. As a result of this limitation, investors may find it difficult to provide security for funding for a new development where no infrastructure has been erected on the land.

Nevertheless, there are certain contractual arrangements permitted by law that can help investors to secure financing. One option is for the borrower and the lender to agree a promissory mortgage arrangement, under which the borrower promises to mortgage the infrastructure to be erected on the land in favour of the lender. Once any improvement is made on the land (and note that the lender does not have to wait for infrastructure to be complete to execute the promissory mortgage), the lender may enforce its right to have the improvement mortgaged in its favour.

Normally and for greater security, in addition to the promissory agreement, the borrower would also have to issue an irrevocable power of attorney granting powers to the lender to constitute the mortgage in its own favour, without requiring the borrower to agree to the transaction. If the borrower does not provide the security at a later date and, if for some reason, the lender cannot unilaterally take the security based on the power of attorney referred to above, the borrower may be compelled by the court to fulfil its promise and offer the agreed security.

It should be noted that the promissory mortgage agreement must be take the form of a public deed and is also required to be registered with the Real Estate Registry in order to be enforceable against third parties.

When the promissory mortgage is registered, the Real Estate Registry enters the promise in the title deed of the property meaning that anyone can see that a promissory mortgage has been made over the property (the same applies with the definitive mortgage). Thus, registration does not only make the mortgage valid, but also makes it public. In case the property is sold, the mortgage will still be attached to the property, that is, transfer of the property implies the transfer of the mortgage and the mortgagee will be entitled to execute the mortgage regardless of the owner of the property.

It should be noted that, from the lender's point of view, there are some risks involved with using a promissory mortgage agreement as a security. As referred to above, a DUAT is initially granted provisionally for a period of two years for foreigners and five years for nationals, and may be revoked if the approved usage plan is not carried out. The promissory mortgage agreement would not subsist if the DUAT was revoked in these circumstances, as the infrastructure would not be erected on the land.

When negotiating the facility agreement, the lender should always include some provisions to mitigate the risks involved. For example, the lender may include a term in the agreement obligating the borrower to inform the lender of any adverse facts that may affect the transaction (including the notification from any relevant public authority regarding the breach of the DUAT obligations and communication of revocation of the provisional DUAT). In this case, the lender, through the irrevocable power of attorney, could substitute the borrower and take corrective measures to prevent the provisional DUAT from being revoked.

> Although Mozambique has passed legislation over the last 10 years to better regulate access to land in Mozambique, land disputes remain common.

Furthermore, the promissory mortgage agreement may also provide that the revocation of the DUAT due to the borrower's fault is a breach of the facility agreement, in which case all amounts owed would become due by the borrower. For this purpose, it is important for the lender to request other securities from the borrower, which can be used in case of any breach from the borrower, before the conclusion of the definitive mortgage agreement.

Conclusion

Although Mozambique has passed legislation over the last 10 years to better regulate access to land in Mozambique, land disputes remain common. Anyone acquiring or funding acquisition of property in Mozambique must make sure the developer holds all the necessary government authorizations.

Despite the fact that the Mozambican land legislation contains some restrictions in respect to the access and disposal of the rights over land, it still is possible to conduct business in the country and to protect investments in real estate. When considering such an investment in Mozambique and its funding, it is advisable for both foreign investors and lenders to seek the relevant legal advice, in order to mitigate the risks involved.

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ON SAFARI: SOUTH AFRICA HUNTS DEALS IN CEE AND SEE

DENISE R. HAMER, LONDON, PRAGUE AND VIENNA

The real estate community was abuzz in March 2016 when South Africa's Redefine Properties acquired a 75 per cent stake in Poland's Echo Prime Properties' 18-asset portfolio, a deal valued at EUR 1.2 billion. This marked the largest offshore purchase to date by a South African property company and moreover, the largest transaction in the history of the Polish real estate market.

That was just the beginning. This year has seen a breathtaking volume of property acquisitions and investments in Central and Eastern Europe (CEE) and South Eastern Europe (SEE) by South African investors.

South Africa's New Europe Property Investments (NEPI) has been active in Romania since 2008, but this year expanded to Slovakia and the Czech Republic with several retail property acquisitions. As well, South Africa's Pivotal Property Fund and Rockcastle Global Real Estate have invested in Poland; Tower Property Fund has invested in both Poland and Croatia; Atterbury Europe has invested in Serbia; and JSE-listed REIT, Hyprop Investments has co-invested in shopping malls in Serbia and Montenegro, which investment at EUR 202 million is the largest single asset deal in SEE in the last five years. In July 2016, Greenbay Properties acquired the Planet Tuš Shopping Centre in Slovenia and in October 2016, Accelerate Property Fund announced its intended November 2016 acquisition of the OBI "DIY" retailer's real estate portfolio in Austria and Slovakia. As we approach the end of 2016, it is clear that South Africa has become a meaningful player in CEE and SEE.

CEE and SEE property markets have long been supported by foreign investment. In the years 2011–15, Western Europe and the United States invested EUR 16.4 billion into the CEE and SEE region. Investment in CEE and SEE from Western Europe was predictable, given their respective geographies and economies (during this period annual growth in Poland averaged 3.9 per cent as opposed to an average of 0.9 per cent in the Eurozone). In addition, given their respective histories, CEE and SEE regional investment was predictable from Russia. Even Israel and China have shown interest in CEE and SEE investment, although on a more selective basis and to some extent, as a gateway to Western European investment.

But South Africa's investors have traditionally preferred domestic property markets. Only this year, Vukile Property Fund ventured out of South Africa with its investment in the British Atlantic Leaf Properties which focuses on the United Kingdom.

So what is it that is enticing South African investors to hunt for deals in the CEE and SEE property markets?

There appears to be a confluence of two integrated economic factors. South Africa is experiencing a rising interest rate cycle. The cost of five-year debt in South Africa exceeds 9 per cent. Simultaneously, South Africa is experiencing a softening real estate market. Average yields on prime properties in South Africa are below 7 per cent. Thus, South Africa is beset by expensive capital/ lack of liquidity and low yield.

In contrast, aggressive post-financial crisis quantitative easing schemes in the United Kingdom and the Eurozone have reduced the average debt cost to 3 per cent and under, while average prime property yields have exceeded 6 per cent. CEE and SEE investment offers South African investors low cost capital/liquidity and yield.

Added to these two economic factors is a particularly significant risk/reward factor that makes CEE and SEE particularly attractive to South African investors. They have a decidedly different perspective to that of other investors on CEE and SEE political and legal risk. From South Africa, CEE and SEE may be viewed as a political and legal, as well as economic, investment safe haven.

To conclude, South Africa is a welcome source of foreign investment in CEE and SEE as we enter 2017. DLA Piper will continue to update you on legal and commercial developments in CEE and SEE.

> "What is it that is enticing South African investors to hunt for deals in the CEE and SEE property markets?"

AFRICA | USA

PROJECT FINANCING IN SUB-SAHARAN AFRICA

JOSEPH A. TATO AND PAOLO S. BOADO, NEW YORK

"An understanding of local law and how it works with New York or English law is essential in structuring a project properly."

Financing power and infrastructure projects in Sub-Saharan Africa

The World Bank estimates that Africa's annual infrastructure financing requirements are US$ 93 billion, roughly equivalent to 15 per cent of the continent's GDP. As this amount dwarfs available in-country resources, there has been an effort to seek alternative financing throughout much of the continent in order to address the gap. This insufficiency in infrastructure financing is felt most acutely in Africa's power sector where it is estimated that only about 30 per cent of Sub-Saharan Africa's population have access to stable electricity, stifling economic growth throughout the Sub-Saharan region.

Why project finance?

The financing of infrastructure projects, including energy generation and transmission projects, is essential to the development of emerging market countries. Since traditional financing sources are insufficient to meet the infrastructure needs, and in some instances are not even available, we have seen the rise of limited recourse project financing throughout much of Sub-Saharan Africa. This is often arranged and funded by international and regional lenders including multilateral agencies (eg, International Finance Corporation, Africa Development Bank) development financial institutions (eg, Overseas Private Investment Corporation, FMO, PROPARCO), export credit agencies (US Export–Import Bank), commercial banks and capital markets (usually in New York or London). Limited recourse project financing is a viable alternative to address a host of risks not typically experienced in more mature markets. These risks include perceived political risks, credit quality, underdeveloped legal and economic systems as well as unfamiliarity of local stakeholders with accepted financing requirements. In order to address these risks, many project sponsors have turned from traditional sources of capital to the more document-intensive and complicated financing technique of project financing.

Limited recourse project financing for infrastructure and energy projects combines the use of debt with deal-specific project structures. The ultimate credit basis for a project financing is the ability of the structured projected cash inflows generated by an asset or group of assets to service debt timely and to distribute equity returns to the project sponsor. Project finance lenders rely on the projected cash flows—not on a sponsor's balance sheet—as the credit basis and consequently require structuring that often ultimately relies on real property issues. As such, project finance lenders (both international and regional) and sponsors require a thorough security package over a project's assets, including real property.

Common real property issues in project financing

At the development stage of a project, the project company (usually a single-purpose entity) owns few assets other than contracts with project counterparties and possibly certain permits and approvals granted by the host government. Except for the real property where the project is situated, there generally are minimal assets for lenders to secure a financing. This lack of project assets highlights the importance of ensuring a lender's ability to secure the project's real property assets,

whether the project site is owned by the project company or held through a long-term leasehold or concession interest. The security package, including the real property assets of the project company, comprises the lender's collateral.

To help secure the collateral for the project, lenders require assurances on the following key questions:

- Can real property be acquired or obtained for the project?
- Can a valid security interest or charge be created that has priority over competing claims to the real property assets of the project?
- Are there any legal restrictions affecting real property assets of the project, its ownership or sale and conveyancing?

Unlike other project financing documents which are generally governed by New York or English law, *lex situs*, that is, the law where the real property is located, governs contracts affecting real property. Consequently, an understanding of local law and how it works with New York or English law is essential in structuring a project properly.

Creation and perfection of a valid security interest or charge

Assuming that local law permits the creation of a valid security interest or charge over real property, it is important to understand in what form the security interest or charge may be created. In addition, there are generally local law procedural requirements or formalities that need to be observed, such as the execution of notarial deeds or particular signing conventions, that are not customary in more developed markets.

Key among the lender's diligence before entering into a project financing in Sub-Saharan Africa is understanding the quality of the custodial management both of land records and of security interests or charges over real property. Some countries, such as South Africa, have an efficient and robust land recording procedure where the system of land registration helps to assure lenders of the project's title. However, not all jurisdictions enjoy such reliability, making it necessary to undertake independent investigations.

Foreign ownership restrictions

While a complete delineation of the laws affecting real property in Sub-Saharan Africa countries is beyond the scope of this article, it is not uncommon for countries in Sub-Saharan Africa to restrict the types of rights individuals or project companies may hold. For instance, Nigerian law generally prohibits non-Nigerian citizens and entities from owning land unless permitted by the governor of the state where the land is situated. In Ghana, non-Ghanaian citizens and entities are permitted a maximum 50-year leasehold interest. In Ethiopia, Ethiopian law reserves the ownership of all land to the state but permits a non-Ethiopian citizen or entity to own immovable property, if it holds an investment permit from the appropriate authority, or lease immovable property. Lenders also need to investigate whether a foreign lender can enforce its rights over real property or if the appointment of a local security trustee is required to effectively enforce its rights. Sponsors and lenders also need to ascertain which governmental approvals, notifications or submissions should be submitted before local courts or a regulator to effectively enforce their rights either in their own name or through a local security trustee.

Ownership of ancillary sites

Large infrastructure projects also typically include smaller ancillary sites that are essential for the construction, operation and maintenance of the project. Power generation projects, for example, usually require the maintenance of additional sites for transmission lines, substations, docking facilities and water access. All such additional facilities and rights-of-way should be included in the real property secured by the lenders.

Conclusion

Project financing has been a viable source of additional capital for much needed infrastructure in Sub-Saharan Africa. Its basis, however, is rooted in an assurance that the underlying real property interests will be properly documented and are enforceable when needed. It has been said that project financings are really complicated real property transactions. While this statement may be debated in professional circles, what is beyond debate is the essential role that real property aspects have in well-structured project financings of energy and infrastructure assets.

AFRICA | ZIMBABWE

FOREIGN REAL ESTATE INVESTMENT OPPORTUNITIES AND INVESTMENT PROTECTION IN ZIMBABWE

JABULANI NHONGO AND BRIDGET MAFUSIRE-KAMANGA, HARARE

Introduction

Following the period of hyperinflation that gripped Zimbabwe from the late 1990s until the end of 2008, the period between 2009 and 2012 was marked by an economic rebound following the introduction of the multiple currency system, with the economy growing at an average rate of 11.0 per cent per annum during this period. However, from 2013 onwards GDP growth decelerated sharply, culminating in GDP growth at 1.5 per cent in 2015. Additionally, Zimbabwe is currently facing a cash crisis, although this has presented a unique opportunity for generating value through the real estate sector.

The real estate sector has thus taken on an increasingly important role as a store of value in Zimbabwe. This has necessitated innovative financing and development structures in respect of real estate in order to cater for various clients' needs. Despite the cash challenges facing Zimbabwe, the demand for well-priced real estate remains strong because real estate is perceived as a domestic investment safe haven, particularly among Zimbabwe's population in the diaspora, who maintain a continued, significant interest in property investment in their home country.

Ownership of and investment in land

Although agricultural land is typically state-owned, and rural land is typically communally owned, urban land in Zimbabwe is held under freehold title, and registered at the Deeds Registry under the Deeds Registries Act. Due to the real rights that attach to ownership of urban land, there is thus significant interest in, and potential for, investment in urban land in Zimbabwe.

Despite the difficulties encountered in Zimbabwe's manufacturing sector, industry benefits from having a strong infrastructural base, with the corollary being that investment in industrial property would not necessitate wholesale infrastructural restoration. Rather, investment in industrial property represents an attractive opportunity due to the potential for such an investment to trigger the resuscitation of the manufacturing sector, thereby aligning with the Government's policies geared towards stimulating Zimbabwe's export economy.

Investment in residential property has also seen an interesting shift in the profile of investment and development. Cluster housing developments, and sectional title housing have become very popular in Zimbabwe, largely due to affordability, size and the ability to implement innovative pricing structures for these types of investments.

As mentioned above, due to the continued interest in property amongst Zimbabwe's diaspora population, there has been an increased demand for smaller-scale, affordable housing in both low and high density areas. This demand, and the need to address it, look likely to grow as property assumes increased centrality as a custodian of value within Zimbabwe.

Furthermore, on 31 October 2016 the Special Economic Zones Bill was passed into law. Under this legislation, certain areas in Zimbabwe (based either on geographical location or sector) are designated as special economic zones which are tailor-made to promote investment through the provision of various incentives. Due to the high demand for housing in Zimbabwe, as well as the fact that the Government has identified affordable housing as a priority, it is conceivable that the real estate sector may benefit from this legislation and the incentives that come with it; thereby acting as a further boon for the real estate sector.

Risks and protection mechanisms

From a risk perspective, common risks which have been identified in relation to investing in real estate in Zimbabwe include restrictions on repatriation of funds and arbitrary amendments of government policies (particularly policies governing indigenization and exchange control).

Notwithstanding the above, there are measures in place which are aimed at addressing these risks. For example, the Zimbabwe Investment Authority Act provides for certain incentives for licensed investors, including assistance with regards to repatriation of funds invested in Zimbabwe; whilst the indigenization policy has been streamlined so as to apply on a sectoral basis such that each investment is viewed by the relevant authorities through the prism of each individual sector, and on a case-by-case basis (rather than a "one size fits all" approach).

Furthermore, Zimbabwe is signatory to a number of treaties which are aimed at protecting investment in Zimbabwe; as well as recently becoming a member of the African Trade Insurance Agency (ATI). In addition, a large number of the Bilateral Investment Promotion and Protection Agreements (BIPPAs) entered into by Zimbabwe include standard clauses which provide a legal basis for investors to enforce their property rights in Zimbabwe.

Conclusion

The following factors are vitally important when assessing how the real estate sector can act as a catalyst for investment and development in Zimbabwe:

i. *Demand*: approximately 1.5 million people do not have access to housing, which thus presents a readily available target market. Furthermore, the Government has identified affordable housing as a priority, which may foster beneficial investment conditions.
ii. *Growth of the informal sector:* the considerable growth of the informal sector has resulted in a need to accommodate informal traders through the development of smaller scale commercial structures outside of the central business district in major urban hubs.
iii. *Infrastructure development*: there is a need to upgrade Zimbabwe's infrastructure to keep up with the increasing use of this infrastructure (roads, sewerage system, water delivery and drainage).
iv. *Natural resources*: Zimbabwe's abundant natural resources provide the materials necessary to build affordable housing in the country.

In light of the above, there is a need to foster an environment which takes advantage of the demand and opportunities available in the real estate sector. To date, this has taken the form of cluster housing and sectional title models using inventive pricing models aimed at addressing concerns regarding affordability of urban land. However, due to the acute demand for urban land (including commercial property and industrial property) and housing, there are further opportunities in the real estate sector which can assist in addressing the challenges currently facing Zimbabwe, and thus improving its investment environment.

Manokore Attorneys is an independent law firm in Zimbabwe. Although DLA Piper does not have a formal relationship with Manokore Attorneys, we work together regularly.

> "Zimbabwe's abundant natural resources provide the materials necessary to build affordable housing in the country."

GENERAL REAL ESTATE | DENMARK

SALE AND LEASE BACK TRANSACTIONS GAINING GROUND IN THE DANISH PROPERTY MARKET

MICHAEL NEUMANN, COPENHAGEN

As the Danish real estate market has become increasingly popular among foreign investors in recent years, gradually, the property sector has simultaneously experienced tougher competition. At the same time, as the employment rate improves, many companies are looking for more office space, a demand which is being met by the many new real estate projects under construction in the larger cities. These projects continue to provide the market with an influx of prime office assets.

Taken together, these factors make for a low yield commercial property market, which has encouraged both investors and sellers to make use of alternative transaction structures when dealing with commercial properties. In particular, sale and lease back transactions have become popular as they provide investors and their newly acquired properties with a reliable occupant and consequent rental income, while allowing the former owner of the property, now turned lessee, to allocate the capital previously tied up in the property to his business activities instead.

2015 saw several sale and lease back arrangements with institutional investors acquiring the domiciles of larger Danish corporations, most of which were concentrated in and around the central parts of Copenhagen and Aarhus. Numerous sale and lease back transactions have also been completed in 2016 with more expected to come, as the trend remains popular among investors who are looking for a stable yield.

Basic structure of sale and lease back transactions

In essence, sale and lease back transactions are comprised of two parts: a transaction agreement concerning the sale of the property, and a lease agreement concerning the seller's right to continue to occupy the property. It is imperative for the efficacy of the transaction that the two underlying agreements are structured on back-to-back terms in order to be both coherent and to reflect the intentions and conditions of both parties. Individually, however, both the lease agreement and the transaction agreement require the level of attention a party would typically put into such agreements.

It is important to note that there is a certain level of interconnectivity between the price paid for the property by the investor and the rent paid by the lessee in accordance with the lease back scheme, which is examined below.

Two important issues

A lease agreement subject to regulation by the Danish Business Leases Act or a financial instrument?

Often, investors will seek to ensure that the lease agreement is exempt from regulation under the Danish Business Leases Act, as the lessee may otherwise benefit from the significant protection provided by the Act.

Investors may be indifferent as to whether they pay a high price to acquire the property and in turn receive a correspondingly high rent, or whether they pay less and receive less rent in order to make the ultimate return on investment correspond to their expectations. However, if the investor has paid a high price expecting to collect a proportionally high rent, it should be aware that the Danish Business Leases Act allows for a party to demand a rent review and have the rent adjusted to correspond to the market rate, and there could be a detrimental effect on its profits if the rent is adjusted downwards without sufficient regard to what was paid for the property.

To avoid such a scenario, the parties must consider the agreements to be parts of a financial instrument, whose primary purpose is to provide the investor with a return on the price he paid for the property, rather than acting as a lease agreement, which will only be considered an underlying obligation of the financial instrument. In short, it is essential for the entire body of agreements to highlight the investment in the property as the main activity of the arrangement. The lease serves only to help finance the project, and is thus not considered a business lease in terms of the Business Leases Act.

There have been several cases before the Danish courts in which the key issue was whether an agreement is subject to regulation by the Business Leases Act or exempt. The judgments to date indicate that this is an issue to be determined on a case by case basis, but a decisive factor is that the agreement differs significantly from a customary lease agreement under the Business Leases Act.

It is difficult to anticipate with any certainty when the Danish Business Leases Act will apply and when it will not, so parties should define the specific terms of their agreement in sufficient detail. Relevant terms may include the right to terminate the lease, additional expenditures aside from the base rent and the parties' respective rights to carry out alterations and renovations to the property.

Insolvency or illiquidity of the lessee

An agreement with a lessee who is unable to perform its financial duties as they fall due is a general risk lessors take and this must be taken into account when doing business. However, if the sale and lease back transaction concerns a property in which adaptations have been made specifically to suit the needs of the lessee, it is probably going to be difficult to find an occupant willing to replace that lessee on similar terms.

This risk is particularly significant where the lease agreement was intended to run for an extended period, and the insolvency of the lessee occurs when the investor has taken few or no steps towards preparing the property for sale. The exact consequences are of course specific to each case, but it is not unlikely that the investor will be forced to make do with a temporary—or even permanent—reduction in rent, or worse, the property will remain vacant for as long as it takes to find a new, suitable lessee.

Therefore, it is highly advisable that investors thoroughly investigate the liquidity of the seller as the investment strategy relating to sale and lease back arrangements often strongly relies on a stable lessee.

Conclusion

In a low yield market, sale and lease back arrangements constitute a stable and attractive investment for investors. With many companies looking to release themselves from their property assets, there is potential for lucrative investments in sale and lease back transactions.

However, it is important that the arrangement is structured as an investment with the objective of obtaining a return, while the lease is a derived obligation meant to contribute to the financing of the investment and not to act as a lease agreement in its own right. Otherwise, regulation may seriously alter the terms of the lease agreement. These terms may have been crucial to how the arrangement in its entirety has been conceived and how the contracts have been negotiated, potentially rendering the investment less profitable than initially assumed.

With the proper due diligence and strict drafting of the relevant contracts, it is possible to mitigate the above-mentioned risks, thus providing a viable alternative investment strategy for property investors looking to expand their portfolio. Indeed, the Danish market continues to see many cases where the sale and lease back model is employed to the benefit of both the investor and the selling company.

Horten is an independent law firm in Denmark. Although DLA Piper does not have a formal relationship with Horten, we work together regularly.

GENERAL REAL ESTATE | FRANCE

CHANGES TO THE FRENCH CIVIL CODE AND THEIR IMPACT ON CONTRACTUAL PRACTICES IN REAL ESTATE

ANTOINE MERCIER, PARIS

Although certain of its provisions have been amended from time to time, a substantial part of the Napolenonic Code, that is, the French Civil Code, still dated back to 1804. However, a wide reform of the Code was recently undertaken, and Loi 2015-177 of 16 February 2015 (the "Reform") came into force on 1 October 2016.

The Reform, which both acknowledges the contribution of case law and also contains entirely new provisions, is of huge significance because it impacts the most important part of the Civil Code, the provisions on contract law. This means it affects most contractual arrangements which are commonly used in transactions involving real estate in France.

Extension of the principle of good faith to the formation of the contract

The Reform extended the principle of good faith to all phases of a contract's life, from the pre-contractual phase, including the way negotiations are conducted (article 1112) to performance (article 1104). Moreover a general duty of information was created extending the scope of good faith even further. Thus, for example, under article 1112-1, where a party becomes aware of information which would affect the other party's consent, that party must be given that information. This general duty to inform is crucial since its breach may allow the other party to rescind the contract.

These new provisions will affect all contracts that are generally used in real estate transactions, including contracts for the sale and purchase of land, leases, management agreements, construction contracts, etc. The rest of this article will examine the main contracts affected in this area.

Ascertaining rights under pre-emption agreements

When the parties to a sale and purchase agreement (whether under a share sale or an asset sale scheme) or to a lease agreement decided to include a pre-emption right to the benefit of either party, there was often uncertainty as to the existence and enforceability of that right. Now, however, the new article 1123 incorporates into the Code a definition of, and the legal regime applicable to, the pre-emption agreement (*pacte de préférence*). In particular, it specifies the enforcement measures available to the parties. The right of the beneficiary of the pre-emption agreement to be substituted in the sale and purchase for any third party acting in bad faith (ie a third party aware of the existence of the pre-emption agreement and of the beneficiary's intention to exercise it) is confirmed in the Code, whereas previously, it was only acknowledged in the case law. Further, any third party who suspects the existence of a pre-emption agreement is now entitled to approach in writing the assumed beneficiary, who must confirm within a reasonable time, whether such a pre-emption agreement exists and whether the beneficiary intends to seek performance. Where the beneficiary fails to respond timeously, it will be deemed to have waived any right under the pre-emption agreement.

Reinforcement of rights and obligations under unilateral undertakings to sell

There are many reasons why parties might want to structure an agreement as a unilateral undertaling of one party granting an option to the other party(ies). Unless one party is not legally entitled to make any binding commitment, unilateral agreements are often used to set out final terms and conditions of a specific type of agreement, such as a sale, while the formation of the contract itself is postponed until the time when the other party actually performs specific obligations, such as upon exercising a call option. This has a number of potential benefits such as, for example, the avoidance of performance risks for a seller. Usually the granting of a call option under a unilateral agreement is made subject to a deposit. Where the beneficiary of the option fails to exercise it within the contractual deadline, the seller takes the deposit and is free to sell immediately to any third party.

The legal rules governing unilateral agreements before the Reform were unclear, particularly as regards whether the promissor (ie the party committing from the outset) could withdraw from its commitment prior to the formation of the contract (ie the date of exercise of the call option under a sale contract). The Code now specifies in article 1124 that the unilateral undertaking cannot be withdrawn until the time period specified in the contract has passed. As soon as the beneficiary confirms its agreement to the contract, the contract becomes binding upon both parties. Where the seller has granted another concurrent right to a third party, this right becomes null and void.

Obligation to re-negotiate in case of unforeseeable events

There was a trend supported by recent case law whereby parties to an agreement, the performance of which had become too onerous for one party as a result of unforeseeable circumstances, had to re-negotiate. This trend has now become a legally binding obligation under article 1195 of the Code. The new provisions state that a party for whom performance of a contract becomes "excessively onerous" due to an unforeseeable change in circumstances (which change was a risk that the party did not agree to bear), is entitled to seek re-negotiation of the contract with the other party. Where this re-negotiation is unsuccessful (throughout which the parties must continue to perform their contractual obligations), either party may have recourse to the courts for help in re-negotiating the contract or for an order to terminate it. Although this could be seen as judicial intervention in a contract that parties have freely agreed to, it should be noted that the parties are entitled to waive or restrict this right in the contract. Nevertheless, for contracts which are not performed in full simultaneously by all the parties, it is advisable to include an express waiver or limitation.

GENERAL REAL ESTATE | **HUNGARY**

THE COMMERCIAL REAL ESTATE MARKET IN HUNGARY

SZILARD KUI , BUDAPEST

> "The 12-month period under review saw an interesting shift as non-EU investors (mainly from the US and the Middle East) accounted for 53 per cent of the transactions, outperforming EU investors by 35 per cent."

Overview

We recently published our first Hungarian Real Estate Intelligence Report, examining the developments and market trends of the past 12 months, on the basis of data obtained from 15 deals in which we acted either for the sellers or purchasers.

The Report indicates that during the last 12 months, the market has demonstrated healthy growth in terms of completed deals and transactions values, as well as the return of foreign investors. The terms of these deals suggest that it remains a seller's market. There is strong competition for good assets and sellers are generally able to negotiate exits which expose them to limited residual risk.

Our data clearly shows some new trends such as the strong appetite of investors for logistics properties, the increasing number of foreign buyers from non-European Union (-EU) countries as well as the complete absence of bank guarantees as the means to secure payment of the purchase price.

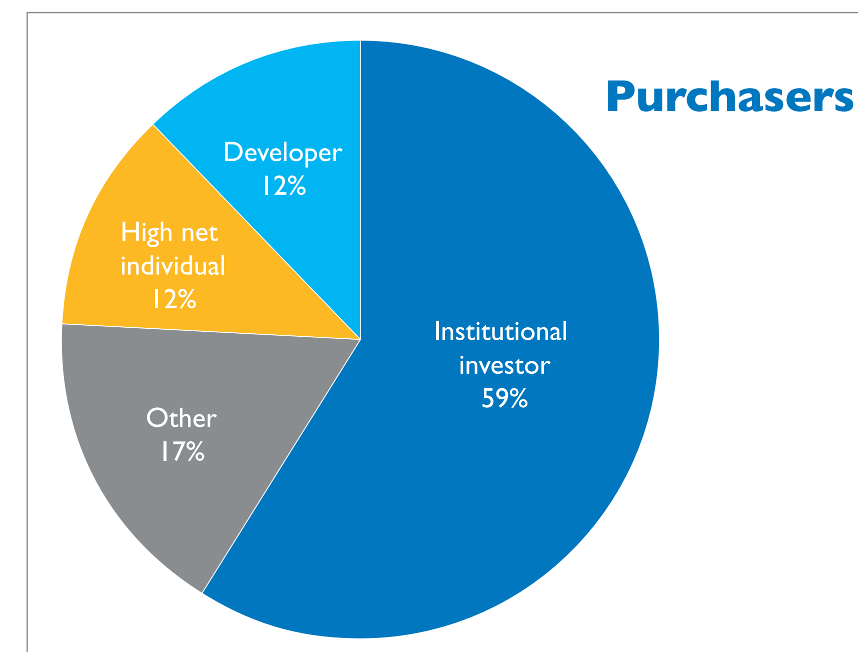
Asset classes

In line with past trends, office properties remained the dominant commercial asset class on the Hungarian commercial real estate market, accounting for 44 per cent of the deals. There has been a significant increase in logistics/industrial transactions, which stood at 25 per cent, and as in other countries in the region, was mainly fired by demand from the automotive and e-commerce industries.

Another story is told by the relatively high number of development property transactions, which stood at 25 per cent and included plots and buildings for refurbishment in almost equal proportions. This is a clear sign that the property development cycle has already restarted and developers are struggling to keep up with increasing demand. The increased acquisition activity from developers will translate into new commercial assets being introduced into the market around Quarter 4 of 2017 and Quarter 1 of 2018.

Who are the purchasers?

Institutional investors were once again the most active homogenous investor class, dominating the field with a share of 59 per cent, followed by high net individuals and developers both accounting for 12 per cent of the deals respectively. No other single investor class reached 10 per cent and multiple players shared in the remaining 17 per cent.



It is interesting to note that although only 12 per cent of the purchasers were developers, 25 per cent of the total assets traded during the period under review were development/redevelopment properties, which means that it was not only developers who were seizing the opportunity to acquire these properties.

While the Hungarian commercial real estate market was always dominated by international investors, we saw an interesting shift during the period as non-EU investors (mainly coming from the US and the Middle East) accounted for 53 per cent of the transactions, outperforming EU investors by 35 per cent.

Compared to previous years there was a slight increase in the activity of domestic players who were responsible for 29 per cent of all transactions considered.

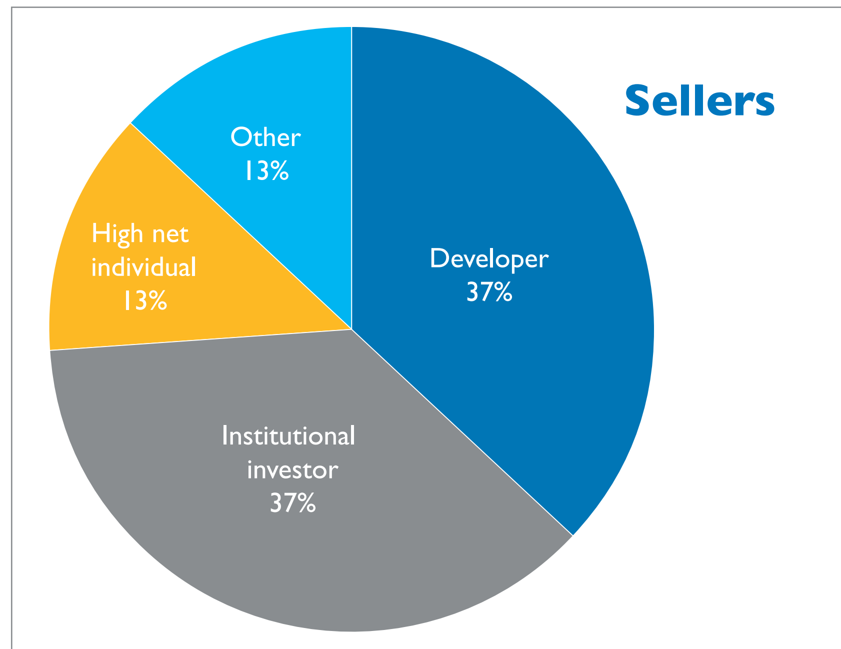
However, this is still lower than the figures we usually see in other Central and Eastern European (CEE) countries.

Sellers

On the seller side, we saw a diverse picture where developers were just as active as institutional investors, both reaching 37 per cent. This increased activity from developers is mainly driven by the fact that increasing prices mean they are now able to offload assets which could not have been sold at a profit during previous years. Due to the lack of new developments and increasing demand, we have also seen a few transactions where developers successfully sold such non-core, less attractive assets for which there was no investor appetite before. With 13 per cent of the transactions, high net individuals showed roughly the same level of activity as on the purchaser side.

Domestic sellers accounted for 50 per cent of the transactions, a figure which is partly explained by the healthy number of newly developed properties—which are usually owned by domestic actors—being sold.

EU-based sellers scored 37 per cent while non-EU sellers only reached 17 per cent. These figures basically reflect the dynamic of the CEE market, where EU-based (mainly German) investors, through individual acquisitions, put together portfolios in order to sell them in big packages at a premium to heavy weight investors coming from the US and the Gulf Area.



Share deal or asset deal?

There is nothing new under the sun when it comes to deal types as 69 per cent of the transactions were once again concluded as share deals.

Share deals are particularly advantageous for purchasers for a number of reasons: they can be structured in a way to reduce the real estate transfer tax bill; lease agreement securities and supplier contracts do not need to be transferred from seller to purchaser, they remain with the special purpose vehicle (SPV) being sold; title to the property remains also with the SPV so it is not necessary to deal with the various pre-emption rights that would otherwise apply in an asset deal; and finally there might be some losses accumulated in the SPV which can be carried forward for the purpose of lowering future corporate income tax bills.

From 2008 the number of portfolio transactions in Hungary rose year on year and stood at a record high of 44 per cent during the period we examined. It is clear that international investors are increasingly looking for opportunities where they can acquire a pan-European package of 40 to 60 properties in a single transaction.

Fixed or adjusted purchaser price?

When it comes to agreeing on a purchase price the parties have two options: either they agree on a fixed purchase price, or on a variable purchase price which addresses the reality that the value of the property does not necessarily remain static throughout the transaction period. During the period we examined, in 56 per cent of the transactions, the parties used a variable purchase price that was adjusted and finally determined after closing. In all these instances the closing accounts mechanism was used and we have not seen any examples of the locked-box structure which is more common in classic M&A transactions.

An important concern for any seller is to ensure that the buyer will be able to pay the purchase price at closing and accordingly sellers typically asked for securities in addition to the representations and warranties made by the purchaser in a sale and purchase agreement. Traditionally bank and parent company guarantees played an important role on the Hungarian market, as well as letters of credit or escrow arrangements. However, one of the consequences of the recent economic and banking crisis is that bank guarantees have all but disappeared from commercial property acquisition transactions. Escrow arrangements have become virtually the only security and these were used in 63 per cent of the transactions by the parties. In 37 per cent of the transactions, no payment protection was used at all. This relatively high number of unprotected transactions is explained by the fact that there are more and more heavyweight players on the Hungarian market who use their brand as payment security and by doing so, can lower their transactional costs.

Warranties

Sellers will always try to agree on warranty periods that are shorter than the statutory warranty periods that would otherwise apply. In 37 per cent of the transactions, sellers failed to agree on shorter periods than those provided by statute, while in 63 per cent of the transactions there were various provisions in the contract limiting the warranty periods.

If we look at the contracts where limitation periods were agreed we see a diverse picture: in 45 per cent of these contracts warranty periods were limited to between 36 and 48 months. Even shorter periods of between 24 and 35 months were agreed in 33 per cent of the transactions. However, the Hungarian market is still very conservative when it comes to limiting the warranty period for shorter than a period of 24 months, as in only 11 per cent of contracts were such short periods agreed.

Purchasers successfully avoided de minimis and basket clauses in 37 per cent of all transactions. In 19 per cent of the contracts only de minimis provisions were used, while in 44 per cent of the contracts sellers secured both de minimis and basket clauses.

Further, we found that in 37 per cent of the transactions no liability caps were used at all and most of these transactions were asset deals. In 44 per cent of the contracts a liability cap was introduced on some but not all warranties, with the warranties not covered by the cap being title and tax warranties. Only in 19 per cent of the transactions were all warranties capped.

Finally, it is interesting to examine the actual cap amounts agreed between the parties. In 46 per cent of the transactions the agreed cap was higher than 30 per cent of the purchase price. The next block is between 20 and 30 per cent of the purchase price, which accounted for 23 per cent of all transactions. In roughly one third of the transactions the cap amount was lower than 20 per cent of the purchase price.

> "Bank guarantees have all but disappeared from commercial property acquisition transactions."

GENERAL REAL ESTATE | **ITALY**

EVEN THE SUPREME COURT MAKES MISTAKES SOMETIMES

CARLOTTA BENIGNI, MILAN

> “The Supreme Court approach is certainly not consistent with the current law.”

In a recent case concerning registration tax and particularly the interpretation of article 20 of Registration Tax Act, the Italian Supreme Court gave a surprise judgment that may well create confusion and uncertainty, as well as frustrating the Government's attempts to attract foreign investment.

Article 20 provides that "registration tax is applied according to the intrinsic nature and the legal effects of the deeds registered, even if they do not match the title or apparent form of the deeds".

In a number of previous decisions, the Supreme Court had agreed with the tax authorities, applying registration tax to the deed that triggered the highest tax liability. One of the most common challenges in this regard was related to the contribution of a going concern into a NewCo followed by the sale of the quotas of that NewCo. This transaction is subject to registration tax at the fixed amount of EUR 200, while the sale of a going concern would be subject to proportional registration tax. Italian tax authorities tend to disregard the two separate transactions (contribution and sale of quotas), arguing that the true nature of the transaction is, in fact, the transfer of the going concern, and on this basis they apply the higher proportional taxation.

The Italian Supreme Court has pointed out in many previous decisions that, on the basis of article 20 of the Registration Tax Act, for the purpose of the interpretation of one or more deeds, "it must give prominence to the real and overall cause of the economic transaction, compared to the forms of the individual legal transactions" and of particular regard is "the interest actually pursued by the contracting parties, even if executed by means of a plurality of non-contextual deeds".

A Supreme Court judgment of last December extended these principles

further, effectively ruling out the possibility that "the sale of 100% of the shares of a company has the same economic function of the sale of the going concern. Both these contracts tend in fact to realize the legal effect of transferring the powers of enjoyment and disposal of the going concern by a group of subjects to another entity or group of entities."

Consequently, in the Supreme Court's opinion, "the sale agreement concerning 100% of the shares in a company is comparable, for registration tax purposes, to the transfer of the going concern, without it being necessary for the tax authorities to prove the elusive intent during the proceeding" (as would be the case under general anti-abuse laws). As a consequence, instead of fixed registration tax at EUR 200, the transfer should be subject to proportional registration tax (with rates ranging from 3 per cent to 9 per cent, depending on the assets held by the going concern). Furthermore, the Supreme Court stated that Italian tax authorities do not even have to prove intent.

This recent judgment recalled another judgment published in 2009, which also concerned the re-qualification of the transfer of shares into a going concern. However, the 2009 judgment was related to the transfer of the participation into a partnership, while December's judgment dealt specifically with the transfer of quotas.

The principles stated by the Supreme Court have also been applied by some of the regional tax courts throughout the year.

However, it seems that this decision (and others) were based on an incorrect interpretation of the law, for a number of reasons. But more importantly, even though the Supreme Court only gave judgment in this case in December, it is based on the old legislation on the abuse of law. A new law (article 10-*bis* of Law 27 July 2000, no. 212) came into force on 1 January 2016. Under this provision, a transaction can be challenged and disregarded by the Italian tax authorities as an elusive transaction only if (i) the relevant transaction does not have an economic justification, (ii) there is an undue tax advantage, and (iii) the transaction is essentially aimed at obtaining such undue tax advantage.

The taxpayer is now expressly granted the freedom to choose between different transactions, each with different tax liabilities, with the possibility of choosing whichever option leaves it liable to less tax. Since the new law came into force, the older decisions of the courts based on an (incorrect) interpretation of article 20 of the Registration Tax Code, are no longer relevant for transactions entered into after 1 January 2016.

The Supreme Court approach is certainly not consistent with the current law. Of course, it is difficult to deny that the substance of every sale of a company is the business that company conducts. However, not accepting the parties' choice to transfer the shares of a company rather than the business itself, would mean share deals being treated in the same way as asset deals in any case in which the parties transfer 100 per cent of the shares in a company. This would constitute a fundamental change in tax law which cannot be introduced by the courts, but requires the intervention of the legislator (as has happened in Germany and Belgium, for example).

It is to be hoped that the Italian tax authorities will seek clarification of the exact scope of application of article 20 of the Registration Tax Act, possibly they could do so in the imminent Official Position, commenting on the introduction of the new article 10-*bis* as a general anti-avoidance rule. This rule reflects the start of a new relationship between the Italian Government and tax authorities with the taxpayer, and it is not for the Supreme Court to derail that.

GENERAL REAL ESTATE | **POLAND**

TAX CHANGES IN POLAND: IMPACT ON THE REAL ESTATE SECTOR

ALEKSANDRA KOZŁOWSKA, WARSAW

The real estate sector in Poland holds some attraction for investors, with its great development potential and the possibility of achieving good returns. However, before making a final decision on any investment, including real estate, as well as estimating potential revenues, it is also necessary to determine the costs that will be incurred. Tax liability always has a negative impact on investment profitability, and therefore any new taxes must be taken into account when calculating cash outflows. Taxation is currently a key issue for the Polish Government, which has deemed closing the existing loopholes in tax law to be a priority. As a result, many amendments to the Polish tax regulations are currently being introduced. This article highlights those changes that affect the real estate sector.

Introduction of GAAR

The main element of the Polish Ministry of Finance's plan to tighten tax regulations was the introduction of the General Anti-Avoidance Rule (GAAR) in July 2016. As a consequence, Poland, along with a number of other countries such as the Netherlands, Germany, France, Canada and the UK, may now question the legal arrangements of taxpayers who perform artificial transactions in order to gain tax benefits. The GAAR in Poland is limited to cases in which a taxpayer has achieved an aggregate tax benefit exceeding PLN 100,000 (approx. EUR 23,000) in a given settlement period, which is very low in the context of real estate transactions. If the rule applies, the tax authorities may disregard all artificial elements of the transaction. Moreover, in cases where artificial constructions are used, protection resulting from previous tax rulings will no longer apply. Instead, in order to secure tax settlements in the case of using any methods to reduce tax liability, the taxpayer may apply for a "protective opinion" on a planned, ongoing or concluded transaction or set of transactions. The Ministry of Finance will only issue such an opinion if the circumstances described in the application confirm that the planned transaction complies with tax law and does not constitute tax avoidance.

It is worth adding that the GAAR in Poland is applied to tax benefits resulting from transactions carried out before the GAAR came into force if they are received after this date. This means that all transactions aimed at reducing tax liability made in the past in respect of which tax consequences (eg, payments or depreciation write-offs) take place after 15 July 2016 may potentially be subject to the GAAR. In the past on the Polish real estate market many "step-up" operations (aimed at increasing the initial value of fixed assets) and other M&As within groups were performed—these transactions may now become subject to review by the tax authorities.

Taxation of shops

Another hot topic for the shopping mall sector in Poland is the introduction of the "retail tax". On 1 September 2016, the Polish Government introduced a new law imposing an additional tax on retailers operating on the Polish market. Under the new law, the retail tax is to be paid by entities that sell movable goods or parts thereof to natural persons who do not conduct any business activity. E-commerce is not subject to the retail tax and the law. Moreover, some types of goods are exempted (eg, electricity, gas, oil and medicines).

However, in September 2016, the European Commission opened an in-depth investigation into Poland's retail tax and its application for membership has been suspended until the Commission concludes its assessment. A spokesman for the Polish Ministry of Finance recently announced that the introduction of the retail tax has been postponed until 1 January 2018, with the European Commission's investigation scheduled to finish by the end of 2017. Therefore, the fate of the retail tax has not yet been settled.

Taxation of common parts

A significant change to tax regulations affecting real estate operators came into force at the beginning of 2016. Under the new regulation, the common parts of buildings, such as corridors or stairwells, are now subject to real estate tax, under which more stringent rules apply. Prior to 2016, separating premises within a building made it possible to significantly reduce the level of real estate tax levied on the common parts. This method of reducing liability to tax was commonly applied by the owners of shopping malls in Poland. However, under the new provisions, the tax is calculated on all the common parts and is charged to all the co-owners in proportion to their share in the real property, making the tax burden much higher.

New transfer pricing obligations

As of 1 January 2017, those involved in the real estate sector will be subject to additional obligations and costs as a result of new transfer pricing provisions. The Corporate Income Tax (CIT) Act broadens the scope of information and documents which a taxpayer will have to submit to the tax authorities in order to confirm that its relations with group companies do not affect the market nature of a transaction. In particular, in the case of taxpayers whose revenues or costs exceed EUR 10 million, the documentation will also have to include a benchmarking study based on data used in calculating inter-company settlements and indicating the source of the data. These changes bring the Polish regulations into line with international trends. Nevertheless, from the perspective of Polish companies, the obligations with respect to transfer pricing will be significantly increased.

> "As of 1 January 2017, those involved in the real estate sector will be subject to additional obligations and costs as a result of new transfer pricing provisions."

Real estate investment trusts

The Polish Government recently published the much-discussed and long-awaited draft of a new law on real estate investment trusts (REITs). The new REIT regime introduces certain tax benefits to the Polish market that are already common in other EU jurisdictions, such as income tax exemption. As incomes from REIT-type entities are taxed only once (as a tax on dividend paid), this tax status makes REITs equivalent to direct investments in other properties (eg, the purchase of a flat or usable premises for lease). Therefore, it may be seen as a way of encouraging citizens to make long-term investments in existing commercial properties. The draft is currently out for public consultation.

At the same time, the first draft of a law abolishing the CIT exemption for closed-end investment funds was set out. Closed-end investment funds are often used by real estate investors as they allow a full tax exemption on any income made from rent, interest and capital gains. The new law is likely to come into force on 1 January 2017. This means that any investor using a closed-end structure should consider taking appropriate action now to adapt the structure to the anticipated change in the legal regime.

GENERAL REAL ESTATE | **ROMANIA**

RECENT LEGISLATIVE CHANGES AFFECTING THE REAL ESTATE MARKET IN ROMANIA

FLORINA TOMA, BUCHAREST

Against a background of various natural disasters across the globe and the potential for earthquakes existing in Romania, investors and citizens alike have turned their attention to the increasing construction activity taking place throughout the country. But the question is—have the demands of the construction market actually changed in Romania? The answer is yes, they have changed both on a legislative level, through the recent enactment of Law No 163/2016 regarding quality issues in construction, but also in the raised awareness of the public, who now looking beyond pricing, to consider also the quality and safety of a building. This has led to developments in the Romanian real estate sector, typified by an increased awareness of environmental issues and the long-lasting impact of construction and development works on society.

What has changed?

Law No 163/2016 was enacted in response to one of the major problems facing the construction industry in Romania—the continuous decline of the quality of construction works, prompted by the lack of an express legal framework, which permitted the shortening of the guarantee periods and the use of construction materials of questionable quality.

Law No 163/2016 made significant changes to the existing law regarding quality issues in construction as regards: (i) the warranty period for building works; (ii) the obligations and liabilities of the owners and users of such buildings; and (iii) the sanctions applicable in case of non-compliance. The most notable amendments which have entered into force are as follows:

The minimum warranty period

Law No 163/2016 provides that a minimum warranty period for construction works is to be inserted into parties' agreements, depending on their category, as follows:

(i) five years for building works included in categories A (exceptional importance) and B (special importance), for example, roads, railways, airports, dams and reactors;

(ii) three years for building works included in category C (normal importance), for example, industrial buildings and residential buildings with more than two floors; and

(iii) one year for building works included in category D (minimal importance), for example, residential buildings having no more than one floor, temporary constructions and outbuildings.

These construction importance categories are regulated by Government Decision No 766/1997 regarding the approval of the regulations concerning quality in building work.

The warranty period is extended in accordance with the time needed to remedy the qualitative defects discovered within that period.

The purpose of this amendment is to avoid situations when the warranty period granted by the contractor is very short compared to the lifetime of the building, as such situations have permitted or even encouraged in practice the use by contractors of low quality building materials. One notable example concerned a stretch of highway for which the contractor granted a warranty period of only two years.

This amendment will, of course, be of great interest to investors, who are now exposed to claims regarding the quality of their constructions for a longer period.

The obligations and liabilities of investors, owners and users of the building works

Law No 163/2016 states that the new obligations are incumbent on:

(i) *Investors* who are required to perform a final check on the construction upon the completion of works and also at the expiry of the warranty period;

(ii) *Owners* who are required to (1) hand over the construction following its approval upon the completion of works, (2) take over the construction, and (3) obtain all relevant authorizations required by law;

(iii) *Administrators and users* who are required to notify the owner where qualitative defects arise within the legal warranty period.

Sanctions

As a general rule, the fines applicable in case of breach of the provisions of Law No 163/2016 have doubled, now ranging from RON 3,000 (approximately EUR 650) to RON 40,000 (approximately EUR 9,000). In addition, the sanction of mere warning is no longer available.

Further, the limitation period within which the competent authority (ie the State Construction Inspectorate (SCI)) is entitled to apply these sanctions has been extended from three to five years.

Certification of specialists in the construction field

One additional amendment introduced by Law No 163/2016 is the technical and professional certification of the economic operators performing construction design services, consulting in the construction field and/or performing construction works and continuous professional education requirements of specialists in the field of construction. However, this amendment is not due to come into force until 24 February 2018. In the case of breach of the provisions, on top of the applicable administrative fine, the authorities will also be able to order the suspension or cancellation of the technical and professional certificate of the construction specialist in default.

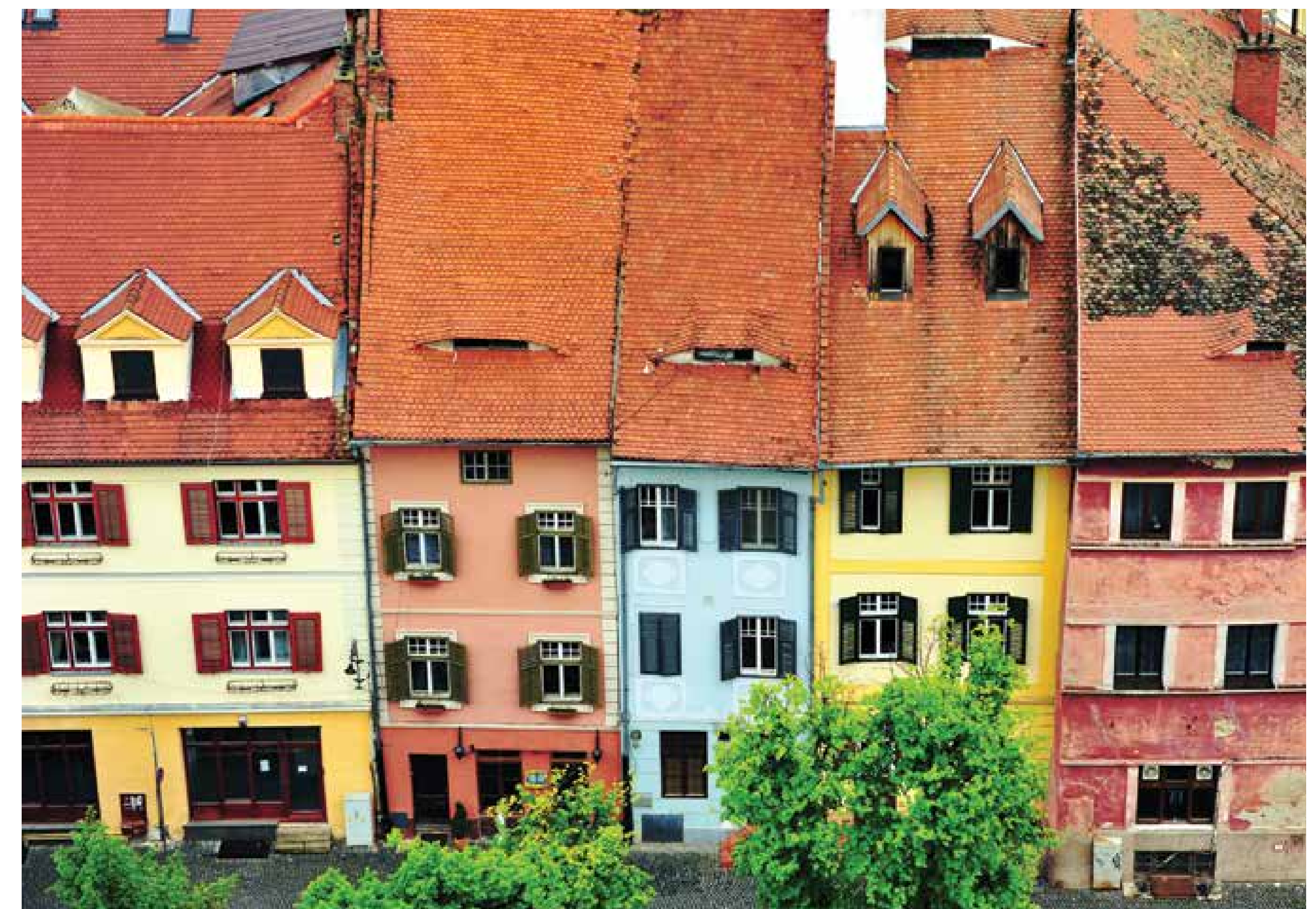
Other recent legislative changes impacting the real estate market

On 30 June 2016, the Government Emergency Ordinance (GEO) No 35/2016 came into force, the main purpose of which is the acceleration of the land book registration of plots of agricultural land located outside the city limits. Legislators have argued that these need to be treated with utmost priority to ensure a high level of funding by the European Union for the purpose of financing the common agricultural policy. In particular, it is anticipated that, from 2020, the granting of subsidies for agriculture will be conditioned upon the existence of a cadastre for the plot of land for which the subsidies are requested. Thus, the lack of cadastre for a plot of land might lead to the loss of those subsidies.

The land book registration of the agricultural plots of land located outside the city limits will be initiated by the administrative units based on the financial support of the National Agency of Cadastre and Real Estate Publicity, irrespective of the capacity of the holder of the real right—owner, holder of a real right over the property, or possessor. In case of the administrative units where there are no plots of land located outside the city limits, these units may use the budged allocated by the National Agency of Cadastre and Real Estate Publicity for the land book registration of the plots of land located within the city limits.

In order to accelerate the registration process, as well as increasing the number of properties registered in the land book, GEO No 35/2016 enables the National Agency, through its territorial offices, to open *ex officio* land books at the level of the administrative units, by converting into electronic format the information regarding real rights and the graphic information existing in the data base of the territorial offices. The holders of real rights over such real estate are entitled to request the correction or update, as the case may be, of the registrations noted in the land books opened by the National Agency within one year following their opening.

Other amendments by GEO No 35/2016 regard increased access to the online database of the land book granted to public institutions, public notaries, legal experts, persons authorized to perform cadastral works, court bailiffs and courts.



GENERAL REAL ESTATE | **SPAIN**

CHOOSING THE RIGHT MORTGAGE IN SPAIN

NATALIA ZUMÁRRAGA AND
FÁTIMA RICO-VILLADEMOROS, MADRID

Spanish law recognizes several types of mortgages. Since each type is meant to cover different types of risks or obligations, but all need to be registered at the Land Registry in order to be valid, it is important to choose the right kind of mortgage from the start depending on the type of transaction and obligations to be secured.

The standard mortgage is known as an ordinary mortgage (*hipoteca ordinaria*). This ensures the fulfilment of one particular fixed-amount obligation or contract which must be identified and therefore must already exist at the time of granting the mortgage. This is the type of mortgage used in simple transactions such as residential purchase financings.

The securities mortgage (*hipoteca cambiaria*), regulated by article 154 of the Spanish Mortgage Law, is meant specifically to secure bearer securities or securities transferable through endorsement notes. It enjoyed popularity some decades ago when consumer finance was structured through payment via bills of exchange, but it is now rare as more modern financing options have appeared in the market.

Another, far more common type of mortgage is the credit account mortgage (*hipoteca de máximo*), which is considered more flexible because, while securing a single obligation, the amount thereof may be uncertain but determinable. This type of mortgage is regulated in article 153 of Spanish Mortgage Law. The debt corresponds to the amount marked in the accounts of the lender and borrower, so there is a specific procedure to fix the actual amount of the claim. This type of mortgage is often used to secure credit facilities (where the amount that will actually be drawn is not known at the outset). The amount secured by this type of mortgage may be considered as a cap.

The fact that a mortgage guarantees a single obligation arises initially from the principle of ancillarity and determination (*principio de accesoriedad y determinación*), which means that each obligation secured requires a separate guarantee. However, this requirement imposed unnecessary limitations as modern financial needs became increasingly complex, and thus a more flexible interpretation of this principle was required. Spanish case law initially recognized that the credit account mortgage can also cover ancillary obligations such as interest. But real flexibility was introduced in 2007 with the recognition by Spanish law of the "floating mortgage" (*hipoteca flotante*), which is regulated by the article 153 *bis* of the Spanish Mortgage Act.

The floating mortgage exists as a subtype of the credit account mortgage but has several particular features. Its main feature is that it may be used to secure a basket of different debts, whether existing or future, which may vary over time and therefore need not be defined in detail, as in the other types of mortgage. However, this mortgage may only be granted to financial entities, tax authorities or social security authorities (in the latter case, only as a guarantee of tax credits or social security credits). Special dispensation was granted so that SAREB (the Spanish "bad bank", which is not technically a financial entity), could also be a beneficiary of these mortgages, since it inherited a huge portfolio of loans already secured with floating mortgages which otherwise could not have been enforced.

Floating mortgages are most often used to secure a facility together with its associated derivatives, or facilities with diverse tranches. However, the possibilities are much wider, given the following considerations:

- The mortgage can secure loans belonging to various creditors, which may be present from the start or as a result of the assignment or subrogation of all or part of a secured debt.
- The basket secured by the floating mortgage can comprise existing obligations, future obligations, or a combination of both.
- No exhaustive description is required of the distinguishing elements of the secured obligations, but rather it is considered sufficient to give a mere description of the legal acts from which may arise the secured obligations in the future (eg, categories of contracts covered, such as credit lines, derivatives, loan facilities, etc).
- It is not necessary to distribute the mortgage liability between the secured obligations, so the guarantee would cover any breach of the obligations secured up to the maximum amount of the agreed mortgage liability.
- In case of insolvency proceedings regarding the borrower, the floating mortgage is protected unless it is proved that it was made with the intention to defraud creditors (*en fraude de acreedores*).

However, in contrast with other types of mortgage, the floating mortgage requires a specific term of duration, which does not coincide with the one agreed for the secured obligations (which is logical enough, since the secured obligations may change during the life of the mortgage). The term of the mortgage is for the benefit of the next registered owners of the property as well as for the benefit of the creditors of the owner (mortgage creditors or not). The exercise of foreclosure action (*acción hipotecaria*) is only allowed during this term, so it is wise to have a longer duration of the mortgage than of the obligations to be secured with it.

The term of the floating mortgage must be registered with the Land Registry so that, once this term has elapsed, the floating mortgage is extinguished and the cancellation of its registration in the Land Registry should take place, unless a foreclosure has started during the term.

The main advantage of the floating mortgage is that since a guarantee covers all obligations arising (or which may arise in the future) from the financing transaction(s) secured by it, there will be no need to amend the mortgage if the financing is amended, entailing significant tax savings, as most mortgage amendments are subject to stamp duty.

Although the floating mortgage was introduced as a legal type in 2007, it is still not the predominant type used. On one hand, this is due to conservatism from the banks, who are more familiar with other types of mortgage; on the other, registration in the Land Registry of this type of mortgage is still sometimes problematic. This is because land registrars have not been able to gain much experience of such mortgages and sometimes try to impose requirements that go beyond what is legally required, including the breakdown of mortgage liability between the different secured obligations. To ensure prompt registration and to avoid registration problems, it remains good policy to discuss the relevant mortgage with the applicable Land Registry and to submit the mortgage for a preapproval by the registrar before granting it.

GENERAL REAL ESTATE | **SWEDEN**

TENANTS' RIGHT TO COMPENSATION ON TERMINATION OF A LEASE: RECENT DEVELOPMENTS

JAN RÅSSJÖ AND EMANUEL SKÖLD, STOCKHOLM

Introduction

In the last couple of years in Sweden, we have seen a great increase in the amount of damages awarded to tenants in commercial leases due to wrongful termination or refusal by the landlord to extend the lease on premises. Last year the municipal court of Stockholm awarded a record-breaking MSEK 136 in damages to a tenant as a result of the wrongful termination of premises where the tenant ran a restaurant business. This year we saw the same court award MSEK 31 to compensate for the wrongful termination of a lease on garage premises from which the tenant was running a parking business. We are currently awaiting judgment in yet another dispute where the tenant is claiming MSEK 250 in damages for the termination of premises from which the tenant ran a hotel business.

Before the rulings mentioned above, the amount of damages awarded in such situations rarely exceeded a few million SEK. This great increase in the amount of damages being awarded may significantly change the way in which commercial leases are handled, particularly in terms of risk, when investing in commercial properties in Sweden, negotiating and entering into new leases, or what kind of circumstances will give rise to a dispute on termination.

Indirect security of tenure

In comparison to a residential tenant, a non-residential tenant has no statutory right to renew a lease agreement. The tenant of non-residential premises is instead, protected through what may be called an indirect security of tenure (*indirekt besittningsskydd*). In contrast to the direct security of tenure for residential tenants, the indirect security of tenure does not mean that the tenant, following the landlord's notice of termination at the expiration of the lease period, has the legal right to remain on the premises, but rather that the tenant is entitled to damages if a landlord wants to terminate the lease or refuses to extend the lease without a legitimate reason. The goal of the indirect security of tenure is the same as that granted to residential tenants, which is a prolongation of the lease. It is therefore constructed so as to encourage the landlord either to renew the lease or pay damages to the tenant. The tenant and the landlord may, however, agree in writing to waive the tenant's rights in this respect, however, such a waiver may, under certain circumstance, require the approval of the Rent and Tenant Tribunal to be valid.

When does the landlord have a legitimate reason not to extend a non-residential lease?

Under Swedish tenancy law (*hyreslagen*) a landlord is deemed to have legitimate reasons not to extend a lease for non-residential premises in the following four cases:

1. If the tenant has disregarded its obligations;
2. If the building/s on the property is/are to be demolished or undergo major reconstruction and the tenant is offered alternative premises, which are acceptable to the tenant;
3. If the landlord's demands for extending the lease are legitimate; or
4. If there are any other just causes for the landlord not to extend the lease.

Damages

If a lease is terminated by the landlord and there is no legitimate reason to do so, the tenant is entitled to compensation for economic loss as a consequence of the termination of the lease.

The minimum damages that can be claimed are equivalent to the amount of one year's rent. If the tenant suffers losses that exceed the minimum amount, the landlord must (to a reasonable extent) compensate the tenant for damages connected with the termination of the lease. These damages include costs for moving, hiring extra staff, advertising its move to customers, costs related to decreased value of the tenant's property, for example, interior decoration which cannot be used at its new premises, and also any losses due to clearance sales as well as damage to the tenant's business (*rörelseskada*). If the damage to the business has the effect that the tenant is unable to carry on its business elsewhere, the damages can amount to the total worth of the tenant's business.

Principles for assessing damage to the tenant's business

The principles of assessing the damage to the tenant's business are not found in the Swedish tenancy code or in its preparatory works. Instead reference is made in the preparatory works to the principles found in the Swedish Expropriation Act (*expropriationslagen*). Under this Act, compensation is to be paid in an amount equivalent to the market value of the real property being expropriated, that market value reflecting the amount a potential buyer would be likely to pay for the property at that time.

When it comes to choosing the method for evaluating the market value of the business it is quite well established in case law, although not without objections, that tenants have the right to choose whichever method that is most advantageous to them. However, the tenant has to show that certain requirements in this respect have been met.

The case of *Municipality of Stockholm v. Profilrestauranger AB*

Profilrestauranger AB leased restaurant premises at the Stockholm City Hall from the Municipality of Stockholm. The leased area was approximately 1,345 sq. m. with a yearly rent of approximately MSEK 4. The lease contained exclusive rights for the restaurant to serve during certain events at the City Hall such as city council meetings and the Nobel banquet, but also to the staff of the City Hall. The landlord terminated the contract on 14

> "If a lease is terminated by the landlord and there is no legitimate reason to do so, the tenant is entitled to compensation."

Image credits: Shutterstock

> In general, it is submitted that tenants are or will be more likely now to bring a claim for damages in the event of termination of the lease by the landlord.

August 2008 and the reason given for terminating the lease was that the city council had to procure any services performed on the premises through a public procurement process. The Court of Appeal ruled that the landlord's reason for terminating the lease was not legitimate since there was no obligation under Swedish procurement law or EU law to procure service concession. The landlord therefore had to pay damages to the tenant for the wrongful termination of the lease.

The tenant presented two methods for evaluating the market value of its business. The first method was defined as the "owner's value" (*ägarvärde*) and was based on the presumed value of the business if the owner kept the business. The value is therefore derived from the present value of all future profits that can be distributed to the owner. The second method was defined as the "transaction value" (*transaktionsvärde*) and was based on the amount for which the business could be sold on an open and unregulated market. The first method resulted in a valuation of approximately MSEK 162 and the second method resulted in a valuation of approximately MSEK 132. The court dismissed the "owner's value" valuation on the basis that it was unreasonable to assume a lower risk assessment when calculating the required return of the business. It found the "transaction value" valuation applicable instead, and awarded the tenant total damages of MSEK 136, which included MSEK 132 for damage to the business, MSEK 4 for the loss of goodwill and a smaller amount relating to moving costs.

Looking to the future

The case described above may signal a change in approach to commercial leases in Sweden in general, and could potentially also affect areas other than tenancy disputes, such as transactions and risk assessments related to transactions.

In general, it is submitted that tenants are or will be more likely now to bring a claim for damages in the event of termination of the lease by the landlord. It also seems likely that landlords will be less willing to enter into leases with tenants unless the legally binding effect of such agreements is subject to conditions in a separate document whereby the tenant, with the approval of the Rent Tribunal, waives its right of indirect security of tenure before the start of the lease.

We can also anticipate greater emphasis being placed on assessing risks and potential losses of value related to a commercial tenancy agreement in connection with real estate transactions, both on the seller's and the buyer's side.

DLA PIPER OFFICES

AUSTRIA
Schottenring 14 A-1010, Vienna
T: +43 1 531 78 0 | F: +43 1 533 52 52

BAHRAIN
Office 701, 7th Floor The Address Tower Building
655, Road 3614, Block 0436
Manama, Kingdom of Bahrain
T: +973 1755 0890 | F: +973 1755 0887

BELGIUM
Brusselstraat 59, 2018, Antwerp
T: +32 (0) 3 287 2828 | F: +32 (0) 3 230 4221
106 Avenue Louise, Brussels B-1050
T: + 32 (0) 2 500 1500 | F: + 32 (0) 2 500 1600

CZECH REPUBLIC
Perlová 5 CZ-11000, Prague 1
T: +420 222 817 111 | F: +420 222 246 065

FINLAND
Asianajotoimisto DLA Piper Finland Oy,
Fabianinkatu
23, Helsinki, FI-00130
T: +358 9 4176 030 | F: +358 9 4176 0417

FRANCE
27 rue Laffitte, 75009 Paris
T: +33 1 40 15 24 00 | F: +33 1 40 15 24 01

GEORGIA
Melikishvili street # 10, Tbilisi 0179
T: +995 32 2509 300 | F: +995 32 2509 301

GERMANY
Joachimstaler Str. 12, Berlin D-10719
T: +49 (0)30 300 13 14 0
F: +49 (0)30 300 13 14 40
Augustinerstraße 10 Cologne Germany D-50667
T: +49 (0)221 277 277 0
F: +49 (0)221 277 277 10
Westhafenplatz 1, Frankfurt D-60327
T: +49 (0)69 27133 0 | F: +49 (0)69 27133 100
Jungfernstieg 7, Hamburg D-20354
T: +49 (0) 40 1 88 88 0
F: +49 (0) 40 1 88 88 111
Maximilianstraße 2 Munich Germany D-80539
T: +49 (0)89 23 23 72 0
F: +49 (0)89 23 23 72 100

HUNGARY
MOMentum Office Building
Csörsz u. 49-51. Budapest H-1124
T: +36 1 510 1100 | F: +36 1 510 1101

ITALY
Via della Posta, 7 Milan Italy I-20123
T: +39 02 80 61 81 | F: +39 02 80 61 82 01
Via dei Due Macelli 66 - 00187 Rome
T: +39 06 68 88 01 | F: +39 06 68 88 02 01

KUWAIT
Suad Commercial Complex 3rd Floor, Block A
PO Box 22833, Safat 13089, Kuwait City
T: +965 2291 5800 | F: +965 2291 5801

LUXEMBOURG
37 A, avenue John F. Kennedy, L-1855
Luxembourg
T: +352 26 29 04 1 | F: +352 26 29 04 3000

MOROCCO
Casa Marina Business Center, Tour Crystal
3, 2ème étage, 10 ème étage, Boulevard des
Almohades, 20000 Casablanca, Morocco
T: +212(0)522 64 16 25 | F: +212(0)522 64 16 01

NETHERLANDS
Gebouw Meerparc Amstelveenseweg 638
1081 JJ Amsterdam
T: +31 (0)20 541 98 88 | F: +31 (0)20 541 99 99

NORWAY
Advokatfirma DLA Piper Norway DA
Bryggegata 6 PO Box 1364, Vika, 0114 Oslo
T: + 47 24 13 15 00 | info.norway@dlapiper.com

OMAN
Penthouse, Al Manahil Building Al Sarooj Street,
Shatti Al Qurum PO Box 200, Postal Code 134
Jewel Beach, Muscat
T: +968 2464 7700 | F: +968 2464 7701

POLAND
ATRIUM II Building I.L. Pereca 1 Str. 00-849
Warsaw, Poland
Tel: +48 22 540 74 00 | Fax: +48 22 540 74 74

QATAR
Level 9, Alfardan Office Tower, PO Box 25800 ,
West Bay, Doha
T: + 974 4420 6100 | F: + 974 4420 1500

ROMANIA
Metropolis Center 89-97 Grigore Alexandrescu
Str. East Wing, 1st Floor Sector 1, 010624,
Bucharest
T: +40 372 155 800 | F: +40 372 155 810

RUSSIA
Leontievsky pereulok, 25, Moscow 125009
T: +7 (495) 221 4400 | F: +7 (495) 221 4401
Nevsky pr., 28, bld. A (Zinger house),
St. Petersburg 191186
T: +7 (812) 448 7200 | F: +7 (812) 448 7201

SAUDI ARABIA
Centria Centre, Level 7 Olaya Street, Al Olaya
PO Box 57774 Riyadh Saudi Arabia 11584
T: +966 11 201 8900 | F: +966 11 201 8901
Level 21, Khobar Gate Tower,
King Abdul Aziz Street, PO Box 31532,
Al Khobar, Saudi Arabia 31952
T: +966 13 330 8323 | F: +966 13 330 8350
Jameel Square Building Level 4 Office 408,
Tahlia Street, Jeddah 21444
T: +966 12 284 3939 | F: +966 12 284 6969

SLOVAK REPUBLIC
Suche myto 1 SK-811 03, Bratislava
T: +421 2 5920 2122 | F: +421 2 5443 4585

SOUTH AFRICA
Graysand Office Park, 2 Sandton Drive
Sandton, Johannesburg 2196
T: +27 (0)11 282 0692 |
enquiries.za@dlapiper.com

SPAIN
Paseo de la Castellana, 35 -2º 28046, Madrid
T: +34 91 319 12 12 | F: +34 91 319 19 40

SWEDEN
Stockholm
Advokatfirma DLA Piper Sweden KB
Kungsgatan 9 PO Box 7315, SE - 103 90,
Stockholm
T: +46 8 701 78 00 | F: +46 8 701 78 99

UAE
Level 10, EIBFS Building Muroor Road
PO Box 109950 Abu Dhabi
T: +971 2 494 1500 | F: +971 2 494 1501
Level 9, Standard Chartered Tower, Emaar Square,
Dubai
T: +971 4 438 6100 | F: +971 4 438 6101

UKRAINE
77A Chervonoarmiyska Str., Kyiv 03150
T: +380 (44) 490 95 75 | F: +380 (44) 490 95 77

UNITED KINGDOM
Victoria Square House , Victoria Square,
Birmingham B2 4DL
T: +44 (0) 8700 111 111
F: +44 (0) 121 262 5794
Rutland Square, Edinburgh EH1 2AA
T: +44 (0) 8700 111 111
F: +44 (0) 131 242 5555
Princes Exchange, Princes Square, Leeds LS1 4BY
T: +44 (0)8700 111 111
F: +44 (0) 113 369 2949
India Buildings , Water Street, Liverpool L2 0NH
T: +44 (0) 8700 111 111
F: +44 (0) 151 236 9208
3 Noble Street, London EC2V 7EE
T: +44 (0) 8700 111 111
F: +44 (0) 20 7796 6666
One St Peter's Square, Manchester M2 3DE
T: +44 (0) 8700 111 111
F: +44 (0) 161 235 4111
1 St Paul's Place, Sheffield S1 2JX
T: +44 (0) 8700 111 111
F: +44 (0) 114 270 0568

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KEY CONTACTS

AMERICAS
Jay Epstien
Co-Chair, Global Real Estate Practice
Co-Chair, Global Real Estate Sector
Washington, DC
T +1 202 799 4100 | F +1 202 799 5100
jay.epstien@dlapiper.com

EMEA
Carsten Loll
Head of International Real Estate
Munich
T +49 (0)89 232 372 150
carsten.loll@dlapiper.com

EMEA
Olaf Schmidt
Co-Chair of the Global Cross-Practice Real Estate Sector
Milan, Italy
T +39 02 80 618 504 | F +39 02 80 618 201
olaf.schmidt@dlapiper.com

ASIA
Susheela Rivers
Head of Asia-Pacific Real Estate
Hong Kong, People's Republic of China
T +852 2103 0760 | F +852 2810 1345
susheela.rivers@dlapiper.com

AUSTRALIA
Les Koltai
Head of Australia Real Estate
Melbourne
T +61 2 9286 8544 | F +61 3 9274 5111
les.koltai@dlapiper.com

MIDDLE EAST
Tom O'Grady
Head of Middle East Real Estate
Dubai
T +971 4 438 6322 | F +971 4 438 6101
tom.o'grady@dlapiper.com

UK
Laurence Rogers
Head of UK Real Estate
London
T +44 20 7796 6272 | F +44 20 7796 6666
laurence.rogers@dlapiper.com

USA
John Sullivan
Chair, US Real Estate Practice
Boston
T +1 617 406 6029 | F +1 617 406 6129
john.sullivan@dlapiper.com