

Property Bulletin

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Introduction

Welcome to the second edition of this Bulletin. The publication has been designed to:

- provide general real estate comment for the listed jurisdictions; and
- highlight specific legal developments that may be of interest to investors and occupiers.

We advise clients on both commercial and residential property matters in a number of countries. Our international network enables us to run cross-border transactions, providing a seamless service to match our clients' needs.

If you have any questions on the issues raised or wish to speak to one of our property experts please contact the relevant partner listed at the back of this publication.

Dubai

Market overview

The property market in Dubai has undergone a significant correction. Availability of commercial space, previously very tight, has eased considerably and landlords can no longer rely on tenants having to meet asking terms without question or negotiation.

In the residential market, the downturn in the general economy and decreased demand from expatriates (both in terms of occupation and investment) has led to a marked fall in prices. The market is expected to recover, but it is difficult to forecast the timing or strength of that recovery.

New law on buyer default

Law number 9 of 2009, concerning the termination of contracts, is now in force. It seeks to address situations where a developer wishes to cancel an off-plan sale and purchase contract due to a purchaser's default. The Law provides a scale, based on the percentage of completed construction works, for calculating the amount of money a developer can retain from the purchaser's deposit. It is applicable to all contracts and is retrospective.

All terminations must now be undertaken through the Land Department. If a purchaser defaults the developer must inform the Land Department, who will give the purchaser 30 days notice to fulfil their contractual obligations. If within this period the purchaser fails to meet those obligations, the law provides as follows:

- a. If the developer has completed construction of at least 80% of the project, the developer can retain all the money that has been paid and can request the purchaser to settle the remaining amount of the contract price. If the purchaser is unable to do so, the developer may then request that the property be sold at auction and reclaim the balance of the monies owed accordingly.
- b. In cases where the developer has completed at least 60% of the project, it is entitled to revoke the contract and retain up to 40% of the purchase price.
- c. In situations where less than 60% of the project has been completed, the developer is entitled to revoke the contract and retain up to 25% of the purchase price.

A developer may be able to retain up to 30% of the total amount paid by the purchaser in cases where the construction has not yet commenced, if the failure to start on site is due to matters beyond the control of the developer, and without any negligence or omission on its part.

In situations where a developer is required to return money to a purchaser following a termination, it must do so within one year from the date of termination of the contract or within 60 days from the date of resale of the property, whichever occurs first.

The law also gives RERA (Real Estate Regulatory Agency) the right to cancel a project following its consideration of a "grounded report", although it is unclear on what grounds it can exercise this right. The law provides that once such an order for cancellation is made all monies owed to the purchaser must be returned (and the provisions of Dubai Escrow Laws shall apply).

There have been some early criticisms of Law number 9, in that it largely favours the developer and gives no right for a purchaser to terminate a contract.

It is not clear what will constitute reasons beyond a developer's control, or who will have the final say in determining construction milestones or the reason why works on a project have not commenced. These issues could therefore form the basis of potential disputes in the future. On the face of it a purchaser's main option (short of relying on a RERA cancellation) would be to try to negotiate a settlement (which the developer would be under no legal obligation under Law 9 to agree).

Another potential difficulty is that the law does not specify a timeframe within which the Land Department must issue its 30 day notice of default to the purchaser; there may come to be an issue with capacity, depending on the amount of cases that are filed.

It is thought that subsequent Executive Regulations will provide guidance on some of these issues; we await seeing them, and how this law will be interpreted by the Dubai Courts.

It will be interesting to see how this law develops in practice, especially in what many anticipate will be some challenging months ahead, with an expected exodus of expatriates, some of whom will undoubtedly have invested in the property market.

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France

Market overview

Although the French property market has suffered less from the economic downturn than that in other European countries, there has been a noticeable drop in property transactions over the past two years. The French economy generally remains unstable and the French are concerned about their spending power. As a result property projects, be it sale, purchase or development, are temporarily being put on hold. Businesses too are watching cash flow attentively, and certain industry sectors (e.g. automobile) have been making large-scale redundancies whilst others scale back investment plans, resulting in reduced activity within the commercial property sector.

The volume of residential property transactions fell by 20% during the last half of 2008 and the first quarter of 2009, with sellers choosing to wait for better conditions rather than face a drop in asset values.

Property prices have not fallen significantly in France, unlike other countries particularly Spain, the UK and the USA. This is attributable to the slower rise in property prices over the last decade and the fact that they did not reach the same excessive levels or frenzied purchase behaviour as experienced by other countries.

This price stability, despite the small decline during the second quarter of 2008, is partly due to continued fairly low interest rates (fixed rates at 4 to 5% on average) and flexible loan conditions.

During the first quarter of 2009, residential property prices decreased (-0.4% for flats and -1.7% for houses) but not at the rate of -6.5% that was experienced during the third and fourth quarters of 2008. A national trend has also emerged; house prices in the suburbs, outskirts of the big cities or properties in the country are dropping, whereas one or two bedroom flats in town centres remain stable.

The commercial real estate market has contracted recently in line with the general economic slowdown. Rental values have decreased, however they remain relatively high, particularly in the Paris area (Ile de France).

State support

French authorities are offering a number of incentives in an effort to boost the property market. The first of these incentives was introduced in December 2008 through increasing the thresholds for eligibility for the interest free mortgage (*prêt à taux zéro*). More recently, in March 2009 the "Molle" Law was passed, aimed at improving housing conditions. The Molle Law contains several provisions intended to protect the underprivileged as well as tenants (such as obligations to state in residential property leases the floor area of the rented property, limiting the rights of landlords to obtain a guarantee for the lease, improving property co-ownership etc.).

These measures follow on from the LME Law (*Loi de Modernisation de l'Economie*) of 4 August 2008 intended to boost the French economy. The LME Law included several provisions relating to commercial property such as the possibility for non-trading professions (e.g. lawyers) to enter into a commercial lease or the extension of the period granted to the tenant to leave the premises if the lease is not renewed by the landlord.

Foreign purchasers

Current economic conditions have led to a significant drop in property purchases by foreigners. Like French purchasers, foreigners looking for second homes or a place to retire to have felt the effect of the financial crisis.

The drop in the value of the pound and the US dollar against the Euro means French properties are now more expensive and people living in France with UK incomes (e.g. state pensions) are finding that the cost of living has increased compared to a year ago.

The decline in property purchases by foreigners is particularly noticeable especially in rural cottages or country houses. Areas like the Dordogne or the Quercy are still popular amongst British purchasers, but many are now reviewing their budgets or putting their French property plans on hold. However, in places like Paris and the Côte d'Azur, although property prices have dropped slightly, there is still a strong demand from foreigners for upmarket properties with prestigious addresses.

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Germany

Market overview

So far the German real estate market has remained relatively stable and less affected by the economic downturn than other sectors. Nonetheless, it is expected that the impact will be felt soon, especially when the financial difficulties of commercial tenants begin to directly impact the market. There have been a few indicators that also suggest a downturn is imminent; the market sees a reduction in demand for commercial real estate, particularly office space; fewer new development projects are being undertaken; it is becoming increasingly difficult to obtain large-scale financing; the loss of investors is apparent, especially with banks being reluctant to invest as the cost of financing of projects with less than 40 per cent equity contribution from the borrower has risen disproportionately.

Insurance companies, however, remain reliable financing partners attracted by the reliable cash flow their investment generates.

Residential property, is, overall, currently defying the crisis. The outlook for this sector in Germany is positive due to rising investment volumes, stable returns, lower tenant default rates, moderate rises in operational expenditure and falling vacancy ratios. Eastern parts of Germany are benefiting the most; a relative lack of new development projects coinciding with rising demand at the lower end of the sector spell hope for growth in rental returns. Western Germany has seen a slight slowdown, but this is attributed more to new energy standard requirements than to the financial crisis.

Climate Change and Refurbishment Costs

The Government energy conservation and carbon emission targets, initially agreed on a European level and since implemented by (amongst other things) the German Renewable Energy Heating Act 2009 and the German Energy Savings Regulations 2002, 2007 and especially the revision in 2009 (to enter into force in October of this year) require significant investment in existing property. Legislative changes have placed the

financial burden largely with the industry, without support through adequate funding programmes (even though Government subsidy levels have been raised to EUR 1.5 billion for 2009).

Investment costs may not be fully passed on to tenants, even if they indirectly benefit from a reduction in operational expenditure. Required refurbishment therefore becomes all the less attractive for owners as it directly affects profitability. The environment and climate protection suffer from this dilemma where tenants are not required, and investors are not willing, to unilaterally pay the cost of climate protection.

Proposals by the industry have now been put forward to distribute the burden of climate investment by allowing owners to pass some cost to tenants, such rules to be accompanied by tax relief for energy-related refurbishments. However, even though the German chancellor did acknowledge the need for reform, election campaigns are gaining momentum for this year's general elections. It therefore appears unlikely that any change will happen soon.

One Year On: The Business Tax Reform 2008

The "interest barrier" or "earnings stripping" rule, which replaces the former thin-capitalisation rules and which was introduced by the business tax reform of 2008, is facing continuing opposition from the real estate sector.

Under the new regime interest expense is only deductible up to the amount of interest income in the same financial year. Any excess interest expense is only deductible up to 30 per cent of the company's EBITDA less its interest income. Excess interest expense is not tax-deductible but may be carried forward to the following business years, but again only within the limits of the interest barrier. There are three principal exceptions:

- (i) Interest expense exceeding interest income in the same financial year is fully deductible if the excess expense remains below a threshold of EUR 1 million (exemption limit). Where the excess is more than EUR 1 million, the 30 percent EBITDA threshold will apply to the business' entire negative interest balance.
- (ii) Where the borrower is part of a consolidated group of companies, interest expense is fully deductible if the borrower has the same or a better equity balance sheet total ratio in comparison to the ratio of the group on a consolidated basis (escape clause).
- (iii) Interest expense of a non-consolidated company is fully deductible, unless the excess expense exceeds 10 per cent of the total net interest expense and is paid as interest to a direct or indirect shareholder with a more than 25 percent participation or related person thereto (in the meaning of the German Foreign Tax Act) or a third party having recourse against such shareholder or related person (stand-alone clause).

Business tax rules have never been easy to navigate, but the present regime is remarkable for its complexity. At the same time tax is a major driving force behind the structuring of large scale project investments.

New data from the German Property Federation (ZIA) supports the concerns of the industry. The interest barrier has disproportionately hit the real estate sector; it relies heavily on debt capital for its high-volume financings, whilst typically displaying a low EBITDA in the present market environment. The majority of the industry is affected, and much more so than was anticipated when the new rules were introduced. Present proposals to tentatively adjust the interest stripping rule are being challenged for not going far enough, and affected groups are calling for an increase of the threshold and deductibility quotas (if not an outright abolition of the rule). In practice the interest barrier rule is being actively managed by "atomising" projects and distributing the interest expense over several companies, which allowing multiple applications of the EUR 1 million threshold (as well as the complex "escape" clause in a consolidated group of companies). However, additional costs of overly complex structures directly increase the strain real estate investors already face, and in the present market environment, any limitations on deductibility are particularly unwelcome. Government has recently acknowledged the key role of the real estate sector for the economy as a whole by presenting its first report on the industry in June 2009, so there is hope that the voice of market players will not go unheard, but this is not yet certain.

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Greece

Market overview

In May 2009 the Greek Parliament announced an amendment urging those involved in the real estate industry to consider reducing prices in an aid to boost the Greek property and construction markets.

The State now guarantees the final 25% of mortgages, meaning that prospective buyers can obtain 100% finance. Tax rebates on the interest paid on mortgages have become more attractive, and new laws apply to housing loans granted by 31 December 2010. As a result, it is anticipated there will be an increase in residential property purchases.

We set out below a brief overview of the commercial and residential property markets in relation to the current economic climate, and also outline the legal environment concerning property purchase in Greece, which differs significantly from that of other countries in Continental Europe.

Commercial property market

The impact of the global economic crisis in Greece has been less harsh on commercial property when compared to other countries.

The most developed commercial real estate opportunities, and where most of the activity currently takes place, is in the tourist areas. Many of the hotels throughout the country, from cities to the islands are now owned by non-Greeks. Typical returns can still be double figures.

The country has also seen, since the 2004 Olympic Games, a rise in shopping centres, premier office space and industrial/logistics centres.

As a tourist destination Greece is ranked 24th out of 124 countries. On the back of its popularity the country is experiencing an increase in the number of tourists visiting from new markets, including Russia and Asia. The increase in high-end visitors has meant second-home and integrated resort market, golf courses, marinas, spas, and eco-tourism related projects are beginning to develop.

What is most topical for those in the industry is what impact the financial crisis will have on the tourist sector - considered the "heavy industry" of Greece. The Minister of Tourist Development has recently stated that up to date information shows a decline of 8.8% in tourist numbers.

Residential property market

The residential market is currently facing a slowdown.

Although house prices have not yet dropped significantly, the market has softened and there has been a reduction in the number of transactions. Those with large flats and houses have been the most affected by the downturn. Developers are not embarking on new projects, and are waiting for their existing "stock" to be sold first. Clearance of inventory is happening, albeit at very slow pace. Rents do not generally appear to have reduced.

As a result, two characteristics have appeared:

- reduced demand in large cities and other areas of continental Greece, with prices either remaining stable or reducing by approximately 10%; and
- price stability prevailing (with reduced demand) in the tourist destinations including the islands, which are still attractive to foreign investors.

Buying a property in Greece – the legal environment

EU foreign nationals are able to freely purchase real estate in most locations in Greece, compared with non-EU nationals who must obtain prior approval from the local prefecture for property purchases in certain areas including Rhodes, Crete and some regions in northern Greece.

A purchase is effected by a contract, signed before a Notary Public. The Notary Public calculates the official estimated price of the property. This "official estimated

price" (the tax value) is assessed by the local tax office. This is usually lower than the true purchase price, and is usually stated in the contract. Ownership passes to the buyer when registered at the land registry.

Two kinds of land registries exist.– The traditional ones where registration is made in each owner's name, and the new registries (Cadastré), where the property is identified by a number.

Prior to the execution of the contract the buyer has to pay purchase tax and obtain a tax number. This can be done at any tax office throughout Greece.

Associated costs

A number of taxes, duties and fees are associated with property purchase. These impact both the seller and purchaser. They are:-

Purchase tax: for properties situated outside the borders of a village or town, tax of 7% is paid up to a total purchase price of 15,000 Euro; a 9% tax is paid on amounts exceeding 15,000 Euro.

For properties situated within the borders of a town or village, tax is paid at 9% up to a total purchase price of 15,000 Euro and 11% paid on amounts exceeding 15,000 Euro.

Local Municipal Tax or Community Tax: currently calculated at 3% of the purchase tax and is paid together with the purchase tax.

Legal fees: a local conveyancing lawyer should be instructed when purchasing property in Greece. They have the knowledge of all statutory requirements and charges which can be considerable and are not easily identified.

A lawyer will execute all the preparatory works, draw up the contract of sale (in Greek), arrange a signing meeting with the seller (normally at the office of the Notary Public) and attend the signature of the contract.

The legal fees are state regulated and set at 1% up to a purchase price of 44,440.00 Euro and 0.5% on amount exceeding this. Legal fees may vary however depending on the nature of the services rendered.

Notary Fees: these vary from 1% to 1.5% on the Tax Office calculation of the value (or the price declared, if a higher price has been declared).

Land Registry: 0.00475% plus a fixed charge is paid for registration.

Real Estate Agent's fees: normally 1-2% of the purchase price is usually paid by the buyer, whenever an agent is involved in the sale and purchase transactions; the amount is negotiable.

Annual Property Duty: charged on all properties or plots situated within the borders of a city, town or village. This

is generally a small amount and is included in the electricity bills. Many municipalities have not started to charge this yet.

There are currently no annual property taxes in Greece if the total property value does not exceed 200,000 Euro. The valuation of properties is carried out by the tax office ("taxed" values).

If a foreigner owns a property exceeding 150 sqm, he is obliged to complete an income tax return every year to prove that the income has been imported as a foreign currency.

Since January 2006 a 19% VAT was imposed on new buildings.

Capital Gains Tax: the seller may be asked to pay this tax and is calculated as the difference between the original purchase price and the sale price. The tax rates are set out as follows:

- Property ownership of less than five years tax is charged at 20%
- Property ownership of between five and fifteen years tax is charged at 15%
- Property owned between 15 and 25 years, tax is charged at 5%
- No tax is charged on properties owned for more than 25 years.

Capital gains tax is paid after January 2006. In addition a 1% tax is paid on transfer of property within the same year the latter has been acquired.

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United Kingdom

Market overview

For the UK commercial investment market the last three months have brought some signs of recovery, with an increased level of interest from buyers who perceive that prices have fallen too far. However, quality of tenant and length of income stream remain extremely important. In the commercial letting market there are still low levels of tenant demand and downwards pressure on rents, although some agents now feel the bottom has been reached.

On the residential side there is evidence of a limited recovery. Buyer demand has increased due to better availability of mortgage finance, and the increasing perception that now might be a good time to buy.

Prices and rents nonetheless remain well below their previous peaks. Activity levels, whilst increasing, are not high by historical standards.

Tenant Default and Insolvency

Given the current economic climate, we briefly examine here some issues in relation to tenant default and insolvency.

Landlords need to keep a close eye on tenants. A tenant restructuring its affairs is often a precursor to insolvency, and therefore landlords should monitor tenants for early warning signs such as credit downgrades, rights issues and poor trading statements. Landlords who are aware of their legal remedies, and who act quickly and decisively to enforce them, are more likely to obtain recovery than those who simply allow events to unfold.

If a tenant is not paying rent but is still solvent then the landlord should strongly consider serving a statutory demand on the tenant or sending in bailiffs¹ to recover the arrears whilst they have the opportunity. If a tenant company is placed in administration (a form of insolvency where efforts are made to salvage the business) then there is a moratorium preventing any form of legal action against the tenant without the consent of the administrator or permission of the Court.

It is important not to allow arrears to build up based on the false hope that the tenant's trading conditions will improve; by the time it becomes clear they will not the landlord could be owed a large debt which then proves irrecoverable.

If a landlord is considering forfeiting or taking a surrender of a lease in order to recover possession from a defaulting tenant it should think carefully before taking any action. Unless the landlord has an immediate use for the property, it must bear in mind that once the lease ends time starts to run for the purposes of rates relief (rates are a local property tax). Empty industrial and warehouse properties benefit from six months relief, and other commercial properties only three months – after which time the landlord will be responsible for the full rates payable. As referred to above, it is also worth remembering that a landlord cannot forfeit a lease of a defaulting tenant in insolvency without obtaining the consent of (where appropriate) an administrator, liquidator or the Court.

Landlords should not forget that they can also potentially recover rental arrears from a previous tenant, if that tenant provided the landlord with an Authorised Guarantee Agreement when it assigned the lease. In certain circumstances the previous tenant may also be required to take a new overriding lease of the property if the current tenant company is liquidated.

¹ The process of recovery of rental arrears by using bailiffs to seize goods is likely to be amended within the next year with the introduction of the Tribunals, Courts and Enforcement Act 2007

When a landlord has entered into some form of insolvency procedure, there can be some confusion for the tenant as to whom rent should be paid. For example, should the rent be paid to the landlord, an appointed insolvency practitioner or a superior landlord (who may be demanding that payment be made direct to it)? The tenant needs to be clear on this subject, in order to avoid remaining liable for rent by incorrectly paying the wrong party.

Where a landlord itself has a leasehold interest and enters into liquidation, the appointed liquidator may decide to disclaim that lease. The result in such a case will be that any sublease will also be brought to an end. Whilst the subtenant will have the right to apply for a vesting order for the superior lease to be vested in it (so allowing it to remain in the property) it may find that the terms of that lease are less favourable than those under its own (now terminated) sublease.

For both landlords and tenants it is vitally important to consult a property lawyer as soon as possible for specialist advice. Matters should be kept under review and, if possible, necessary action taken before any formal insolvency process commences; after such commencement the landlord's or the tenant's ability to take further action is likely to be restricted.

The Ince property team has been advising both landlords and tenants on these types of issues over the last year, and for the moment we foresee no decline in the number of enquiries of this nature.

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