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Real Estate

Newsletter of the International Bar Association Legal Practice Division

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PROPERTY FOR SALE

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The International Bar Association's Human Rights Institute (IBAHRI), established in 1995 under the Honorary Presidency of Nelson Mandela, has become a leading global force in setting governments' agendas in human rights, supporting judges, lawyers and human rights campaigners and promoting respect for the rule of law worldwide. The IBAHRI runs training and workshops, capacity building projects, fact-finding missions, trial observations, technical assistance, thematic reports and guidelines and many other projects in pursuit of these goals.

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Map illustrating the IBAHRI's work around the world

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Signs of hope

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As the current turmoil unfolds, the real estate industry and legal practitioners learn how to cope with the new circumstances. Although a bleak economic situation has put a shaded veil over the outlook, each day we hear about new opportunities pursued, new deals closed and new projects developed. As always, chances are there for those who can recognise them. Real estate lawyers now, more than ever, have to demonstrate a level of creativity supported by sound expertise and well balanced advice. We believe that these qualities are well reflected in the new issue of our Real Estate Law Newsletter.

The current edition of the newsletter encompasses 20 contributions covering 12 jurisdictions. The publication would not be possible without tremendous support and efforts from many members who have decided to share with us their views and conclusions on various aspects of real estate law. In addition, we bring to you a new mission statement of our Real Estate Committee which strives to encapsulate new spirit and new ideas that have made our committee one of the fastest developing sections of the IBA Legal Practice Division. We hope that this might inspire you to get more involved in our committee's new projects.

One of those projects has proven to be a great success. Although held in the middle of the financial crisis devastating the world real estate market, the conference 'Global investments in real estate: trends, opportunities and new frontiers' held in Miami on 5 and 6 February 2009 has brought together lawyers in private practice, in-house counsels, bankers active in the real estate industry, fund managers, senior managers in real estate companies, brokers and other service providers of the industry. Leading experts in their respective fields have discussed a variety of topics and offered their views on the opportunities in the present economic and legal climate. More detailed conference reports can be found on the pages of the newsletter.

We were delighted to see that the received country contributions have somewhat strayed away from the omnipresent economic crisis. A number of our contributors have concentrated on various aspects of environmental law and its impact on real estate transactions. Stephan Hubner and Kathleen Fitzgerald (United Kingdom) analyse the emergence of green leases in the London area while Izabela Zielinska-Barlozek (Poland) writes on assessments of environmental impacts of buildings and liability for contamination under Polish law. Ian Wattie (United Kingdom) analyses potential effects of the introduction of the Scottish Climate Change Bill on real estate developments.

Of course, it is not possible or even advisable to neglect the present economic state of affairs and all the pitfalls and dangers it brings for real estate lawyers. Contributions from Philip G Skinner (USA), Dace Cirule (Latvia), Piero Marchelli and Lorenzo Muzii (Italy) and Terry A Selzer (Denmark) help us not only to better understand how to avoid or mitigate these perils but also to recognise new opportunities.

Besides reports on interesting legislative developments, it is always inspiring to learn how the decisions of the state or arbitral courts may affect not only the rights and obligations of interested parties but also scope and content of entire legal institutes. Rustam Aliev (Russia), Nikolaus Pitkowitz and Martin Foerster (Austria), Sandis Bertaitis (Latvia) and Marija Gregoric (Croatia) show how decisions of different fora ranging from arbitral tribunals to constitutional courts have induced important developments in the real estate law of their respective countries.

Remaining contributions cover a broad array of topics ranging from particular contract clauses to football. Samantha Taylor (Australia) strives to emphasise the importance of proper drafting of market rent clauses in tenancy contracts. Also dealing with tenancy issues, Peter Kunz and Birgit Ertl (Austria) describe the impact of legal solutions embodied in tenancy laws on investors' purchase decisions. On the side of interesting legal developments, Radoslaw Biedecki and Michal Zolubak (Poland) write about the introduction of the transmission easement in the Polish legal system, Daniel Dillier (Switzerland) informs us about the harmonisation of real estate taxation in Switzerland while Alvaro

Rosenblut (Chile) analyses functioning of the Condominium Law in the context of the Chilean real estate projects. Adding to the variety of topics covered in the Newsletter, Abe J Schear (USA) illustrates issues typically connected with the mixed use projects and Arthur Nitsevych (Ukraine) leads us through novelties in the important stage of the real estate development – its certification. Finally, Radoslaw T Skowron (Poland) makes an interesting example of the impact football can have on our profession describing already visible effects of the forthcoming UEFA EURO 2012 on the Polish real estate market.

Again, I would like to extend my sincere gratitude to all the authors who have decided to contribute to the current issue of our newsletter. Without their enthusiasm and commitment to the real estate law, this publication could never succeed. I hope you will enjoy reading it and I look forward to meeting many of you in Madrid.

IBA Real Estate Committee – mission statement

The recent globalisation of the real estate industry has fundamentally changed the committee's focus. While real estate assets are traditionally governed by national rules, real estate transactions have long ceased to be a purely national matter. Today, the ownership of properties is traded among investors around the globe. Increasing internationalisation of all aspects of real estate law has also changed the types of lawyers involved.

Transactional specialists who often have a corporate law background have in many cases replaced traditional real estate lawyers. In this evolving context, the Real Estate Committee provides a unique and valuable forum for lawyers from different countries and different legal backgrounds to address all sorts of practical and legal issues, exchange views and meet during conferences.

In recognition of its remarkable invigoration, the committee has recently been officially recognised with an award by the IBA Legal Practice Division. Members of the Real Estate Committee are encouraged to participate actively in the committee's work at its annual conferences, its annual open officers meetings, and, throughout the year, through special projects and through articles in the committee's newsletter. Involvement with the Real Estate Committee provides an excellent opportunity not only to exchange views on real estate related matters but also to make useful contacts with real estate lawyers from all over the world.

This newsletter is intended to provide general information regarding recent developments in real estate law. The views expressed in this publication are those of the contributors, and not necessarily those of the International Bar Association.

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Investing in bricks. Is real estate still a good investment? How is the financial crisis affecting the real estate market and the emergence of new opportunities?

Joint session with the Latin American Regional Forum.

Session Co-Chairs
Eugenio Hurtado Segovia *Capín Calderón Ramírez y Gutiérrez-Azpe SC, Mexico City, Mexico; Website Officer, Latin American Regional Forum*
Carolina Zang *Zang Bergel & Viñes Law Firm, Buenos Aires, Argentina; Chair, Real Estate Committee*

The old paradigm that the value of real estate never drops has been destroyed. The bubble created by the construction of more homes than real demand, relying on heavy indebtedness and massive purchase of land, has led to the bankruptcy of construction companies in Spain and other European countries. The horizon looks gloomy; however, the winds of change in the real estate business are blowing. The panel will focus on topics such as refinancing of debt of heavily indebted companies; the participation of banks in the real estate sector; the transfer of liabilities from construction companies to individuals as a mean to diversify risks; comparisons of different real estate scenarios in the framework of the credit crunch; the role of governments; the management of the crisis up to a recovery time; acquisition opportunities; the unclearness of the question of capital availability; and the new real estate opportunities in housing and tourist projects in different parts of the world such as India, Brazil, Mexico, Panama and Russia.

The analysis will be carried out by key players in the Spanish real estate industry as well as by attorneys with expertise in their particular jurisdictions.

Speakers
Irina Anyukhina *Alrud CJSC, Moscow, Russian Federation*
Estiff Aparicio *Arias Fabreza y Fabraga, Panama City, Panama*
Rossana Duarte *TozziniFreire, São Paulo, Brazil; Regional Representative Latin America, Real Estate Committee*
Alberto Flores *Obrascón Huarte Laín SA, Madrid, Spain*
Eugenio Hurtado
Santos Maulión *Abengoa SA, Lima, Peru*
Bernat Mullerat *Cuatrecasas Gonçalves Pereira, Barcelona, Spain*
Carlos Ramos *Ramos Miranda Barrera Siqueiros y Torres Landa, Mexico City, Mexico*
Jorge Ignacio Sastre Cabrerizo *Ibercon, Palma de Mallorca*
Rafael Truan *Díaz-Bastien & Truan, Madrid, Spain*
Carolina Zang

MONDAY 1000 – 1300
Bogotá/Caracas, 2nd Floor, Right

A DINNER will be held for members and guests.

Pedro Larumbe, Calle Serrano 61, 28006 Madrid

Price: €75 (€70.10 + €4.90 Spanish VAT)

TUESDAY 2200

Continued overleaf

Credit crunch crisis: the role of the real estate lawyer in cleaning up the mess

Session Co-Chairs
Claudio Cocuzza *Cocuzza & Associati Studio Legale, Milan, Italy; Secretary, Real Estate Committee*
Carolina Zang

A key element of current real estate practice is to understand the clients' needs and the changing environment. In a distressed scenario, as lawyers, we need to know the law, but also to understand clearly our clients' business and how it has been affected by the global crisis, and to tailor our advice to their specific needs. Following our successful February 2009 conference 'Global investments in real estate: trends, opportunities and new frontiers' in Miami, the aim of this session is to be an interactive think tank for issues related to the questions commonly faced by real estate practitioners, such as what clients expect from their real estate counsel in these times of crisis and the top challenges faced by lawyers when dealing with those expectations, as well as the role of real estate lawyers in the remediation of damages. All attendees will be encouraged to participate and share experiences. Expert panellists, not only from the legal profession but also from the industry, will discuss how real estate business culture is evolving, including:

Crisis and opportunity as two sides of the same coin

what can we understand as 'distressing'?
- the perspective and prospective about investment in a complex context; and
- making business: beyond//between the classic perspectives of 'need to sell' and 'desire to buy'.

The core of the struggle: financing
- new sources of financing;
- great Expectations: is liquidity coming back? and
- possibilities and the value of creative solutions.

Speakers
Ivan Azinovic Gamo *Gómez-Acebo & Pombo Abogados, Madrid, Spain*
Jeffrey A Blount *Fulbright & Jaworski LLP, Hong Kong SAR; Senior Vice-Chair, Asia Pacific Regional Forum*
Roger Cooke *Cushman & Wakefield Inc, Madrid, Spain*
Carlos Portocarrero *Clifford Chance LLP, Madrid, Spain*
Marco Salvini *AIG Lincoln Italy, Milan, Italy*
Philip G Skinner *Arnall Golden Gregory LLP, Atlanta, Georgia, USA*

WEDNESDAY 1000 – 1300
S.Prensa, 1st Floor, Right

Madrid real estate tour

Following the tradition started in Buenos Aires, all attendees will be invited to join a wonderful guided tour of Madrid real estate.

Attendees will have an insider's look at a number of unique properties and developments and will receive useful information regarding the real estate industry in Madrid.

For further information and to register for the tour please visit the Speakers Desk at the IBA Registration Desk.

WEDNESDAY 1500 – 1800

Latest developments in cross-border European real estate investments

Joint session with the European Regional Forum.

Session Co-Chairs
Didier De Vliegher *NautaDutilh, Brussels, Belgium; Regional Representative Europe, Real Estate Committee*
Martin Holler *Giese & Partner, Prague, Czech Republic; Vice-Chair, Real Estate Committee*

There is probably no other part of the legal profession that is more affected by the events of the last months than lawyers working on international real estate investments. Following last year's hugely successful conference in Copenhagen, this session will focus on the latest legal and market developments in this field. Speakers from both the industry and the legal profession will discuss those questions that have the most substantial impact on real estate lawyers, such as:

- What has happened with real estate investments one year after the financial crisis? What has changed in the real estate industry?
- Who are the new players?
- What is the role of the banks?
- Are new legislative initiatives necessary to attract investment in real estate funds?

Speakers
Thomas Albrechtsen *Kromann Reumert, Copenhagen, Denmark*
Dovile Burgiene *Lideika Petrauskas Valiūnas ir partneriai LAWIN, Vilnius, Lithuania*
Marija Gregorić *Babić & Partners, Zagreb, Croatia*
Alistair McGillivray *Clifford Chance LLP, London, England*
Vassily Rudomino *ALRUD, Moscow, Russian Federation; Senior Vice-Chair, European Regional Forum*
Agustin Redondo *Uría Menéndez, Madrid, Spain*
Izabela Zielínska-Barlozek *Wardyński & Partners, Warsaw, Poland*

THURSDAY 1500 – 1800
Lisbon, 4th Floor , Left

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Creativity as the solution

The annual conference of the IBA Real Estate Section
5–6 February 2009, JW Marriott Miami Hotel, Florida, USA

While the worst economic turmoil in a generation was hitting hard on every segment of economy, real estate market was amongst its severest victims. Projects were delayed, abolished and abandoned all around the world. Real estate markets were suffering and the real estate industry was experiencing an unprecedented downfall.

In such gloomy circumstances, the IBA Real Estate Committee decided to set up a specialist real estate conference which would bring together experts from all backgrounds of industry and strive to provide sound analysis of the moment as well as predictions and suggestions for time to come. The organising committee (Ms Carolina Zang, Mr Luis Moreno, Mr Nikolaus Pitkowitz, Mr Martin Holler and Mr Boris Babic) led by Mr Claudio Cocuzza as the Conference Chair succeeded in coming up with a perfect blend of lawyers in private practice, in-house counsels, bankers active in the real estate industry, fund managers, senior managers in real estate companies, brokers and other service providers of the real estate industry. By putting in tremendous efforts, organisers, supported by the IBA Latin American Regional Forum and the North American Regional Forum as well as by diligent IBA staff led by Ms Flavia Alves, overcame the murky overall outlook and successfully launched the first annual Real Estate Section Conference *Global investments in real estate: trends, opportunities and new frontiers.*

The conference was held on 5 and 6 February 2009 in the JW Marriott Hotel in Miami, Florida and attracted more than 90 participants from 38 countries. While giving the opening remarks, Mr Luis Moreno and Mr Claudio Cocuzza emphasised that the event would strive to offer refreshing and positive views on the current developments and other hot real estate issues in a unique manner. As the conference went on, it became apparent that they had succeeded.

In the introductory session on current trends, key players and opportunities, Mr John T Riordan (International Council of Shopping Centres), Mr Robert Kaplan (Olympian Capital Group), Mr John McCarthy (Leisure Partners) and Mr Jorge Abelardo Garcia (Martin & Drought PC) gave a dynamic overview of the real estate industry, emphasising risk aversion and the fear of the unknown as the key factors influencing the stand-still situation. Understandably, the economic crisis and its effects were the main topic of the presentations. Speakers described challenges facing the real estate markets and their views of the possible developments focusing on US and Latin American countries. Although Latin American markets were to a certain degree shielded from the depths of the turmoil by a somewhat conservative approach of their banks, serious financing problems occurred everywhere. Of course, as Mr Kaplan noted, the origin of the collapse could be found in US style transaction structuring where '100 per cent financing' projects without real equity were not just a strange anomaly but rather an often occurrence. However, all speakers also recognised that these were times of extraordinary value creation opportunity and that those able to recognise and seize the chances would take part in one of the largest wealth transfers in modern history. Echoing an ultimately positive tone of the presentations, numerous delegates from eg, US, Sweden, Spain and Nicaragua took part in an enthusiastic discussion by focusing on possibilities for projects in the industry and for related legal work. This initial focus on the opportunities and search for solutions gave a positive momentum which was maintained throughout the conference.

The conference continued with the session on shopping centre industry and the retail sector which was moderated by Mr Claudio Cocuzza (Cocuzza & Associati) and featured Mr Luis Ayesteran (Consorcio ARA Division Construccion y Desarrollo), Mr Kieran Mulroy (Ivanhoe Cambridge) and Mr Mario Suarez (Thompson Hine). Starting with Mr Cocuzza's European perspective and overview of diverse systems across the European Union

and the EU accession countries, speakers gave detailed insights into the challenges facing retail developments in their respective jurisdictions. Mr Mulroy presented the Canadian experience noting different levels of regulation affecting retail developments as well as socio-economic factors influencing investors' decisions. Mr Suarez's presentation concentrated on new industry features such as green retail but also made interesting notes on the 'death-spiral' effects of some standard contract clauses (eg, co-tenancy clauses). Mr Ayesteran gave a brief overview of the situation in Mexico especially noting the effect that the developed tax system may have on the projects.

After lunch during which the keynote address had been made by Mr Carlos Rosso (Related Group), two sessions discussed cross-border element in the real estate transactions. The first session concentrated on the constant struggle between global standards and local requirements. Moderated by Mr Martin Holler (Giese & Partners) and featuring Mr Bernat Mullerat (Cuatrecasas Abogados SRLP), Oscar R Rivera (Siegfried Rivera Lerner De La Torre & Sobel) and Ms Lisa E McGinley (Fidelity National Financial Group), the session offered vibrant debate on the importance of local legal particularities and how they affected structuring of cross-border deals. On the example of the title insurance it was noted that typical institutes of one jurisdiction do not necessarily have to function in other jurisdictions and that clients as well as lawyers have to be prepared to adapt to specific features of the national legal regimes. Speakers also touched upon the lawyers' role in the transactions and the serious challenges facing the profession as well as clients in these difficult times.

The next session on financing in cross-border real estate investments was introduced by Mr Luis Moreno (Haynes & Boone LLP) who offered his comments on the current liquidity crisis and emphasised the importance of well balanced legal advice. He was followed by presentations of Mr William A Weber (Hughes Hubbard & Reed LLP), Mr Jürgen Necker (Helaba Landesbank) and Mr Fabio Perrone Campos Mello (Campos Mello Pontes Vinci e Schiller Advogados). All speakers shared their first hand experiences from the recent deals and noted that the paralysis in financing had affected not only the number of deals but also their structure, timeframe and legal documents. While Mr Weber demonstrated outside counsel's experiences with changes in financing structures and changes in the scope and number of covenants accompanying transaction documents, Mr Necker presented the banks' side of the story through interesting examples of recent transactions. Mr Campos Mello explained how the current confidence crisis in Brazil influenced the Brazilian banking system, current and expected projects and the overall investment climate.

The working part of the first conference day was closed with the session on Real Estate Investment Trusts. Introduced by Mr Michael T Fishman (Greenberg Traurig), presenters led the audience through the specific features this investment vehicle had taken on the two sides of the Atlantic. Mr Kenneth R Uncapher (Carlton Fields PA) described the original US scheme providing detailed overview of the structure and qualifying requirements for the REITS. Mr Heiko Gemmel (Lovells) followed with the presentation of experiences in various EU countries such as Germany, France and Italy analysing tax treatment as well as structure and shareholder requirements of different national REIT structures. In the discussion that followed participants elaborated on reasons why REITS had been so successful in some parts of the world while virtually non-existent in others such as tax incentives, investment restriction, listing requirements, etc. It was also interesting to learn about more or less successful attempts made by some countries (eg, Columbia and Mexico) to introduce REIT regime in their national legal systems.

The second day of the conference started with the session 'Credit crunch crisis: Are we at the end of the tunnel?' It was moderated by Mr Nikolaus Pitkowitz (Graf & Pitkowitz Rechtsanwälte GmbH) who invited the participants to share their views on the reach and impact of the pressures facing the property financing industry and their forecasts. Echoing the title of the session, Mr Jürgen Necker (Helaba Landesbank) compared the start and the development of the crisis with a trip through a tunnel. Mr Necker described in detail certain landmark events and their impact on the business, wittily illustrating particular contract clauses (eg market distortion clause and agency clause) as signals of different stages of the trip towards the light at the end of the tunnel. Mr Juan P Loumiet (Greenberg Traurig PA) provided comments from the US perspective emphasising the unpreparedness

of the whole sector including the legal profession to the complexity and size of the turmoil. Through the case study of the fall of Lehman Brothers, Mr Loumiet depicted the intricacy of legal and financing structures that accompanied every single real estate project and which ultimately led to a ‘perfect storm’ hitting the economy and the real estate markets. In his presentation of business opportunities that could be pursued even in the difficult times, Mr Johannes Roth Pollack Parnau (Lidevelopment GmbH &CO KG) explained a specific project in Romania featuring a buyout of rights to the land which resulted from the ongoing process of denationalisation. Lively discussion that followed concentrated not so much on the pitfalls of the crisis but rather on various opportunities that still exist and could be supported by balanced financing.

The final part of the conference was devoted to the interactive panel discussion on the role of local counsel in real estate cross-border transactions. Summarising messages of all previous speakers, Ms Carolina Zang (Zang Bergel Viñes) emphasised the creativity as the main asset for transactional lawyers in time of crisis. Mr Manuel Barreiro (Cypress Real Estate Advisors) provided valuable input on what clients expect from their legal advisors and which qualities should be sought after in the client-lawyer relationship. Mr Sergio Socolsky (America’s Capital Partners) underlined the need for quick execution and business related advice while Ms Lisa E McGinley (Fidelity National Financial Group) shared her experiences in dealing with local lawyers not accustomed to the title insurance system. At the end, the presentation of Mr Albert Garrofe (Cuatrecasas) was devoted to the challenges facing the legal profession. Mr Garrofe pointed out that law firms are feeling the crisis as well and that the role of lawyers involves more matchmaking than ever before. The discussion extended to the floor with numerous delegates explaining how their position of outside legal counsel was affected by the change in economic circumstances and related change in values pursued by the clients. It was concluded that with a creative approach not only to the legal work but also to the client relationship, lawyers could adequately tackle the new professional challenges and thus contribute to the success of their clients.

Precisely because of such creativity shown by the organisers and driven by Mr Cocuzza, the conference turned out to be a great success in face of rather unfriendly odds. A well structured balance of working sessions and networking breaks provided an excellent opportunity for participants to extend specific legal knowledge, but also to further business goals and establish new collegial relationships. A mixture of expert speakers coming from different backgrounds and attractive presentations turned each session into an interesting debate provoking valuable input from the delegates from the floor. Organisers, as well as speakers, should also be credited for excellent time management appreciably adding to the overall quality of the event. Being a significant part of the revitalisation of the IBA Real Estate Section, the success and quality of the conference *Global investments in real estate: trends, opportunities and new frontiers* clearly opened the door and set a high standard for forthcoming annual section’s conferences.

Documenting the deal: the importance of clarity in drafting market rent review clauses

AUSTRALIA

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In the case of a commercial lease that is not subject to retail tenancy legislation, the scope of a market rent review will be determined by the review clause in the lease itself. Accordingly it is important that the definition of market rent review set out in the lease, reflects the parties intentions.

There are many different terms used to refer to a market rent review. These include market rent, open market rent and current market rent. The terms reasonable rent and fair rent are also used.

It is important that the term used in the lease is appropriate, having regarding to a broader body of law that has considered the interpretation of market rent review clauses, to ensure that the market rent review clause 'documents the deal' between the parties. That is, if the parties have intended a market review to occur, it is important that the language of the lease does not inadvertently, result in a departure from what the parties have originally agreed.

It is important that the market rent review clause sets out in detail the procedure for implementing the market rent review, the factors that are to be taken into account in determining the market rent, the role of the valuer and, any limitations that are to be placed on the market rent review. The consideration of these issues is beyond the scope of this article.

The term 'market rent' is commonly understood to mean the highest rent obtainable after the premises have been offered for letting generally on the market.[1] Case law indicates that the terms 'open market rent' and 'current market rent' will be interpreted in the same way as market rent.[2] The common theme between the terms market rent, open market rent and current market rent is that the rent for the premises is determined by reference to an objective criteria. That is not so when it comes to determining the 'reasonable rent' or 'fair rent' because these terms require consideration of what is reasonable between the particular landlord and the particular tenant. This adds an element of subjectivity to the review process.[3]

Having regard to the uncertainty that can result from an unclear expression of the intended method of review, it is extremely important that the parties use well established expressions and phrases. If it is intended a market rent should occur, the terms 'market rent', 'open market rent' or 'current market rent' should be used. In particular, it is important to avoid using construed terms such as 'fair market rent' or 'fair and reasonable market rent', as these terms are likely to cause confusion.

Failure to use clear, and commonly understood expressions and phrases may result in the market rent review establishing a rent that was not intended by the parties when they were 'doing the deal'.

Note: This paper does not consider residential and retail tenancy legislation and regard must be had to such legislation where it applies.

Notes

1 Alan Hyam, *The Law Affecting Rent Review Determinations* (2005) The Federation Press at 13.
2 *Sterling Land Office Developments Ltd v Lloyds Bank plc* [1984] 2 EGLR 135 at 137.
3 Derry Davine, 'Market rent reviews in commercial leases' *Australian Property Law Journal*, Volume 13, Number 3 (2006), pp 299–328 at 300.

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Damages for non-disclosure of a change in ownership: new pitfalls for M&A deals involving property

Section 12a of the Tenancy Act provides that if a business operating on leased premises is sold, the lessor is entitled to increase the rent to the market level. This applies to both share deals and asset deals.

In a recent judgment the Austrian Supreme Court dealt with the case of a company renting office space. The defendant had purchased all shares of the renting company in 1997 without disclosing the transaction to the landlord. When the landlord found out about the transaction in 2004, it raised the rent to the market level and claimed the difference between the actual rent and the market rent for the time between 1997 and 2004 in damages, arguing that the company was in breach of its duty to disclose a change in ownership. As the renting company itself had fallen into bankruptcy, the landlord addressed its claim against the managing director and against the majority shareholder of the tenant.

An additional twist to the case is that the landlord had itself only recently acquired the building. Therefore, the defendant argued that the plaintiff itself had not suffered any loss between 1997 and 2004.

The Supreme Court found in favour of the plaintiff and confirmed that section 12a of the Tenancy Act not only protects the current, but also the future landlords. The managing director of a renting company is under an ongoing duty to disclose structural changes and can be held personally liable if he breaches this duty. The case was remitted to the court of first instance, the judgment is not final.

The judgment is surprising in that the Supreme Court grants the plaintiff a double favour: on the one hand, the plaintiff is entitled to claim damages for a loss which had been suffered not by the plaintiff, but by its predecessor. On the other had, one would assume that the purchase price paid by the plaintiff when acquiring the property was based on the actual rent paid, rather than the possible rent increase which the previous landlord knew nothing about.

The judgment is interesting for investors on either side. Renters must be aware that they are under an ongoing duty to disclose and that they may have to indemnify the landlord for the entire period in which the rent could have been raised. This may result in heavy payment obligations, in particular because the limitation period (three years) starts only when the landlord finds out about damage and non-disclosure. Landlords, on the other hand, may receive windfall profit since they may be awarded damages even for the time before they acquired the premises.

An overview of significant aspects of the Austrian tenancy law for the real property investor's purchase decision

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The legal framework requirements have an influence on economic efficiency

Every real property investor's purchase decision is based on extensive economic considerations regarding the question which profits can be gained with the real estate on a short/medium or long term. In particular, which rental income at which costs (maintenance and investments) with the specific real property, on the basis of the current and also future economic conditions, can be earned, are of fundamental importance for an investor. To assess this, it is necessary to know if, and, in case of affirmation, through which restrictions the general freedom of contract of the parties concerning lease agreements are limited by the provisions of the Austrian tenancy law. So it is of little use, for example, if the investor can correctly appraise the future attainable rent at a specific location, due to the investor's business knowledge, but de facto cannot obtain this rent because of the statutorily stipulated rental limit. At this point, the following should highlight which legal restrictions in Austria are essential for real property investors and at all events must be examined in the course of a legal due diligence.

The Austrian tenancy law

In Austria, within the range of the general civil law, freedom of contract exists to a large extent. It is only restricted in the area of the right to lease, save for a few exceptions, by the principle of unconscionability (that means for leases unprotected by mandatory tenancy law). Thus, if the parties, ie, lessor and lessee, have not agreed upon contractual provisions concerning a certain aspect of the lease, the General Civil Code stipulates the provisions, which subsidarily apply in such cases.

Contrary to this, the Austrian Rent Control Act (*Mietrechtsgesetz*) has numerous mandatory regulations for the protection of the lessee. It cannot be deviated from these by mutual party agreement to the lessee's disadvantage; contractual clauses conflicting with these protection provisions are therefore null and void. Nevertheless, within the scope of the Austrian Rent Control Act the general provisions of the tenancy law are also subsidarily applicable as far as the Austrian Rent Control Act's provisions are not sufficient or offer less protection for the lessee.

The Austrian Rent Control Act's scope of application

The question, which mandatory legal restrictions within the property's realisation of profits, in particular, in line with further renting, the investor must put into consideration for her/his purchase decision, mainly depends on the extent of the Austrian Rent Control Act's scope of application.

Thus, exempt from the Austrian Rent Control Act's scope of application, and therefore unprotected by mandatory tenancy law, are, for example,

- lease agreements for space leases, such as parking lots or undeveloped property, as well as for lease objects located on real property consisting of not more than two autonomous premises;
- tenancy agreements that determine the demise (*Pachtvertrag*) and not the lease (*Mietvertrag*); in this respect it is important for an investor to be aware that there is an ongoing discussion by case-law and doctrine, whether tenancy agreements regarding shopping centres are deemed to be demises or lease agreements and, therefore, if the Austrian Rent Control Act is applicable or not;
- certain types of lease agreements, for example the leasing within the scope of lodging companies, garages, forwarding companies, or storing companies; as well as
- extremely short leases, which have been concluded for a time period of less than six months.

But also within the Austrian Rent Control Act's scope of application it is differentiated between the partial scope (*Teilanwendungsbereich*) and full scope of applicability (*Vollanwendungsbereich*) of this Act, depending on the date of the issuance of the building permit and the utilisation of public funds, which is information generally not written in the agreements and therefore not visible in the data room in the scope of a legal due diligence.

Thus, in the partial as well as full scope of applicability of the Austrian Rent Control Act, the mandatory restrictions of the contractual autonomy primarily include the lessee's termination protection in the form of the lessor's termination possibilities reduced to good causes.

If the Austrian Rent Control Act is fully applicable, besides the lessee's termination protection, essential mandatory regulations are, for example:

- the amount of the permissible rent stipulated by the lessor;
- the lessor's maintenance and improvement obligations;
- the compensation of the lessee's efforts for the apartment;
- the subletting;
- the lessor's right to increase the rent to an adequate amount in case of alterations within the entity of the lessee as well as [at the disposal or leasing of a rental company increasing the rent to a suitable amount]; as well as
- the operating and ancillary costs including public taxes as well as their invoicing.

The termination protection of lease agreements

According to relevant provisions of the Austrian Civil Code as well as those on the basis of the Austrian Rent Control Act, lease agreements can be concluded for definite (time limited lease agreements) as well as indefinite time periods (unlimited lease agreements).

Time limited lease agreements

Time specified lease agreements terminate automatically after expiration of the agreed time without requiring an explicit termination notice of either of the parties. If no explicit termination right was stipulated within the time limited lease agreement, both contract parties can only terminate the lease ahead of schedule upon good cause. Unfavourable use of the lease object by the lessee or the repeated non-payment of the rent is considered to be good causes for an extraordinary termination on part of the lessor according to the general provisions of civil law.

In this connection, the Austrian Rent Control Act stipulates, both in its full and partial scope of application for a valid limited duration, the mandatory requirement of the written form for limited duration agreements. Also, the limited duration of an apartment lease must have the minimum duration of three years. Should these requirements of a valid limited duration not be adhered to the lease is deemed to be concluded for an unlimited time period.

Unlimited lease agreements

Within the scope of the Austrian Civil Code (for leases unprotected by mandatory tenancy law), unlimited lease agreements can, in principle, be terminated at any time by means of formal termination notification of one of the two parties subject to specified termination periods and dates. Normally, the parties determine a termination period of one to twelve months and for the termination date either the end of the month, the quarter, or mid-year is chosen.

To establish an incentive for economic investments into the real estate and to create a certain predictability of the contract duration, the unilateral or mutual waivers for exercising the ordinary right of termination for a certain time period is usually stipulated in the lease agreement.

The lessor is always required to state a *good cause* to terminate a lease within the scope of the Austrian Rent Control Act, hence in the case of an unlimited lease agreement as well. Such a *good cause* can only arise either from the exemplary reasons listed in the law or from the stipulated general clauses of the Austrian Rent Control Act. Therefore, as long as the lessee of rent protected lease objects principally conducts her/himself in accordance with the contract and the existing law, such leases are practically interminable on the part of the lessor (real estate investor). However, even within the scope of the Austrian Rent Control Act, the lessee can in principle terminate the lease at any time, subject to the contractual or statutory termination periods and dates.

In addition, the Austrian Rent Control

Act stipulates within its scope of application an indispensable right of termination for apartment leases, which is not limitable to the lessee's disadvantage. According to this, the lessee may terminate the lease in any case after expiration of one year, in written form respectively at the end of the month, subject to a three-month termination notice.

The extraordinary right of termination within the acquisition of a real estate

The general tenet 'purchase breaks lease agreements'

According to the tenet 'purchase breaks lease agreements' in general civil law, the purchaser of a real estate enters into the lease agreements, by act of law, whereby in the absence of the registration of the lease agreement into the Austrian land register or of a separate agreement between purchaser and lessee the particular lease agreement automatically converts, in any case, into an unlimited one. Thus, the purchaser obtains the right, to terminate the lease agreement subject to the legal notice periods at the statutory termination dates. In such case, the purchaser of a real estate therefore can, in spite of contractually agreed termination waivers or other contractual restrictions, duly terminate leases that are located on the real property.

However, if the lease was entered into the Austrian land register for a certain time period, due to the provoked reification of the property right, every purchaser of the lease object, therefore, of the real estate as well, must adhere to the lease agreement's time period entered into the Austrian land register before s/he can terminate the lease.

The purchaser's termination restriction within the scope of the Austrian Rent Control Act

Within the scope of the Austrian Rent Control Act, however, a legal successor on part of the lessor of a real estate, alternatively a lease object, irrespective of a possible registration of the lease into the Austrian land register, is, by act of law, bound to all provisions of an existing lease agreement. This legal transfer of the lease to the legal successor comprises not only the general legal provisions of the Austrian Rent Control Act but also all the terms and conditions of the lease agreement at hand, as well as additional agreements to the lease of exceptional content, insofar as the legal successor had or should have had knowledge of these.

The essential criteria for the rent amount

In addition to the termination protection of lease agreements, the real property's attainable rent profit for the envisaged acquisition is one of the most essential aspects for the purchase decision. Dependent on the Austrian Rent Control Act's applicability and the type of lease object different limitations for the legally permissible rent amount agreed upon come into consideration.

Outside of the scope of (for leases unprotected by mandatory tenancy law) as well as within the partial application of the Austrian Rent Control Act, regarding the legally permissible rent amount only the general civil law protection provisions apply, eg, error, fraud, coercion, extortion, or *laesio enormis*. Moreover, no statutory limitation of the rent exists, so that one party cannot rescind this amount once it has been contractually agreed upon.

The 'adequate rent' within the full scope of the Austrian Rent Control Act

Due to the law the adequacy of the rent is based on the size, type, quality, location, amenities and maintenance conditions of the lease object. A contractual agreement of the rent of an adequate amount is especially legally allowed for commercial real estate of all types, for example, business premises, offices, storerooms, workshops, etc, and for rental objects in so-called new buildings (*Neubauten*, building permits issued after 1945) as well as for certain historically preserved buildings.

The 'reference value rent' within the full scope of the Austrian Rent Control Act

The reference value rent (*Richtwertmietzins*) is the amount per square meter of the used area, which is stipulated by means of regulation for the so-called standard rental apartments annually for each state. The criteria that such a standard rental apartment must possess are accurately described statutorily and include, for example, a certain size, as well as the useable condition of the apartment, its type, its number of rooms, and the building's proper maintenance conditions etc. In comparison

to the standard rental apartments, additional fees or fee reductions from the statutory reference value rent must be made for a specific apartment to establish value elevating or decreasing variations from the standard rental apartment. In practice, the ascertained reference value rent for apartments is generally considerably lower than the typical attainable fair rent on the market.

The lessor's maintenance and improvement obligations

The question, who has the duty of maintenance and improvement, is significant for economic considerations of a purchase decision as well, since a high rent profit could be decimated by a broad maintenance and improvement obligation of the lessor and therefore an overall lower rent profit without maintenance and improvement obligation ultimately could yield a larger profit for the real property investor.

According to the general statutory provisions of the civil law (for leases unprotected by mandatory tenancy law) as well as of the partially applicable Austrian Rent Control Act, the lessor must maintain the real estate in suitable condition during the lease pursuant to the contract purpose. However, this provision is considered to be flexible law and is contractually waived in practice inasmuch as the lessor is merely responsible for the maintenance and improvement of the general parts of the property and the lessee is responsible for the lease object itself.

However, in application of the full scope of the Austrian Rent Control Act the lessor is obliged to maintain the general parts of the building; whereas lease objects are only subject to the maintenance and improvement obligation of the lessor if it includes the remedy of serious building defects or of considerable health hazards.

The operating and ancillary costs

Regarding the attainable net rent profit amount arising from the real property, it is significant for a real estate investor if s/he can shift the operating and ancillary costs onto the lessee or if s/he is obliged to bear these costs her/himself.

In principle, the general civil law (for leases unprotected by mandatory tenancy law) stipulates that the lessor must bear the operating costs, however due to the civil law's prevalent freedom of contract these are generally shifted to the lessee by contract.

On the contrary, the operating costs that the lessor (property investor) may pass on to the lessee in the Austrian Rent Control Act's full scope of application are listed in the law exhaustively. For example, these include the expenses for the building's water supply, chimney flue maintenance, sewer clearing, garbage removal, and pest control, the costs for the illumination of general parts of the building, adequate insurance, costs for the management and building supervision, as well as public taxes. The operating costs for the real property not mentioned in this legal catalogue, for example, repairs of general parts of the property including the roof and the facade of a building, cannot be shifted onto the lessee and the lessor must therefore bear these costs alone.

Lease agreement fees (stamp duty)

A material feature of the Austrian law, although that does not stem from the Austrian Rent Control Act but from the Fees and Duties Act, is the obligation to pay a fee (stamp duty) for lease agreements. According to this, with a few exceptions, all concluded lease agreements in written form must be notified to the appropriate tax authorities within a certain time period. For certification of the duly notified lease agreement and remittance of the appropriate fee to the tax authority, the lessor must affix a self-assessment notation on all of the contract's duplicates. The fee amount is based on the amount of rent, on the one hand, and on the lease duration, on the other.

Conclusion

- The question, if real estate in Austria is subject to statutory restriction regarding leasing, is often not easily clarified. In many cases the information provided in the appropriate data room is not sufficient.
- Some real estate is subject to complete freedom of contract and some have more or less limited freedom of contract with leases unprotected or protected by the Austrian Rent Control Act.
- The least contractual freedom under the scope of the Austrian Rent Control Act exists for apartments in old buildings and the most exists for commercial real estate in new buildings.
- If the wording of a lease agreement concluded for shopping centres is precisely drafted it is, in

general, not subject to the scope of the Austrian Rent Control Act.

- Lease agreements that infringe upon the mandatory provisions of the Austrian Rent Control Act are invalid in this regard.
- The significant legal limitations of the Austrian Rent Control Act are the protection against termination, the rent limitation, as well as the lessor's indispensable maintenance and improvement obligations and the prohibition of shifting the operating costs not listed statutorily onto the lessee.
- As far as the Austrian Rent Control Act is not applicable or a lease has not been entered into the Austrian land register, the tenet 'purchase breaks lease agreements' applies; otherwise the purchaser of a real property must also adhere to the statutory termination protection of the lessee.
- Written lease agreements are subject to stamp duty according to the Fees and Duties Act.

Building-up the Condominium Law

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The Chilean Condominium Law instated in 1997, created a special regime applicable to condominiums built within the city limits and formed by independent units (eg, apartments, offices, parking spaces, storages, etc), over which exclusive domain rights are granted to different owners, but maintaining part of the land and/or of the units in the common and undivided domain of all owners.

The condominium law is currently in the eye of the hurricane, especially in development projects undertaken by corporate developers or private investment funds, designed from the very beginning to be built and sold in several and successive stages, in order to maximise the revenue of each unit and of the real estate as a whole.

One of the major problems that developers have faced, is the claim of the owners of the units sold during the first stages of the development, that once all units built in those early stages are sold, the rights of the developer over the remaining land are terminated, unless a valid building permit for the future stages of development is already in place.

Even though this claim is still being judicially contested and there are no consolidated precedents to rely on, we lawyers have been pushed to create a number of pretty inventive legal devices to prevent such allegations arising and succeeding.

The common denominator of all these remedies is to make buyers of the condominium units have full knowledge of the entire project, including both the already built stages and the rest of the planned units to be constructed in a particular real estate.

These representations are being introduced both in the purchase agreements and in the general rulings of the condominium (required by law and issued by the developer), as a lien imposed to all co-owners, to recognise the developers' ownership rights over the remains of the land.

Also, supplementary clauses designed in the form of powers of attorney, have been introduced in the purchase agreements, allowing sellers to do whatever may be required to complete the original project, without having to obtain the collective approval of the co-owners that according to the condominium law requires higher voting quorums.

Among the customary attributes contained in these proxies, sellers are irrevocably empowered to apply for new building permits, amend the original blueprints and specifications of the project, require supplementary permits and even act on behalf of the co-owners in granting the collective approvals that may be required.

This 'lawyerly' solution – designed to prevent buyers from using a technicality to deprive sellers from their property rights

– has completely shifted the field in favour of developers, to the extent that almost all condominium rights are being surrendered by the co-owners to the developer's will.

We are yet to see the outcome of the judicial disputes over this interesting topic. In the meantime we are forced to keep transforming what used to be relatively simple purchase agreements into very complex codes, filling every single legal gap with reps, warranties, indemnities and other sophisticated clauses, whose enforceability can also be subject to a very good amount of questioning before a court of law.

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Matrimonial property v confidence in the land registry

The Croatian Constitutional Court ruled on a case that conflicted two affirmed legal institutes, matrimonial property and the principle of confidence in the land registry. The Court held that in cases where the land registry fails to accurately reflect the spouses' ownership over a real estate, the rules setting the spouses' ownership over real estate will have preference over the principle of confidence in the land registry.

Under the principle of confidence in the land registry, the status of the land registry is presumed to be true and accurate, unless there is proof to the contrary. Therefore, as a general rule, a person in good faith may rely on information contained in the land registry and be afforded protection when acquiring real estate relying on such information.

The problem occurred when a husband registered in the land registry as the sole owner of a real estate sold the real estate to an acquirer who was acting in good faith and was unaware of the fact that the real estate in question was in fact matrimonial property (ie, acquired during marriage and consequently owned by both spouses in equal shares).

The Court held that the acquirer cannot claim the protection under the principle of confidence in the land registry and declared the acquisition agreement to be null and void on the basis that such agreement violated mandatory provision of the Family Act providing that spouses must consensually dispose with the matrimonial property.

The decision of the Court brought into focus the importance of conducting a thorough due diligence exercise prior to real estate acquisition, and has been criticised by the legal and business community as resulting in non-transparency of the ownership over a real estate.

Dos and don'ts of buying distressed property in Eastern Europe

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Introduction

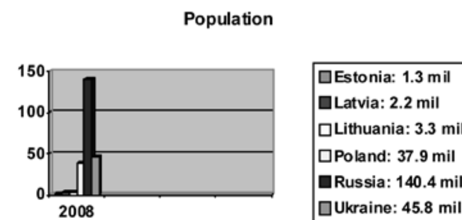
For several years investors in Western Europe and the United States have looked to the real estate markets in Eastern Europe, Russia and the Ukraine to obtain higher yields. Between 2005 and early 2008 there was a boom period with strong economic growth and lots of investment in real estate in Eastern Europe. Now, as a result of the global economic crisis, cross-border real estate investment has plummeted. Prices have fallen, financing is difficult to obtain, and many projects have been stopped in their tracks.

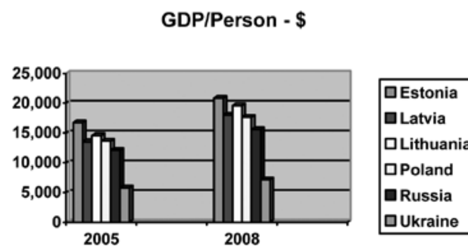
Investors with cash may think they can buy distressed property in Eastern Europe and when prices rebound they will make a fortune. While 'distressed property' seems to be the new buzz word, for now the reality in Western and Eastern Europe is that there does not appear to be a large influx of distressed property into the market. If the real estate market conditions do not improve in the coming months this might change. But before buying distressed property, investors need to be aware of some of the challenges they face.

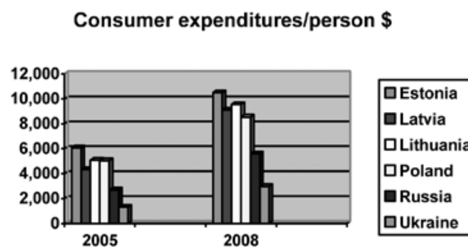
This article looks at some economic trends in several countries in Eastern Europe and offers advice on what to do or not do with investments in distressed property.

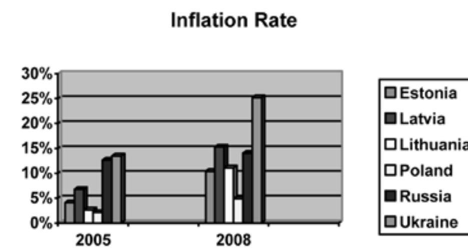
Overview of some Eastern European economic trends

In the charts below, economic indicators for six countries in Eastern Europe (Estonia, Latvia, Lithuania, Poland, Russia and Ukraine) from 2005 to 2008 are compared.









Note: Euromonitor plc(**www.euromonitor.com**) was a main source for the data used in the charts.

These indicators and GDP projections for 2009 indicate that the Polish economy may be significantly stronger than the other countries. Estonia and Latvia had negative GDP in 2008, and negative GDP in 2009 is projected for all of the countries except Poland. In Russia and Poland, consumer expenditures are less than disposable income. Whereas, in Ukraine, Estonia and Lithuania, consumer expenditures have been greater than disposable income for four years. Consumer expenditures per person are much higher in the three Baltic states than in the other three countries. Only Poland has a low inflation rate. The other five countries for 2008 ranged from 10.4 per cent inflation in Estonia to 25.2 per cent in the Ukraine, although Estonia's inflation fell by over half in early 2009.

Several factors seem to be responsible for the strength of the Polish economy. First, the banks in Poland were very conservative in giving loans, thus they are less affected by the sub-prime mortgage crisis than many other European banks. Secondly, Poland exports make up only 35 per cent of its GDP, while in countries such as Hungary and the Czech Republic, nearly 70 per cent of their GDP came from exports. Thus, with global decreases in consumer spending, there are reduced exports and this has a stronger negative affect on those economies than it does on Poland. Thirdly, Poland has a large population of educated and experienced expatriates who are investing in Poland and increased numbers have been returning to Poland.

Despite this strength Poland, like other Eastern European countries, especially Ukraine and Latvia, has seen its currency dramatically weaken in the second half of 2008 and early 2009. Also, throughout Eastern Europe there has been a major decrease in the number of cross-border real estate transactions compared to the numbers in 2005, 2006, or 2007. The situation in 2009 is even worse. There are equity funds with money to invest, but they are extremely cautious and waiting to see more economic stability before re-entering the real estate market.

The great interest in 'distressed property' is that people believe because the price is low for property good returns will be easy to obtain. But, just because the price appears low, this does not mean it is a good investment. One still needs to make a careful investigation of the property and the local market before investing in 'distressed property' or any real estate.

Ten dos and don'ts to consider with investments in distressed property in Eastern Europe

If you are looking to buy or sell distressed property here are several things to do, and some not to do.

1. Do consider the location.

It has often been said that the three most important things to consider with real estate are: Location, Location and Location. It is the same with 'distressed property'. Where is the property located? What is the nature of the properties around it? Are they also distressed? If there is a lot of 'distressed property' in the area, it may take a very long time before the value of the property can be increased. Is it a suitable location for the proposed use? How is its accessibility, by foot, car or public transportation? What is the potential for the area the property is located in to increase in value?

2. Do not buy cross-border property without considering difference in local laws and procedures.

When buying cross-border property there will be laws and procedures different than the investor may be used to in their home country. The investor must be informed of these differences. In Poland, for example, it is common when buying government owned property that instead of getting freehold title to land, a buyer gets the right of perpetual usufruct of the land for a long period of time. In Russia many acquisitions are done through SPVs in off shore locations, such as Cyprus. In addition, there may be misunderstanding in translation of documents. The translator should be sure the correct meaning is followed rather than just making a literal translation.

3. Do understand the local market before buying property.

While there is a lot of talk about globalisation and you can find the same brands of stores in cities around the world, local markets in Eastern Europe are still different from what most westerners are used to. This includes the real estate market. An investor in property needs advice from someone who understands the local market where the property is located. But, the investor also needs advice from someone who understands cross-border issues, western investment ideas and the

investor's vision of what they want to do with the property. Local people who are not aware of this may discount the value of the property or assume the development the investor has in mind cannot happen, or will take far longer to accomplish.

4. Do not buy property without having conducted legal, tax, environmental, technical and commercial due diligence.

Buying property is risky. To reduce the risk, due diligence must be conducted, at least, to see:

a. Can the investor get clear title to the property?
b. Are there encumbrances, liens or easements on the property?
c. Is the property zoned so it can be used or developed as you want?
d. Is there pollution or other adverse conditions affecting the property?
e. What are the conditions of any structures on the property?
f. Can the property generate income?
g. What are the local market conditions for the way the investor wants to use the property (residential, office, retail, service, or other)?
h. If the property is for development, what are the construction and labour costs and availability of labour?
i. What are the tax consequences of removing income from the property, or the proceeds of a sale of the property to the investor's home country?
j. Is the investor as a foreign entity permitted to own or lease the property?

5. Do have an exit plan before buying the property.

Before buying real estate an investor should have a plan of how they are going to dispose of it. Do they just want to build a building and sell it as soon as it is completed? Do they want to operate the facility after it is built? Do they want to own the property, but have someone else operate it for them? For example, if the investment is a new development with a new zoning plan, there may be administrative land taxes to be paid if the property is sold before a certain date. Knowing how and when you want to exit an investment will aid in properly structuring the investment at the start. The investor may want to establish a special purpose vehicle (SPV) in another jurisdiction than their home country or where the investment property is located.

6. Do not buy property without getting clear title.

In many places in Eastern Europe there may be a delay from the time you purchase the property to the date the title is registered in your entity's name. During that period encumbrances might be registered against the property. If you were planning to demolish an old building to construct a new project you may be forbidden because of the newly registered encumbrance. One way to reduce the consequences of this risk is obtaining title and gap insurance. A common practice in Poland to help reduce the risk is to first sign a preliminary purchase agreement in the form of a notary deed and register it.

7. Do consider cross-border tax issues.

Tax treaties between countries are not all the same. Tax treaties with one country may be better or worse if an investor is transferring income produced by the property than it is if the investor is removing the proceeds of the sale of the investment property to another country.

8. Do not buy cross-border property without considering currency exchange rates.

On 1 August 2008 one Euro was equal to 3.22 Polish zloty. On 2 March 2009, one Euro was equal to 4.75 Polish zloty. When conducting cross-border real estate investments it is necessary to know what currency the property is bought and sold in, and if the property has lease agreements in what currency is rent paid.

9. Do know the local zoning plan.

Before buying any property for investment the local zoning plan should be checked to see if the investor's proposed use of the property is permitted. What are the height and density restrictions on the land plots? Are there restrictions on its use, or how much space can be used for certain purposes? Also, be aware of how difficult it is to change the local zoning plan and what rights owners have when there are proposed changes by government entities.

10. Do not buy property without inspecting it.

At first, this may seem obvious, but there are commercial investors who have invested in real estate without inspecting the property.

Pretty pictures in advertisements or on web sites may be appealing, but no one should buy property without an on-site investigation. Photographs can be cropped, enhanced and altered to make a property look much better than it really is. Plus, they can omit significant distractions and problems. If the investor cannot visit the site, make sure the person inspecting the property for the investor knows real estate, understands the investor's purpose in buying the property and represents the investor's best interests.

Finally, our firm strongly recommends an investor to use legal counsel experienced with cross-border real estate transactions and cross-border legal and tax issues who can work together with legal counsel in the jurisdiction where the property is located. Local counsel is necessary in registering title and assisting in the due diligence, but counsel experienced in cross-border transactions can advise on these issues, the overall transaction and ensure the transaction complies with the investor's corporate or fund rules and codes of conduct.

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Italian real estate market: present scenario and possible developments

The real estate market has always represented an important economic sector within the Italian economy. Until about 2000 their knowledge and expertise covering investments in securities was limited and the purchase of real estate was typically considered both by individuals as well as by corporations as a worthwhile target for investment.

In the last ten years this scenario has developed rapidly and the investment market has widened to include the securities market with the development of numerous new financial products, gathering mass attention. However the real estate still stands out as a significant part of the Italian investment scene.

As a consequence of this, the economic crisis over the last two years had a massive impact on the Italian market.

The first quarter of 2009, with 299,419 overall operations, marked another reduction of the annual transactions in comparison with the last quarter of 2008. The number of transactions has decreased by an average of -18.7 per cent. This trend impacts all types of real estate with particular reference to the commercial sector. The residential sector, with 135,872 transactions, fell by 18.7 per cent, in line with the overall trend, whilst the industrial sector declined by 33.5 per cent.

With specific reference to the residential sector, the decrease was higher in northern Italy (-20.6 per cent), and lower in both the centre (-16.9 per cent) and in southern Italy (-16.0 per cent). The market in large urban settlements fell by 15.8 per cent, while in the smaller municipalities the market shrinkage was about 20 per cent, reversing the trend in 2008, where the fall in the number of purchases was bigger in the towns than in big cities.

The scenario depicted above is self explanatory and not very different from the situation in other countries.

In recent years the Italian authorities have introduced certain innovations that impact the real estate sector. We mention the two most significant ones.

The first novelty is the special beneficial tax and statutory regime for Italian-resident corporations which principally carry on a real estate lease business and whose shares are traded on an Italian regulated market: *Società di Investimento Immobiliare Quotata* (SIIQ).

A SIIQ is in many ways similar to the REIT (Real Estate Investment Trust), introduced in the 1960s in the USA and more recently

adopted by other countries (the Netherlands, Belgium, Japan and Hong Kong). France introduced the SIIC (*Sociétés d'investissement immobilier cotées*) since 2003 and it is this country which has inspired the Italian legislator most in the development of the new entity.

In order to qualify for the beneficial regime of the SIIQ, the following requirements must be met:

- No single person must possess, directly or indirectly, more than 51 per cent either of the voting rights at general meetings or the rights to share in the profits; and
- At least 35 per cent of the shares of these companies must be held by entities that do not, directly or indirectly, hold more than one per cent of the voting rights at general meetings and of the rights to share in the profits.

The election can be jointly exercised also by unlisted resident corporations which carry on a real estate lease business as their principal business, in which a SIIQ owns, including jointly with other SIIQs, at least 95 per cent of the voting rights in general meetings and profit-sharing rights.

The letting of real estate can be regarded as constituting the principal business of a company if the real estate owned or otherwise held accounts for at least 80 per cent of the company's assets and in each accounting period the company's lease/rental income accounts for at least 80 per cent of the income recorded in its profit and loss account.

The following elements also need to be taken into account in checking whether the criteria are met:

- shareholdings in subsidiary and affiliated SIIQs;
- financial instruments held until maturity and those available for sale, representing fixed assets;
- shareholdings held in companies exercising the joint option; and
- the relevant dividends from profits deriving from the company's real estate letting/lease activity.

Under the SIIQ regime, each accounting period the company must distribute to its shareholders at least 85 per cent of the net profit from the real estate lease business and from the ownership of shareholdings representing financial fixed assets.

If the aggregate profit for the year available for distribution is lower than the amount of profits deriving from the real estate lease business and from the ownership of the relevant fixed assets, the percentage of distribution applies to such lower amount.

With effect from the first accounting period in which the special tax treatment applies, business profits deriving from income from the letting real estate lease is exempt for corporate income tax purposes (IRES) purposes. A similar exemption applies for purposes of the regional production tax (IRAP), to the portion of the IRAP taxable base attributable to the real estate letting business.

Any capital gain realised on the contribution of the real estate or other real property rights into a company which has already elected, or which will make the election before the end of the accounting period in which it makes the contribution, is subject, at the taxpayer's choice, either to ordinary taxation or to a twenty per cent substitute tax in lieu of the IRES and IRAP, provided that the transferee retains the ownership of, or the benefit of the real property rights over the real estate for at least three years.

Similarly where a company previously subject to the normal tax regime makes the election to become SIIQ it will be treated for tax purposes as having disposed of and reacquired all of its real estate assets at market value, and will be subject to tax.

Neither the election nor a contribution of real estate assets to a company making the election for the special regime fall within the scope of VAT.

Another important measure undertaken by the government is contained in Law Decree No 185 of 29 November 2008, containing a series of urgent measures to sustain the economy. The decree introduces an exception to the normal criteria for valuing real estate in financial reports, as prescribed by article 2426 of Civil Code and other relevant legislation. It introduces the possibility of revaluing land and buildings held as fixed assets (thus excluding land and buildings the construction or buying and selling of which constitutes the company's corporate object) shown in the financial statements as at 31 December 2007. The legislation currently provides that the revaluation can be effected in the accounting period beginning on or after 1 January 2008, but it is possible that the measures will be extended to subsequent accounting periods.

The revaluation is open to:

- resident corporations, cooperatives, mutual insurance companies, European Companies (SE) and European cooperatives;
- resident public and private entities other than companies and trusts, whose exclusive

or main corporate object is the conduct of a trade; and

- Italian partnerships (*società in nome collettivo, in accomandita semplice* and the like), which do not adopt the International Accounting Standards (IAS/FRS) when drawing up the Financial Statements.

At the taxpayers' option the additional value ascribed to the assets at the time of the revaluation can be recognised for the purposes of IRES and IRAP starting from the third accounting period subsequent to the one in which the revaluation is effected. By paying a substitute tax in lieu of IRPEF (Personal Income Tax), IRES and IRAP at the rate of three per cent for depreciable property and 1.5 per cent for non-depreciable property.

The substitute taxes can be paid by the taxpayer either in one amount, or in three instalments, subject to additional interest.

Although some companies have taken advantage of these rules where possible, it is questionable if the law decree will have any positive effect on the present scenario in terms of incentivising real estate transactions. It appears in any case not to have had any particular effect so far. The main impact of the revaluation of real estate is on the financial statements with only a marginal impact on the market, mainly due to the fact that the companies will have fewer taxes on the gain generated by the sale of the property. Also the fact that the real estate has to be held for a minimum of three years and that there is top-up taxation in the event that any revaluation reserve is distributed to shareholders, means that the measure is being used by taxpayers to protect themselves against possible future taxation by paying a small-up front amount, rather than a real incentive toward making a deal.

With reference to SIIQ, two years after the introduction of this important new regime, the Italian market still seems rather unwelcoming and the election for the beneficial treatment seems to have been adopted by a number of companies.

Given the lean results obtained from these measures, as well as by the other measures adopted by the authorities, it is widely recognised that, in order to inject some renewed vigour into the real estate market, further legislative intervention is necessary as regards the tax treatment of real estate.

The Italian tax system has always been particularly rigid in relation to the sector with immoveable property being seen as a relatively easy target for taxation. Investors in real estate are subject to various taxes on:

a) the income arising from immoveable (IRPEF, IRES) property – including on deemed income deriving from second homes and with very limited scope for deduction of costs on residential lettings;
b) the gains deriving from the disposal of real estate, subject to exemption for individuals as regards gains on the disposal of the principal private residence or non-development property held for at least five years;
c) the value of the immoveable – local authority taxes (ICI) – although these have recently been abolished as regards the principal private residence;
d) the services provided to real estate the immoveable (waste tax, tax regarding the occupancy of public area);
e) the transfer of real estate, including some of Europe's steepest transfer taxes (registration tax, mortgage tax, cadastral tax, heritage tax), again with limited relief for transactions involving the principal residence;
f) business transfer of real estate (VAT) again with comparatively limited exemption; and
g) services relating to land (VAT) with some relief in terms of lower rates for restructuring and refurbishment of residential property.

This situation is due to a variety of reasons, ascribable primarily to the ease of taxing immoveable property both as compared to moveable property and based on the perceived easy gains from real estate in boom times as well as the perception of the need to clamp down on tax avoidance.

Nevertheless, whilst these reasons may have been justifiable in the past, as a consequence, inter alia, of the development of Italian urban areas, it seems less applicable in the present day. Furthermore, if the real estate sector might have been seen in the past as a sort of 'launching pad' for border line transactions, that risk is nowadays a marginal phenomenon, particularly for Italy's larger corporations.

Considered in the round, the support measures that might be desirable in order to relieve the real estate sector from its current crisis might consist in reducing or eliminating some of the tax provisions grounded on the assumptions described above (flourishing of the sector and need to stamp out tax avoidance). Many commentators have suggested intervention in terms of extending the VAT deducibility of costs, reduction of transfer taxes, and more in the way of exemption on disposals.

Property management: additional risk for banks

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The financial crisis has forced banks to make decisions regarding what to do with the real property of insolvent borrowers. One solution is the bank's takeover of the title to the property, whether by the bank itself or by a subsidiary especially created for that purpose. Such action involves management costs and risks.

Most often the insolvency affects developers of new housing projects who have already put the building into operation, sold some of the apartments and hired managers based on contracts closed during the boom years. Often these existing contractual obligations do not comply with consumer rights protections and contain unequal obligations and rights of the parties. When granting the credit, the bank may not have paid attention to management issues, whereas now it must live with the unfavourable contract.

New housing developments usually are divided into separate apartment properties by establishing an ownership share of the joint property pertaining to each of them. The law on apartment property states that beginning from the day when the property is acquired every apartment owner (including the bank) has an obligation to participate in the management of the building by contributing a proportionate share of costs related to the maintenance and repair of the building, land and communications, as well as of utilities consumed for common needs (heating and lighting of staircase, waste management). If an owner (including the bank) does not cover these payments a claim for collection of the debt or insolvency can be brought against him.

A general meeting of apartment owners, whose decisions are binding for all owners if more than a half have voted 'in favour', shall decide management issues. Each owner holds as many votes at the general meeting as apartments that are owned by him. Furthermore, to protect the minority ownership, the law provides that an owner who owns more than half of all apartments shall have not more than 50 per cent of the votes at the general meeting. Therefore a bank in such a position cannot take decisions on its own without looking for a compromise.

Upon evaluating the solvency of each developer the bank must analyse a wide range of issues (ie, debts, construction). Despite the fact that management might prove to have a crucial if not conclusive role in deciding on the most appropriate solution, insufficient attention often is paid to management's recommendations. However, by reasonably adjusting and streamlining the laws regulating property management not only would the bank, which has found itself in the unusual situation of deciding property management issues, benefit but so would all other owners as well as the managers themselves.

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The Constitutional Court of Latvia revokes the restrictions to land lease

Within the framework of the land reform, the ownership rights were restored to the landowners or their heirs whose properties were nationalised during the Soviet era and upon which apartment buildings privatised by other persons are located. In the result of such divided real estate between the owner of the land and the building the legal relations of the so called 'compulsory lease' were created, because according to the law the parties concerned were obliged to conclude a lease contract.

For more than ten years the law set limitations for the maximum lease amount with regard to such compulsory lease contracts, ie, the amount of lease could not exceed five per cent per annum from the value of the land calculated for tax purposes. Moreover, due to the considerable increase of the value of land, the law provided additional limitations for increase of the lease amount for the time period of three years. Such regulation materially restricted the rights of the land owner, as the actual income from land lease after taxes and other costs was negligible.

After receipt of a constitutional claim lodged by one of the landowners the Constitutional Court of Latvia on 15 April 2009 rendered judgment in case No 2008-36-01, by establishing that as from today the lease amount received by the landowner does not fulfil the remuneration function and therefore such limitations contradict the principle of proportionality. Consequently, the Constitutional Court decided to declare the legal norm on application of compulsory limitations to the lease amount as not corresponding to the Article 105 of the Constitution of Latvia protecting everyone's rights to the property.

After revocation of the said limitations, the lease amount will be set by a mutual agreement between the landowner and the owner of the apartment building. In the event no such agreement can be reached, the lease amount will be set by the court. In such a case the lease will be set in the amount of the land usage market value which is the average usage value of the respective land plot in the place and time of execution of the lease contract. It means that with respect to the compulsory lease relations the lease amount will be set in the amount to ensure due fulfilment of the remuneration function and economic equivalency between the landowner and the owner of the apartment building.

Regulations regarding utilities transmission: an overview

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A specific institution of transmission easement was introduced as of 3 August 2008 into the Polish legal system. The new institution is designed to regulate legal status of transmission devices and create specific legal relationship between the real estate owner and the owner of an enterprise transmitting utilities onto the said real estate. The transmission easement should also be considered by investors (not only utilities investors) in the light of planned investment process.

The transmission devices

The transmission easement is strictly connected with the term of 'transmission devices'. The Polish Civil Code sets forth their legal definition as devices designed to deliver or remove liquids, steam, gas, electric energy or other similar devices. The said transmission devices are not treated by law as an integral part of real estate if they are part of an enterprise. Following, the principle *superficies solo cedit* is excluded and the ownership of transmission devices (being a component of an enterprise) is separated from the ownership of the real estate on which they were erected.

Thus, an owner of transmission devices who incurred corresponding construction costs may request, from the entrepreneur who connected those devices to its network, to acquire the said devices for appropriate consideration, unless the parties decide otherwise in a relevant agreement. The above mentioned entrepreneur is authorised to raise vice versa an analogical claim.

Legal concept of the transmission easement

The transmission easement is classified by the Polish Civil Code as a limited property right along with: usufruct, pledge, mortgage and cooperative right to premises. In general a limited property right provides the authorised person with a strictly described legal title (which usually belongs to the owner) in regard to somebody else's thing (eg, real estate), which are narrower than the ownership right. All limited property rights are effective *erga omnes*, including the owner of the encumbered thing.

Prior to introducing the transmission easement, the Polish legal system distinguished only two types of easements: real estate easements and personal easements. The first one allows to encumber a real estate (i) in favour of another owner (of superior real estate) with a right to use within limited scope the encumbered real estate, or (ii) the owner of the encumbered real estate is limited in his/her right to perform specified actions in regard to such real estate, or (iii) the owner of the encumbered real estate is not allowed to perform specified rights towards the superior real estate. Upon the second easement (personal) a real estate may be encumbered in favour of a natural person with a right which content corresponds to a real estate easement. The transmission easement is a third kind of easement, which combines the character of both above described easements.

The Polish Civil Code defines the transmission easement as a right pursuant to which a real estate may be encumbered in favour of an entrepreneur, who intends to construct or is the owner of the transmission devices, with a right to use the encumbered real estate within a defined scope in compliance with the designation of the transmission devices. The main difference between the transmission easement and the remaining easements is that the transmission easement is created in favour of an entrepreneur. Furthermore, the transmission easement, unlike the real estate easement, is not established in purpose of increasing the usefulness of the superior real estate.

The easements are binding on third parties upon registration into the land and mortgage register, which is a public register kept by courts.

Establishment of transmission easement

As mentioned above, the transmission easement may only be created in favour of an entrepreneur. Polish law provides the following main methods of transmission easement establishment:

(a) contractual

The transmission easement may be created in return for remuneration (or gratuitously) by way of agreement concluded, in form of notarial deed, between the entrepreneur and the real estate owner.

(b) judicial

If the second party refuses to conclude the agreement mentioned at point (a) above and the transmission easement is necessary for the proper use of transmission devices, the entrepreneur may submit to the court a claim for establishment of the transmission easement upon remuneration. A similar claim may be raised by the owner of the real estate.

The Civil Code does not provide rules of determination of the above mentioned remuneration for transmission easement establishment. Thus, in case of dispute between the parties the courts will have to set forth judicial guidelines for determination of such remuneration.

Assignment of transmission easement

By law the assignment of transmission easement is possible exclusively to the buyer of transmission devices erected on the given property. In addition, in case of acquisition of an enterprise transmitting utilities the transmission easement is also assigned.

Please note that the assignee of the transmission easement shall be entered into the land and mortgage register and the assignor deleted thereof.

Expiry of transmission easement

The transmission easement expires on the date stipulated in the agreement or provided for in the judgment establishing this easement or on liquidation closing date of the enterprise transmitting utilities.

Conclusions

The transmission easement was needed and introduced as a legal instrument allowing the determination of the rights and duties of real estate owners and enterprises transmitting utilities. It shall be used in particular in infrastructure and/or development projects as well by investors and utilities providers. Nevertheless, the real estate owners and enterprises transmitting utilities are free to regulate their relationship upon other provisions in force (eg, use agreement).

Furthermore, the transmission easement shall allow the regulation, either upon agreement or judgment, of the status of utility devices erected in the past without any agreement on third parties property and to specify mutual rights and obligations of real estate owners and enterprises transmitting utilities.

Real estate acquisition in Poland and liability for contamination

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The IBA *Real Estate Committee Newsletter* of February 2009 (Vol 13 No 1) has a description by Martin Foerster on how Austrian law deals with the question of liability for contamination in transactions involving the acquisition of industrial property. Against a background of issues raised by this article, it seems apt to consider the questions of liability for contaminated real estate in Poland, taking into account recent changes in regulations concerning liability for environmental damage.

Environmental due diligence

The problem of ground pollution in transactions involving real estate is always a major consideration, since it is associated, as a rule, with a need to incur considerable expenditure in eliminating this contamination and in the remediation of contaminated land. To understand the extent of possible contamination, it is essential to carry out an environmental due diligence for the real estate – usually a contamination investigation carried out by a specialised auditing entity. This investigation is, obviously, all the more advisable when it comes to industrial real estate. A proper investigation of contamination allows the parties to the transaction not only to adjust the purchase price to the actual value of the real estate, but also to decide what clauses to include in the real estate sale contract, which would govern reciprocal obligations, or other rights of the parties, if damage to the environment comes to light, which, say, this investigation has not found. This is, of course, facilitated by a general principle in Polish civil law: the principle of freedom of contract. In Polish law, any contractual provisions in this area have no effect on the obligations set by mandatory standards of environmental law.

The soil remediation obligation in the Act of 2001

With regard to soil pollution, the Environmental Protection Law of 2001 imposed a remediation duty, in principle, on the possessor of the ground. The Act deemed remediation of contaminated land law as returning the soil to a state required by quality standards. These standards were laid down in a regulation issued in 2002 by the Minister of the Environment, hence the pollution remediation obligation could be deemed to arise, in the context of the Act, when the quality standards specified in the regulation were transgressed.

Under this Act, the possessor of the ground is its owner, unless some other party was disclosed as possessing the land in a public land and buildings registry. Consequently, the acquirer of the real estate, as a rule, acquired responsibility for its remediation. The possibility of avoiding liability in this respect was to demonstrate that the contamination was caused by another identified entity, if the soil contamination happened after the real estate was taken possession of by a new owner. Then, generally, the remediation obligation rested on this party.

The liability for soil contamination in the Act of 2007

In 2007, Polish environmental law was subjected to fundamental changes, which covered issues connected with obligations to prevent threatened damage occurring and remedying damage already caused. These changes were introduced by the Act on the Prevention of Environmental Damage and its Remediation, which constituted a transposition of Directive 2004/35/EC on environmental liability with regard to the prevention and remedying of environmental damage. This Act not only changed the liability for remediation of the environment, but also introduced new legal instruments addressing the problems of damage and the

related liability. The most significant change is the implementation into Polish law of the regulation of liability for environmental damage (including soil contamination), in accordance with the 'polluter pays' principle.

The 2007 Act comprehensively regulates liability for environmental damage caused by a listed range of activity types, which are regarded as posing a risk of damage. These include activities of entities that require permits (such as, integrated permit), and organisations involved in: waste management, introducing genetically modified products onto the market, chemicals and transport of dangerous goods. This responsibility is based on risk therefore it is not dependent on the guilt of the party causing the damage. By contrast, in the event of damage to protected species or to protected natural habitats, responsibility is now based on a principle of guilt. Such liability arises when the damage results from activities other than those involving a damage risk. It should be noted that, under the previous state of the law, these issues were dealt with piecemeal, in various parts of the Environmental Protection Law Act.

The new Act introduces an obligation on an entity undertaking a particular activity to not only undertake corrective actions, if the damage has already occurred, but also to carry out preventive measures, in the event of a direct threat of damage. Polish environmental protection law has, for the first time, a definition of damage to the environment, which currently includes damage to water resources, soil and natural habitats and protected species. For the purposes of this Act, a definition has also been introduced of an imminent threat of environmental damage.

In order to determine whether damage has occurred, and therefore, whether a duty to take corrective action has arisen, the Minister of Environment issued a regulation in 2008 providing criteria for assessing whether damage has arisen. This regulation refers, in the matter of soil contamination, to the Environmental Protection Law Act, and therefore, also to the above-mentioned regulation of 2002.

The 2007 Act applies to damage and imminent risks of damage, which have arisen after its entry into force, so from 30 April 2007. Earlier events and those which have resulted from activity which ended by that date, are subject to previously existing provisions, therefore regulations contained in the Environmental Protection Law Act imposing liability for their remediation and prevention on the possessor of the land. Due to the fact that environmental damage can come to light much later than when it actually happened, and that the law now attaches importance only to the latter event, one must make allowances for the fact that this dual responsibility regime will still have to be taken into account for an extended period of time.

The consequences of the changes for buyers

From the point of view of environmental law, it is essential to determine from whom the state authorities may require specific preventive or corrective actions. In the light of the repealed (but still applicable) provisions of the Environmental Protection Law Act, it is, as a rule, the new possessor of the land (therefore the buyer) who assumes responsibility for carrying out any remediation. The situation in Poland after the entry into force of the 2007 Act may seem rather more complicated. The entity acquiring the property should not only verify the existence of contamination on the property, but also determine its date of occurrence. Unfortunately, it is not always easy or even possible to determine exactly when the damage occurred. However, in the light of new regulations, who bears responsibility for remediation of damage will depend on establishing this date.

If it is established that the damage occurred before 30 April 2007, responsibility for possible remediation transfers to the new owner, in accordance with the provisions of the 2001 Act, previously in force. If, however, damage to the environment or its imminent threat has arisen on or after this date, liability for the damage remains with its perpetrator. This does not mean, however, that the new owner no longer needs to be concerned about contamination on his land, because, despite the application of the polluter pays principle, the law still requires the possessor of the land to exercise caution. The owner will be jointly and severally liable for taking preventive or corrective actions, together with the perpetrator of the damage injury or its threat, if he consented to the perpetrator's actions or knew about them and did nothing. In order to avoid this responsibility, the possessor of the ground should immediately report an occurrence or threat of damage to the relevant administrative authorities.

Summary

The entry into force of the 2007 Act has introduced important changes with regard to liability for environmental damage. Abandonment of charging the possessor of the ground with liability, in exchange for the 'polluter pays' principle is not only a solution which is compatible with community law, but also appears to be more equitable. Although changing the rules on liability for soil contamination, in principle, moves the focus from the owner to the polluter, it does not, however, reduce the importance of carrying out environmental due diligence before a real estate acquisition. On the contrary, in the present state of law in Poland, such an investigation is particularly important.

First, although the law charges the perpetrator of the environmental damage with a duty of carrying out preventive or corrective measures (or more precisely, the entity which uses the environment and whose activity has caused the damage or an imminent risk of damage), a purchaser of contaminated real estate may be jointly responsible with the perpetrator, if, after being informed about the contamination, he fails to immediately notify the appropriate administrative authorities.

Secondly, if a seller has undertaken an activity that has caused contamination or a danger of it occurring, a buyer intending to carry out the same activity on the acquired real estate may himself become a perpetrator of this damage.

Thirdly, as mentioned above, the transitional provisions leave, de facto, two regimes of responsibility in place: that in force under the Environmental Protection Act and a new one introduced under the 2007 Act. Determining the entity responsible for carrying out preventive or remedial action will depend on a prior determination of the date of the damage.

Finally, it is now practice in a sale agreement to regulate the rules of compensation for corrective actions, especially in transactions involving large industrial properties. A properly conducted environmental due diligence allows an assessment of the costs of any possible remediation and their inclusion in the price of the real estate and the introduction of other rights or obligations of the parties in the event of a detection of contamination by the new owner.

Environmental impact assessment in investment processes in Poland

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In November 2008, an act entered into force in Poland amending provisions regulating carrying out environmental impact assessments for planned undertakings. This change has not only significantly affected the procedure of environmental impact assessment itself, but it has also introduced certain changes to construction law. This article aims at explaining the most important issues associated with the new regulations. In the majority of investment project cases, these issues relate to the environmental impact assessment of buildings and other facilities planned on real estate.

Before the entry into force of these new provisions, environmental impact assessment was regulated by the Environmental Protection Act of 2001. The amendment has moved the regulation of this matter to a new Act on Accessing Information on the Environment and its Protection, on Society's Engagement in its Protection and on Environmental Impact Assessment, of 2008.

Environmental impact assessment – a burning problem

It is difficult to avoid an impression that carrying out environmental impact assessments is viewed as a necessary evil by many investors planning projects in Poland. However, it should be acknowledged that Poland has a relatively high percentage share

of environmentally valuable areas, in relation to its total area, in comparison with Western European countries. Therefore, almost every investment undertaking will have, at least, a minimum effect on the environment. This is particularly important in infrastructure investments (eg, the motorway network), which are currently a development priority for Poland.

On the other hand, essential investment in Poland cannot be at the cost of the natural environment. From the point of view of investors, who are assembling funds for a project and at the same time benefiting from EU funding, an accurate environmental impact assessment is essential, as it is one of the conditions required in accessing EU funds for such investment projects.

Non-compliance with EU law

One of the reasons for this change to the law, apart from removing existing loopholes, making procedures more efficient and taking legal practice requirements on board was the improper – in the European Commission's view – transposition of EU law relating to environmental impact assessment. As a result, the previous law constituted a significant hurdle in trying to apply for EU funds to finance investments. The shortcomings pointed out by the European Commission arose, above all, from an improper transposition into Polish law of Council Directive 85/337/EEC on the assessment of the effects of certain public and private projects on the environment (amended by Directives: 97/11/EC and 2003/35/EC).

This situation caused proceedings to be launched against Poland for infringement of the above Directive's provisions. Among a number of charges levelled against Poland, the issue of the meaning of 'development consent' took key position (Article 1 para 2 of the Directive). According to this Directive, this concept includes every 'decision of the competent authority or authorities which entitled the developer to proceed with the project'. Contrary to Polish lawmakers' intentions, the recognition of 'the decision on environmental conditionings' (so-called 'environmental decision') as 'development consent' has been challenged by the European Commission. The environmental decision, often issued at a very early stage in investment proceedings, was supposed to be a type of consent for the realisation of the undertaking, taking into consideration all requirements associated with an environmental impact assessment. However, in the European Commission's view, it was too early to carry out the environmental impact assessment, for example, at the undertaking's location determining stage, without considering the technical and design elements of the investment project. So, therefore, the amendment to Polish provisions assumes that, in some cases, a repeat environmental impact assessment will be required: about which, more later.

Classification of undertakings

An investor planning to carry out an investment project in Poland should, in accordance with current regulations, consider whether the investment corresponds to any one of three groups mentioned in the new Act. Undertakings which can significantly affect the environment are classified in the following way:

i. undertakings which can always significantly affect the environment;
ii. undertakings which can potentially significantly affect the environment; and
iii. undertakings other than those in groups i and ii, which may potentially significantly affect a Natura 2000 area and are, at the same time, not directly associated with the protection of a Natura 2000 area, or do not stem from this protection.

Specific types of undertakings, classified under groups i and ii, are currently listed in the Council of Ministers' regulation of 2004. In line with the Environment Ministry's announcement, it will be replaced with a new regulation in the second half of 2009.

It is worth pointing out that the currently in force list of undertakings which belong to groups i and ii, is one of the issues criticised by the European Commission. In its view, the method of regulation chosen by the Polish authorities (ie, the mixed selection method), although it is in principle acceptable within the spirit of EU provisions, does not completely fulfil the Directive's intentions. In a majority of cases where a categorical selection approach is adopted in classification to a given group (ie, by using thresholds and criteria determined in the regulation), only quantitative criteria have been adopted in the regulation, ie, the size of undertaking criterion. This criterion has been deemed as unacceptable by the European Court of Justice. Therefore, a problem has arisen in beneficiaries demonstrating, in applying

for co-financing of projects from EU funds, that their undertaking, despite being in accordance with Polish law and relieved of the need to conduct an impact assessment, has also been subjected to a proper selection procedure within the context of the provisions and the objectives of EU Directives.

Environmental impact assessment procedure

If an investment project is ascribed to groups i or ii, the investor has an obligation to file an application for issuance of an environmental decision still before obtaining one of the decisions mentioned in the Polish Act concerning specific investment projects. This includes, above all: construction permit, approval of construction plans, permission to resume construction works, decision on terms of construction and plot development, water law permission for construction of water facilities, permission for carrying out a road project, determining the location of a railway line, determining the location of a motorway and determining locations of Euro 2012 associated undertakings. Under a general rule, obtaining an environmental decision will also be essential in the case of a change to a given investment decision.

Depending on the type of the undertaking, a procedure which is started with the filing of an application for issuing of an environmental decision may turn out to be quite time-consuming, since the process of environmental impact assessment is quite complex, and the deadlines prescribed for the public authorities are, in reality, not strictly binding, because – in general – failure to comply with them does not entail any effective sanctions for administrative bodies. The procedure covers not just the preparation of an environmental impact assessment report for the undertaking (for undertakings in group ii: only if the administration demands a report be submitted), but also the process of agreeing the conditions of the undertakings implementation between the administration bodies (and sometimes also obtaining their opinions). Furthermore, in many cases, it is essential to carry out consultations with the community.

Undertakings classified under group iii. will only be subject to environmental impact assessment, if an authority so decides, which is empowered to issue the investment decision. In this situation, the matter will be referred to a relevant environmental authority for an assessment and a decision on agreed terms of implementation of the project in terms of impact on a Natura 2000 area. Only then will the body, authorised to issue the investment decision, be able to continue with the proceedings.

The authority issuing the investment decision is required to comply with conditions contained in the environmental decision or the decision on agreed terms of implementation of the project in relation to its impact on a Natura 2000 area.

Repeat environmental impact assessment

As mentioned earlier, some cases, described specifically in the new rules, will require a repeat environmental impact assessment. For example, a repeat assessment will be necessary when applying for a construction permit, if it is required by a previously issued environmental decision, or if requested by the investor, or if the relevant authority for issuing the investment decision concludes that changes have occurred to the requirements set out in the environmental decision. It should be noted that an environmental impact report prepared for a repeat assessment should, in principle, assess the investment impact on the environment much more thoroughly, because at this stage, there is much more detailed information available about the project than at the stage concerning just the location of the project. This approach allows the aim of the directive to be fulfilled, which is to ensure that an assessment of the environmental impact is carried out before a particular project starts.

Strengthening public participation and information obligations

The Act also introduces changes intended to bolster public participation in the investment process, by significantly expanding the range of rights of environmental organisations in public proceedings. This includes, among others, bringing the status of environmental organisations into line with the status of parties to proceedings. As a result, environmental organisations will have a right to access the files of proceedings at every stage, and will be also entitled to appeal against decisions issued. At the same time, the additional criteria which imposed supplementary conditions on the involvement of such organisations and which existed

under the previous regulations have been removed. Furthermore, the possibility has been introduced of an appeal or complaint against a decision, even if the organisation has not participated in proceedings. But it should be noted that, in extreme cases, such powers may lead to significant prolongations of proceedings.

To meet the requirements of the Directive, Polish legislators have imposed a number of information obligations on the authority conducting proceedings. Information should be made available to the public directly (ie, not, as before, via a public listing of information on the documents with information on the environment and its protection), and also without undue delay.

Changes to the construction process

It should also be noted that the new provisions have introduced some significant changes to the construction process. Due to the 'development consent' being deemed an administrative decision and because of the need to ensure the possibility of appeal against such a consent, the right to carry out a project which requires an environmental impact assessment but not a construction permit (eg, on the basis of a notification) has been removed from construction law. As a result, currently, all projects which require an environmental impact assessment require a construction permit.

Summary

The Act, in effect, does away with the principle, found under the previous legal environment, that an environmental impact assessment should be carried out only once for a given undertaking. Currently, the first impact assessment will, very often, be carried out as early as at the investment project planning stage (eg, in proceedings concerning a decision for the location of a given undertaking), while a subsequent impact assessment will be carried out, if necessary, once the design project is ready and contains detailed technical solutions (eg, during the issuing of the construction permit). Because of this, the environmental impact assessment of undertakings can now fully implement the aims of the Directive. Unfortunately, there are still opinions being voiced that Polish regulations have still not fully eliminated the existing discrepancies with EU law.

The new legal regulations, though more transparent than earlier ones, have raised some doubts as to their application, both among administrative bodies, as well as investors. So as to avoid unnecessary delays, which often lead to increased costs and also make it more difficult to access EU funds, it is important that investors should take particular care in conforming to the new regulations. For this reason, the early publication of the new Council of Ministers' regulation, which will replace the one from 2004, and will be fully in line with EU law requirements, is being keenly awaited. It is also worth taking care over choosing a known, and preferably, accredited, institution specialising in preparing environmental impact assessment reports, since this may significantly reduce the risk of an improper assessment. This is important, also, because the costs of any possible environmental damage, risk of which has not been considered in the report, will most often have to be borne by the party using the environment, namely the investor.

The impact of EURO 2012 on real estate market in Poland

POLAND

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Town hall in Cardiff. 18 April 2007. Meeting of the UEFA (Union of European Football Associations) Executive Committee. Nervous expectation, pressure – everybody is waiting for the verdict. Who will get the right to organise the 14th European Championships in football in 2012? Who will get the opportunity to earn lots of money, to build new roads, motorways, hotels and stadiums and other infrastructure connected with this big event? On the 'battlefield' there still stand candidacies of Poland and Ukraine, Italy, Croatia and Hungary. At last, Michel Platini – UEFA President comes on the scene and announces the decision in two words, two key-words, two words which are so important for the winning countries – POLAND and UKRAINE.

Winning the right to organise Euro 2012 is not only a great chance for economic development but also a logistic and constructional challenge. It is also lots of potential trouble… can Poland manage this investment? How has the decision about granting the right to organise the tournament already affected or will affect real estates in Poland in the near future? Can any progress be seen in the one and a half years since the announcement of the decision?

Experts estimate that Poland can get an approximate €40 billion subsidy from the European Union for the Euro 2012 preparation process. Boom is a perfect word to describe what has been happening with the Polish economy for the last couple of years. These days, when the world crisis is becoming worse, the forecasts for the growth of nominal Gross Domestic Product are at the level of three per cent yearly. There is only one 'but': plans for modernisation and building stadiums, roads and motorways, as well as hotels and other tourist attractions will have a strong effect on the requirement of building materials and the labour force needed for the realisation of these projects. Prices of materials and labour force will be growing systematically and – this must be stressed – these rises are already clearly visible. These will, without any doubt, exert a harmful influence on developing companies building apartments. If anyone counted on a gradual decrease in prices of new flats and apartments they could be seriously disappointed. Real estate prices, which are high today, in nearly four years time will be the prices from the good old years. It seems that this will be one of the few negative aspects of Euro 2012 in Poland.

On the other hand and what is more important, the extension of transport and building infrastructure will have mostly positive results, in particular in Warsaw, Poznań, Wrocław, Chorzów, probably in Kraków (probably, because it is not known yet, if the UEFA agrees to add Kraków to the host cities of championships) and its suburbs. The funny thing is that Kraków, from among all of the host-cities is, so far, best prepared. Its infrastructure – sports facilities, roads and airport have, over the last few years, been systematically modernised, whereas in other cities – besides Warsaw – the work is still in a plan-phase or has just begun. Despite this, Kraków is still held in reserve. Apart from Chorzów, those cities are all popular tourist destinations. It is planned to build about 900 kilometres of motorways, make a network of railways and modernise eight already existing airports. Three brand new stadiums will be created and three others will be rebuilt to increase their capacity. After all thousands of football fans must have a place to stay, a place to eat and, apart from matches and stadiums, a place to entertain themselves. As in the example of Portugal – the host country of UEFA Euro 2004 – the organisation of such a huge sporting event causes long-term growth in the number of tourists visiting that country every year. It is estimated that the Portuguese tourist branch has earned over €92 million, hoteliers over €70 million and business transactions reached an amount of €44 million. What is more, in the experts' opinion, tourist branch incomes after the above-mentioned championships were growing during the nearest future at a level of five per cent yearly. Comparing the aforementioned phenomena to Polish reality it seems even more dynamic increases are very

possible and likely to happen. For example, a few hours after the announcement of the winning countries, the share prices of Orbis, a hotel group and one of the biggest Polish travel agencies, rose by over ten per cent.

For about two years, a systematic growth in numbers of tourists visiting Poland has been clearly noticeable, especially in Kraków and Warsaw. Unfortunately, according to the latest research, our country occupies one of the last places in Europe, taking the amount of hotel beds into consideration – for 1000 inhabitants there are only 40 beds. Those are sufficient reasons to build – as it is planned – 500 new hotels for Euro 2012. Bearing in mind the example of Portugal, it is very probable that after the event the new hotels will not be empty.

It must be stressed that the realisation of the above-mentioned investments will be almost impossible without government help. Because of this, in September 2007, the President of the Republic of Poland signed the UEFA Euro 2012 Football Finals Championships Preparation Act, commonly referred to as the Euro 2012 Act. According to experts' opinion, this legal act contains solutions, which might be very helpful and facilitating in the championships preparation process. Unluckily, there are also some unfavourable rules in it for Polish investors. Under the provisions of this regulation for financing and constructing investments connected with Euro 2008 will be created State Treasuries special-purpose limited liability companies, commonly referred to as special-purpose companies. It means in practice that the meaning of private enterprises will be limited to the role of subcontractors. This must be negatively estimated, because private companies fulfil commissioned tasks faster and cheaper than public entities. New special-purpose companies do not have any technical or organisational experience, which is definitely needed to achieve success.

Positive elements of the Euro 2012 Act is the fact that the new special-purpose companies will be excluded from the Government Procurement Act in addition to correct organisation and performance of tasks connected with championships. Such a solution allows avoidance of a long-lasting procedure, specified in the above-mentioned Act.

What is also important, as the experts claim, the above-mentioned companies will not be governed by the Act, which limits salaries received by employees employed in State Treasuries companies, called in the Polish law-system as the 'chimney act'. This will lead to the employment of people with proper qualifications and experience in management boards of special-purpose companies, which must make a positive effect on the quality of provided services.

It should also be mentioned, that in the near future the government plans to issue a regulation, on force of which, all of decisions passed in connection with the Euro-event will be granted with immediate enforceability. Appealing those decisions will be restricted to a very short time limit. That clause will without any doubts reduce the duration of many procedures, which currently in Poland are very bureaucrative and long-lasting.

It should be stressed, that the Euro 2012 Act and the above-mentioned, planned regulation, are insufficient for proper and, what is more important, in-time realisation of investments. The government must roll up its sleeves, and implement systems changes, especially in construction, road investments and in real estate management law. Those changes should strongly affect labour acceleration and simplification. It should be noted that they are needed not only for the championships preparation process, but also for all other investments conducted in Poland now and in the future.

Even though it is still more than three years to the first match of the championships, Poland has already won. Designation of the country for co-host of UEFA Euro 2012 will, without any doubt, positively affect the whole Polish economy and will improve its reputation and increase its significance in the international arena. Thousands of Europeans will remember Poland not as the Soviet-block and poor Eastern country, but as a real, modern and civilised member of the European Union. The only challenge remains to avoid embarrassment due to bad organisation or simply because of delays in realisation of planned and necessary investments.

Oh... I almost forgot. The Polish national team will have the second opportunity in its history to play in the finals of the Euro championships!

RUSSIA

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Good news for embattled market

The Russian real estate market is suffering like many others, but at least there is some good legal news.

Recent court decisions may have answered a controversial question regarding lease agreements; namely, whether preliminary lease agreements for unfinished buildings are enforceable.

Doubts over the validity of pre-lease agreements for new developments have long been a problem for developers and their financiers.

In the rising market, tenants had no cause to challenge pre-leases, but now things have changed. Until recently, Russian court decisions on the validity and enforceability of pre-leases were inconsistent. In April 2009, however, in a case involving the international retailer IKEA, the highest arbitration court of Russia confirmed that pre-leases were valid and binding and that any other interpretation 'created significant difficulties for the civil turnover'.

We therefore expect that the presidium of the highest arbitration court will adopt a unified approach. Although the Russian civil law system is not based on binding precedents, Russian courts tend to follow the decisions of the highest arbitration court. This decision should help develop property finance and investment in Russia once the market recovers.

In 2007, the Russian authorities gave owners of buildings the right to acquire the freehold to their sites at a discounted price. Developers had to apply for this before 1 January 2010. Obviously this was beneficial, but many lacked the cash to acquire their freeholds.

To provide developers with more opportunities, the Russian authorities are now considering prolonging the discounted period. The State Duma (Russian Parliament) is considering two acts that would prolong it until 2012 or 2013. This is good news for the market.

Despite disturbances to the economy, the economic crisis may in some ways prove beneficial if it provides opportunities to clarify the law and stimulate the market.

SWITZERLAND

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Harmonisation of Swiss real estate transfer taxes

The Swiss Merger Act came into force on 1 July 2004. The Merger Act foresees, inter alias, that after a five year transitional period no cantonal real estate transfer tax shall become due in the event of a reorganisation under the Merger Act. This period, granted to the Swiss cantons for adapting their cantonal tax laws will expire on 30 June 2009. Based on this, the cantonal Swiss real estate transfer taxes are now abolished for qualifying reorganisations.

In Switzerland, taxes are levied on three levels, the Federal, the Cantonal and the Communal level. Each level has its own tax laws. The income taxes on the Federal and the Cantonal/Communal level are to some extent harmonised by the Tax Harmonisation Act, this also includes real estate capital gains taxes. Real estate transfer taxes are not subject to the Tax Harmonisation Act and have now been harmonised by the Merger Act.

A transfer of real estate located in Switzerland generally triggers (beside the real estate capital gains tax) a real estate transfer tax, depending on the canton where the property is located within Switzerland. The real estate transfer tax amounts generally to some one to three per cent of the value of the transferred property.

Based on the Federal and cantonal tax

laws, transactions are supposed to be tax neutral, if such transactions qualify as tax exempt reorganisations. The classical forms of such reorganisations (mergers, de-mergers, conversions and transfers of assets and liabilities) have been defined in the Merger Act.

It is evident from recent real estate transactions that, despite the harmonisation, the Federal and Cantonal corporate income tax laws have adopted a broader interpretation of reorganisations than the Merger Act. It is common sense (and in principle covered by the tax laws) that a 'share to share deal', in German called Quasifusion, where a merger is economically performed by a shareholder exchanging his shares in the target company for shares in the acquiring company, qualifies as a tax neutral reorganisation for income tax purposes. Some tax authorities, however, tend to qualify share to share deals differently for income tax, real estate capital gain tax or real estate transfer tax purposes. This can result in a situation where a share to share deal qualifies as a tax neutral reorganisation in one canton for all taxes, whilst another canton could deny the tax neutrality for the real estate transfer tax. Even though the real estate transfer taxes should be abolished for qualifying reorganisation as of 1 July 2009, it is strongly recommended to investigate the tax situation and consequences prior to the transaction.

UKRAINE

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Commissioning Act

According to the legislation of Ukraine for the owner of completed new buildings it is not enough only to complete the construction. The law provides special procedures for the owner to certify his property rights and enable him to dispose of his new property (in this case, completed building) in full.

The Commissioning Act is a very important final document of the new construction. It is a technical/permission document, but not a title document to real estate or land. The title document to new construction is the certificate on property right (the title certificate), which can be issued by the City Council on the grounds of the Commissioning Act, and subject to obligatory registration in the Bureau of Technical Inventaristion (BTI).

As of 1 January 2009 the new order is in force. It is envisaged by the Resolution of Cabinet of Ministers of Ukraine dated 8 October 2008, No 923. Before, approving new buildings for use was the competence of so-called 'working boards', which assessed the readiness of buildings for use, its compliance with technical engineering fittings, design documentation, etc. Now the board is required only to confirm the building's readiness. After the approval board confirms the building is ready for use, the inspectorate of State Architectural Construction Control should issue the certificate on compliance of the construction with design documentation, requirements of state standards and construction norms and rules within ten days. The building is considered to be approved and ready for use from the date such certificate is issued.

Thus, the procedure and time schedule for the commissioning of new buildings in Ukraine are considerably amended.

London leads the way with green lease toolkit

UNITED KINGDOM

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In the quest to reduce our carbon footprint, it is recognised that the owners and occupiers of buildings have their part to play. London's 'Better Buildings Partnership' (BBP) has devised a green lease toolkit, launched in April 2009 and being trialled for six months by its members and the occupiers of their buildings.

Background

The BBP is a group of the largest commercial and public property owners in London. The formation of the group is as a result of an initiative by the London Climate Change Agency. An important remit of the BBP is to influence change in the marketplace by leadership and demonstrating best practice.

The toolkit is guidance only. Its flexibility is expected to suit properties of any size and status. The toolkit is in three parts consisting of best practice recommendations and two model documents.

Best practice recommendations

A key component is sharing information on energy, waste and water usage and building management (subject of course to strict rules of confidentiality). Records of for example, energy consumption or amount of waste sent to landfill could be circulated among owners and occupiers and new cooperative practices and combined reduction strategy may emerge. The toolkit also promotes regular audits and consistent application of software for meaningful results in monitoring and measurement.

The toolkit brings a focus to the efficiency of plant and machinery, whether it could be reworked more effectively or replaced (when due) with a more energy efficient model.

A combined approach to recycling facilities is also a focus. The recommendations include having joint recycling targets, shared use of facilities and more centralised removal with a unified transport system.

The documents

The toolkit provides a Model Form Memorandum of Understanding for existing leases and Model Form Green Lease Clauses to go into new leases or lease renewals.

The first document sets out the best practice recommendations for use in full or by selection according to the property in question. The second document provides lease clauses to cover cooperative planning for the management of property and restrictions on alterations, landlord works and dilapidations.

These will commit the parties to managing the building in a sustainable way. The benefits will include some or all of the main aims, namely, to reduce energy consumption, carbon emission and waste and encourage reuse and recycling of equipment as an alternative to replacement.

Conclusion

The UK government has consulted on the UK carbon omissions trading scheme. The legislation is scheduled for April 2010. An estimated 5,000 businesses will be caught by the legislation. It is not yet clear how the legislation will adapt to the complexities of property ownership. The work of the BBP is a step towards property being structured so as to be able to comply.

It is hoped that many more companies and landowners across the UK and indeed the World will emulate the work of the BBP and its commitment to 'Leading to a Greener London'.

UNITED KINGDOM

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Scotland looks beyond EPCs

The Scottish Climate Change Bill sets a hugely ambitious target of reduction of CO2 emissions by 80 per cent by 2050. As emissions from buildings make up around 40 per cent of all emissions it came as no surprise that the commercial property sector would be expected to bear the brunt of the measures.

The Scottish government introduced Energy Performance Certificates (EPCs) for non-domestic buildings from 4 January 2009 in implementation of the Energy Performance of Buildings Directive (EPBD). However, the EPBD does not require any action to be taken following the EPC to improve energy performance. Additionally, EPCs are only required at points of sale or rental, and for large public buildings of over 1,000m2. The Government also considers that at ten years, the lifespan of an EPC is too long and when such a certificate reaches seven to eight years, it may no longer reflect the energy performance of the building. The government is therefore proposing to include broad powers in the Climate Change (Scotland) Bill that will permit the government to use secondary legislation to introduce a regime beyond the scope of the EPBD. The government is proposing new framework powers that could be used to:

- shorten the lifespan of EPCs;
- require the owners of non-domestic buildings to obtain an Assessment of the Carbon and Energy Performance (ACEP) of their building, even if they are not required to obtain EPCs under the EPBD;
- require the owners of non-domestic buildings to develop a programme of cost-effective improvements to reduce emissions and improve energy performance and thereafter carry out necessary improvements;
- obtain a further ACEP every five years (for example) with a further programme of improvements;
- develop separate assessment criteria for historic and traditional (pre-1919) buildings;
- include a requirement for operational ratings (ie, how the building is managed) as well as asset based ratings, including the provision of sub-metering to allow building managers to monitor which equipment in the building uses the most energy; and
- deal with contraventions by service of an enforcement notice in the first instance or possibly a penalty charge notice.

The amount of emissions from buildings will have to fall significantly by 2050 for the government to stand a chance of hitting its overall target. Even the Minister for Climate Change acknowledges that the government's target is 'challenging' – therefore the commercial property sector in Scotland should expect more challenging times ahead.

USA

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Mixed-up use

Recently, I had a somewhat solitary 600 mile Interstate highway ride and drove by one outlet centre after another, nearly all of them vacant or wishing that they were. When this late-80s development style went out of vogue, there were few redevelopment alternatives for the failed project short of scrapping the site and starting anew. Given that a reasonable and often affordable redevelopment opportunity existed, there was not serious panic in the real estate community.

As different development styles have continually come and gone with the morphing needs of the consumer, the need to re-think the outlet centre site was hardly new. Failed big box projects or small use tenancies can often be redeveloped, incorporating new uses as the demography shifts, but what are we to do (what will we do) with today's sophisticated mixed use properties; projects with complicated parking issues, long term leases (many of them office tenancies) and residential ownership to name but three

unique issues?

The basic issue regarding mixed use development isn't quite 'What do you do if the project goes wrong?', rather, it is 'What do you do when the project matures?', when the initial tenancies have run their course, hopefully successfully, when the initial office tenants have moved to newer more concession rich projects. As complicated as it is for the attourney to draft documents to make the project work correctly at its inception, it may be worth more than a few minutes (or hours) of the developer's time to futuristically provide needed flexibility. Remember, the longer the lease, the less control for the landlord.

One example specifically deals with the residential component. If the project is actually developed in phases (and/or parcels – a particularly good idea if they can be withdrawn from the entire project), one should consider the rationale of owned units above retail. Maximising the tract with residential over streetfront retail looks great and feels just right, helps with security and surely is practical as to the utilisation of real property. Owned residential over failed retail is, however, perhaps a major future issue as the rights of the residential owner must be (should be) considered as project modifications are needed. Had these residential units been initially developed as apartments, the owner would be provided meaningful flexibility, allowing for an easier remodelling or enhancement of the project as the residential leases expire (or the residents relocated).

Consistent with this analysis, condominiums could be developed on their own parcel(s), developed as an integrated community, one enjoying the benefits of the mixed use project without the foreseeable entanglements. These could be vertical or garden style depending on the project. Parking, noise, project modifications and the like simply are lesser issues when dealing with shorter term residencies, issues which can be practically minimised, yet often are not.

One issue which always seems to vex the mixed use property and which should be better analysed, is how to handle the food tenant: where is the plumbing, what are the maximum hours, where are the vents, how to handle patio seating (and related noise), how to handle the parking (valet or otherwise)? Again, these issues are easier to resolve by assuring that the aggrieved residential tenants are apartment renters as opposed to the owners. Vents may need to be within residential exterior walls, noise may not be easily controllable. These are issues better imposed on renters.

Moving from residential to retail, what do we do with our beloved co-tenancies if retail tenancies continue to flag, if more shopping is online, if tenancies become more and more service and/or entertainment? The lease surely needs to allow the landlord the right to relocate various tenants and, for longer leases, the landlord should attempt to somehow at some pre-determined time be allowed to recapture the space, particularly when redevelopment is needed. Yes, this might be expensive, but it might be even more costly to not have this right. Having the recapture opportunity increases the landlord's flexibility which might be needed if the entire nature of the project is being altered. It is worth noting that landlords should be careful in drafting their co-tenancies, in particular to not tie themselves into fixed 'retail' tenancies and, in all events, a landlord should draft a remedy should the co-tenancy fail (one which avoids the unknown results and timing of litigation).

It is worth noting that two major errors have been made in drafting co-tenancies in many a lease. Tenants routinely fail to analyse the value, the impact of the office tenancies, a key component and a department store like tenancy. What if the projected buildings are not built or are late in delivery? What if the buildings are not full? These concerns can significantly undermine a tenancy, particularly the food user dependent on lunch traffic. Similarly, a landlord often represents that they have 'named' tenancies and though they often have some right to substitute tenancies, these rights are often limited. Landlords need to learn from the past – many of those key 'hot' tenants of 20 years ago are not in business and few, if any, radiate any warmth. Landlords just cannot afford to be stuck in alternative rent which is predictable, which we know will historically occur. It would, for sure, be best for 'named' co-tenancy to be phased out after some period of time, perhaps five years and that co-tenancy be based on standard negotiated percentages of 'leasable' square footage. Certainly the landlord wants to avoid allowing a tenant to exercise an option while the tenant is paying alternative rent.

The office tenant, a key linchpin of most mixed use projects, must be happy as well. These tenancies give life to the project and they depend on and compliment restaurants,

non-food users and other tenancies. So too do they depend on a stable environment, one without unpredictable inconveniences, noise or otherwise. The office tenant needs special consideration regarding its parking, particularly its visitors' parking (where is it, and what are its costs?) If the basic needs of the office tenant are met, usually peace will prevail, but office tenants are (and should be) very concerned about their environment. Unlike the retail tenant which clearly calculates rent as a percentage of sales, the office tenant wants predictability, lack of drama, first class security, client satisfaction. The office tenant field, often full of highly compensated and driven professionals, will brand the project, will enhance or destroy the reputation over perception. The landlord needs to nurture this relationship, every day, 24/7.

Customers travel to the neighbourhood centre for many reasons but 'location' is certainly high on the list (ie, 'in the neighbourhood'). The mixed use project is somewhat different. It is about feel and balance, and environment. It is a 24 hour experience. The project itself is meant to evolve and the documents must allow for this evolution, for the changes which might occur, predictably or otherwise.

The mixed use project, much like a person, will mature and have setbacks, will grow and have losses, and will be difficult to raze and re-invent. Many will be successful and others will struggle and, while there is no common thread, the project with foresight will have a better chance to succeed than the project with intractable but beautiful renderings. The wonderful two dimensional drawings show the present but not the future, and skilled developers need to address the potential hurdles when laying out the development plan, when drafting the development agreement, when drawing up the LOIs, and when drafting the leases.

USA

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Structuring or restructuring US real estate joint ventures during harsh economic times

Introduction

Equity has always had an important role to play in the capitalisation of real estate development projects. Prior to the current economic crisis, this role was arguably diminished somewhat due to the wide availability of debt financing, and the generous terms on which debt financing was available. In today's capital-constrained environment the importance of equity in the capitalisation of new real estate projects and/or the recapitalisation of old real estate projects is once again of paramount importance.

With equity requirements for debt financing being pushed to their highest levels in recent years, the bargaining leverage of the equity investor is likewise at an extremely high level. Consequently, new sources of equity are emerging and old sources of equity are re-thinking the basis on which they are willing to participate in commercial real estate transactions as an integral component of the capital stack for a successful real estate transaction. This is particularly true in connection with existing real estate projects as to which the owners are facing a capital crisis and are looking for a new infusion of equity for their projects.

The circumstances described above combine to create a time of unprecedented opportunity for both domestic and foreign equity investors. For both, the current economic crisis has driven down property valuations considerably across the United States, making US investments very attractive once again.

The purpose of this article will be to discuss certain of the key legal and economic factors that developers and investors who

are, or want to become, joint venture partners should consider. For organisational purposes, this discussion is broken down into the following sections, each of which represents an important area of focus and negotiation between equity investors and developers: I. capital requirements; II. decision-making structures; and III. buy/sell and transfer provisions. While many other issues need to be addressed to the mutual satisfaction of all venture participants, and while additional investment structure and tax considerations must also be addressed for any foreign equity investor, these are three of the key areas of the business structure of any real estate joint venture that must be understood and structured or re-structured properly, particularly in a re-capitalisation transaction.

Discussion

Capital requirements

Whether structured as a limited liability company governed by an operating agreement or a limited partnership governed by a limited partnership agreement, most joint venture agreements contain relatively lengthy, detailed provisions regarding contributions of capital to the joint venture. Such contributions are typically broken down into two main categories: initial capital contributions and additional capital contributions.

Initial capital is the capital contributed by one or more of the participants at formation of a joint venture, or very early in the life cycle of a joint venture, to fund initial capital requirements that are not funded by debt financing. Additional capital is the capital to be contributed by one or more of the venture participants to fund the ongoing business endeavours and capital requirements of the joint venture if the initial capital, debt financing, cash flow and capital event proceeds of the joint venture are not sufficient to do so.

Unlike initial capital contributions, which are almost always crafted as being mandatory, additional capital contributions may be mandatory, in whole or in part, or they may be non-mandatory or discretionary. In the current economic crisis and, in particular, in the context of a joint venture that is faced with a maturing CMBS, mini-perm or construction/permanent loan on their project, this distinction between mandatory and non-mandatory capital contributions may be critical. Of course, even if additional capital contributions are mandatory, one or more venture participants may be unable to come up with the required capital in the current economic crisis. In such a case the provisions that pertain to the failure of a venture participant to contribute additional capital are of paramount importance.

There are a number of questions and issues that both existing and prospective joint venture participants need to consider in this scenario, including the following questions:

(1) who has the right to determine whether additional capital is required and how much additional capital is required?
(2) who has the right to make a call for additional capital?
(3) is the additional capital contribution mandatory or discretionary?
(4) are there penalties (eg, the dilution of ownership interest; a change in distribution priorities; and/or a change in management and/or voting rights), for failure to make an additional capital contribution?
(5) is additional capital for non-discretionary project expenses such as real estate taxes, insurance premiums and mortgage payments treated differently than additional capital for discretionary project expenses?
(6) does the joint venture documentation authorise or permit the admission of new equity participants who bring new capital to the joint venture?
(7) who has the right and authority to solicit, and to determine whether or not to admit, new equity participants?
(8) how will new equity participants be treated for purposes of returns on their contributed capital, the return of their capital, distribution priorities and venture decision-making? and
(9) if sufficient additional capital is not raised, can the venture's buy-sell mechanism be triggered and who has the right to do so?

The answers to all of these questions are critical to understanding the legal and financial obligations of existing and new joint venture participants and creating a business solution for a joint venture that needs to refinance or recapitalise in the current economic environment. For the potential new equity investor in an existing joint venture,

the circumstances that create the need for an infusion of new capital that the existing venture participants are unable to fund are also likely to mean that the new investor can negotiate for preferential treatment regarding returns on and returns of its equity, as well as preferential management, voting and/or other rights.

Decision-making structures

Most LLC operating agreements and limited partnership agreements vest a great deal of power and authority in the manger or managing member of the LLC or general partner of the limited partnership. This is, most often, the developer, not one of the equity investors. Typically, the manager or managing member or general partner of a limited partnership runs the day-to-day business and affairs of a joint venture. As such, this party usually has the primary responsibility to deal with a looming capital crisis, to consider all of the questions posed above, and to come up with the joint venture's business strategy for dealing with the crisis. In many cases the developer may have the least equity invested in the deal, as amongst all members or partners, and may also have the lowest, or least favourable, distribution priority in the distribution waterfall set up under the joint venture documentation. This is particularly true where the manager or general partner is a developer whose ownership interest represented is in large part a promoted or carried interest.

If the developer/manager participant has limited equity, or 'skin in the game,' that is standing *pari passu* with other equity investors' equity, what motivates this person to work hard to find a solution to the venture's capital crisis? The developer who has a personal guaranty on the project's debt financing should be very strongly motivated to find a solution. Similarly, if the developer's 'upside' is tied up in a promoted or carried interest that will be realised only at the end of the distribution waterfall and only if the venture is successfully recapitalised, then that should be strong motivation to try to successfully re-capitalise. That same developer may also have earned but unpaid, deferred management fees, development fees and/or leasing fees that are also unfunded and at risk, providing further incentive for the developer to work diligently to find a solution to the venture's capital crisis. If these incentives don't exist it may be necessary for the equity investors to motivate the developer participant in some other manner or, alternatively, to figure out a way, to take over the decision-making power and day-to-day management and authority of the venture. Such a take over would also be warranted if the developer is so busy working on other, unrelated problems in the current economic environment that he can't devote sufficient time to the venture's problems. Complete removal from the joint venture may be a third alternative, but the joint venture agreement would require close scrutiny to determine whether this was even feasible and how such removal should be structured.

Most joint venture documentation also contains provisions differentiating 'major decisions' from decisions regarding the day-to-day business and affairs of the venture. 'Major decisions' typically require the approval of all, or a majority of or super-majority of, the venture participants. Such major decisions typically include the sale, financing or refinancing of the project; the approval of the annual project budget; the incurring of any obligation above a specified dollar threshold other than as pre-approved in the annual project budget; the admission of new and/or additional participants; and the making of a capital call for non-mandatory additional capital. Each major decision requiring approval represents a potential hurdle that may be difficult to clear, particularly if unanimous consent is required. This is another area of challenge and concern to the existing participants in a joint venture, as well as to new, prospective equity investors, who are trying to craft a solution to a capital crisis in the current economic environment. Where unanimity is required one dissenter can effectively scuttle the re-capitalisation efforts. In many cases, however, the dissenter just 'wants out', so the opportunity may exist to convert the dissenter into a seller, thereby opening the door to a transfer of such party's membership interest or partnership interest to the new investor.

Buy/sell and transfer provisions

The buy/sell provisions of a joint venture agreement are the provisions that allow one or more parties to initiate a predetermined mechanism whereby the initiating party ends up either buying the joint venture interest of the other participant(s) or selling its joint venture interest to the other participant(s). Buy/sell provisions are typically included in joint venture agreements to enable the

participant(s) to initiate a process to effect a non-adversarial dissolution of a joint venture. If joint ventures can be considered the business equivalent to 'marrying for money,' and if joint venture agreements can arguably be considered the business equivalent to 'pre-nuptial' agreements, then buy/sell provisions should perhaps be considered the business equivalent to 'no-fault' divorce.

Such buy/sell provisions must be reviewed to determine who can trigger them, when and under what circumstances they can be triggered, how the buy/sell purchase price is determined and how the purchase and sale is consummated under such provisions. For example, many buy/sell clauses allow one participant to initiate the process by making an offer (sometimes at an appraised price, sometimes at a book value price, and sometimes at whatever price the offeror is willing to offer), but then allow the offeree to elect whether to sell its interest or buy the offeror's interest at the offered price. While most buy/sell provisions were not specifically written for exercise in the context of a venture that is in the midst of a capital crisis, if the provisions are exercisable by their terms in that context then all venture participants should at least consider such provisions as an avenue to follow. This is particularly true if certain venture participants are illiquid and unable to contribute additional capital while other venture participants are liquid. Utilising the buy/sell mechanism may result in a better economic result and a better long-term result for the party with liquidity, allowing such a party to 'take out' its illiquid partners at a low price, take over the management of the venture as a result, and then solve the external capital crisis, rather than to infuse additional capital into the venture without gaining full control.

Transfer provisions governing the removal and/or admission of venture participants must also be examined. Typically, due to their different roles in the operation of the company, many joint venture agreements contain separate transfer restrictions on transfers by the manager/developer than transfers by other investor members. Given the importance of the role of the developer/manager/promoter in developing and operating the project, together with the financial commitments made by the equity investors, at initial entity formation many joint ventures agreements are written to restrict the developer manager from transferring its membership interest without obtaining the consent of the investor members, and/or to prohibit the developer manager from making any transfer prior to the occurrence of certain key events or milestones in the company's business plan. For example, in a ground up development project where the developer manager conceives and will play a pivotal role in the development of the project, a transfer prior to a milestone such as achieving a certificate of occupancy or substantial completion of the project could adversely affect the ability of the entity to achieve its business purpose. The only transfer right the developer/manager typically retains is the right to transfer all or some portion of its interest to an affiliate controlled by the manager's principals or to transfer the developer manager's economic interest only (ie, as opposed to management and decision-making rights and responsibilities), to relatives of the manager for estate planning purposes.

Before the project begins, investor members typically insist that the principals with whom the investor has invested its equity (and whom it is relying upon to make the project a success) will remain in control of and responsible for the day-to-day management and operation of the company. Consistent with the foregoing, many joint venture agreements contractually restrict the right of the manager to resign as manager of the company or withdraw from the company. The agreement might also contain provisions relaxing the foregoing limitations after the company's project has 'stabilised' as evidenced by meeting certain agreed upon objectives.

In the context of an existing joint venture beset with capital problems, venture participants may simply want to force different outcomes rather than strictly abide by the provisions written into the joint venture agreement during better economic times. The venture's transfer provisions may simply not have been written so as to contemplate the forced removal of a manager or general partner during the kinds of economic times and financial crisis that many projects are currently facing. In any case, the existing transfer provisions should be reviewed and must be understood before a solution can be crafted, and the existing and potential new joint venture participants should also remember that a third party lender may well have imposed in project loan documents additional restrictions on the transfer of the developer's joint venture

interest that must also be taken into account in constructing a solution to the capital crisis.

Even though equity members typically do not have the right or the responsibility for day-to-day management and operation of the company, the developer member usually has the right to consent to any transfer of an equity investor's interest, at least until such time as the equity investor has contributed all of its required capital to the company. Following that time, the developer member may have the right to approve or disapprove any transferee based upon the ability of that transferee to meet any future obligations, as well as based upon the reputation of that transferee. These consent/approval rights may be absolute or may be subject to a 'reasonableness' standard.

Generally, neither the developer member nor the investor members will want to be forced to accept unknown or undesirable partners. These provisions may also distinguish the transfer of economic interests from the transfer, assignment or delegation of other rights, obligations and interests, particularly in the areas of management, control, voting and approval rights. Once again, all of these provisions must be carefully reviewed and understood to determine how they apply to the situation at hand. In the midst of a capital crisis, existing venture participants should also recall the old adage, 'beggars can't be choosers', before they get overly picky about the qualifications and character of a proposed new equity member who is willing to bring new capital to the venture. At the same time, the potential new equity member, who should be appropriately aggressive in its negotiations, would be wise to keep in mind the other old adage that 'pigs get fat and hogs get slaughtered,' and measure its demands accordingly.

Conclusion

It has been estimated that in excess of $500 billion of CMBS loans, construction/development loans and mini-perm loans will mature in 2009, with additional loans maturing in 2010 and the years that follow. In today's severely debt-constrained environment, the challenges and difficulties likely to be encountered in refinancing such mortgages are going to be substantial, if not insurmountable, for many commercial real estate projects and their owners. The paucity of available debt financing, coupled with drastically lower debt/equity ratios as compared to what was required when these loans were originally closed, will result in a huge capitalisation crisis in the commercial real estate industry in the United States, and elsewhere, for the next few years. The stark reality of this crisis will hit home when the owners of commercial real estate who are considering selling rather than refinancing their properties come to grips with the materially reduced property valves that are a by-product of the recession in which we are currently mired. The only reason that this has not occurred to many such projects to date is, simply, that the loans on such projects have not matured.

If an owner can't refinance project debt on acceptable terms and can't sell a property at an acceptable price, most of the other options the owner has probably won't look very good either. Such options include the following:

(i) recapitalise your equity structure with additional equity from existing equity participants and/or with new equity from new equity participants;

(ii) if you have capital that you can invest in the venture, analyse the buy/sell requirements and limitations set forth in your joint venture agreement to determine whether it makes more sense to you to trigger a buy-sell on terms and conditions that are favourable to you, and invest your capital in that manner as the buyer under the buy/sell rather than as an additional capital contribution;

(iii) negotiate an extension/modification with your lender (including converting some of their debt to equity or 'preferred equity' if need be); or

(iv) give your lender the keys to the project. The real or perceived threat of giving the project back to the lender (particularly if no personal guaranties are in place), may create sufficient leverage on the lender to negotiate a loan extension. The threat of exercising a buy-sell may create real leverage for the developer, who is the manager of the LLC or general partner of the limited partnership, to convince reluctant equity members to fund additional capital. The ability to attract new capital to the venture presents another solution to existing project owners and an opportunity to the investor, whether domestic or foreign, who can infuse new capital into the venture during dire economic times.

Regardless of which alternative is ultimately selected, the beginning point for any analysis of the alternative courses of action that may

be available is in the venture's existing joint venture documentation and the venture's existing loan documentation. This analysis should be conducted in coordination with qualified accountants and attorneys who are a part of the project deal team. This process should be commenced well ahead of the maturity date of project loan to allow for enough time, and a realistic opportunity, to pursue available alternatives with the best chance for an acceptable outcome.

The equity members of a venture should be proactive and not wait for the developer/manager to do this, particularly since their interests and motivations and those of the developer manager may not be aligned. The potential new equity investor should recall the difference between 'distressed sellers' and 'distressed properties', and make a thoughtful decision about the kinds of investments it is willing to consider making.

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