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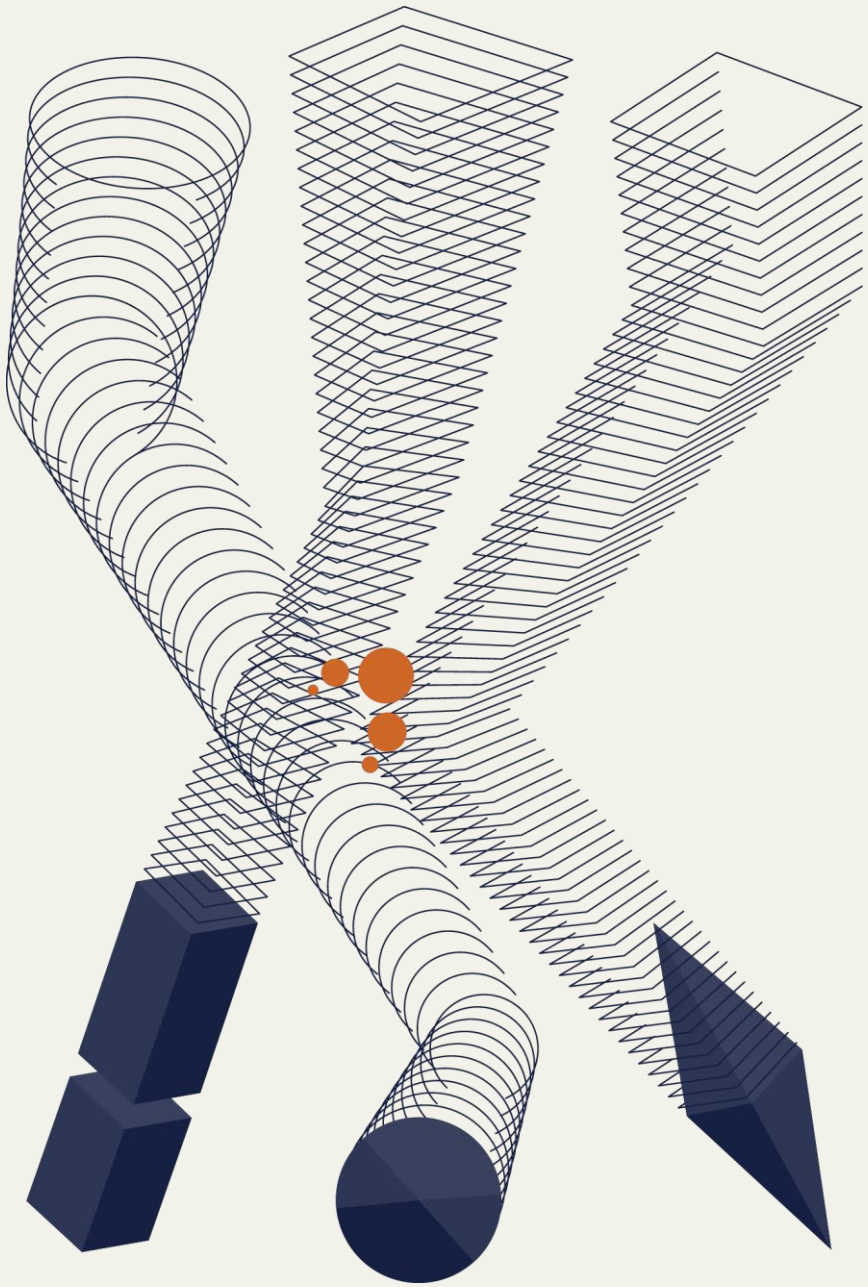

Russia

Real Estate Report 2017

/ Content

/ Real Estate Register

The new federal law “On State Registration of the Real Estate” No. 218-FZ dated 13 July 2015 entered into force on 1 January 2017 and introduced a number of significant changes to the procedure of real estate registration. Some important changes will come into force in 2018.

Merged Real Estate Register

The previous real estate related registers, the Unified State Register of Real Estate and Transactions Therewith (which contained information on rights to the real estate) and the Real Estate Cadaster (which contained information on technical features of the real estate) were merged into the new Unified Real Estate Register which contains both technical and legal information on each real estate item.

Therefore, in order to obtain information on the technical and legal features of a real estate item, it is now sufficient to obtain one excerpt from the Unified Real Estate Register. The excerpt may be issued in electronic form within 1-2 days since the date of application, which makes reviewing information on registered real estate much easier and quicker.

Reduced Registration Terms

The terms for registration of rights to real estate were reduced from ten to seven business days. Registration of technical and legal features may be performed simultaneously and in no more than two steps. The term for simultaneous registration is ten business days since the date of application.

Russia-Wide Competence of Registration Authorities, Establishment of Multifunctional Centers

It has become possible to submit an application for registration to any registration authority, irrespective of the location of the real estate the rights to which are subject of the registration. Previously, such registration was possible only with the authority at the place of the concerned real estate item.

Furthermore, the documents may be submitted not to the registration authority, but to a multifunctional center. Such centers exist in many regions and provide easier procedures for submission of the documents. However, if a registration application is submitted to such multifunctional center, the terms for registration are prolonged for two business days.

Improvement of Legal Certainty Regarding Suspension and Denial of Registration

The legal grounds permitting the registration authorities to suspend or deny registration were clearly specified in the laws. The new law has introduced a detailed list of grounds for

suspension of registration. The list includes almost all situations which may lead to the impossibility of the registration (e.g. an application contradicts rights previously registered). As previously the grounds were not clearly specified in the law, registration authorities were able to suspend or deny registration unreasonably.

If the grounds for suspension are not eliminated within three months (previous law provided for one month), the registration application will be denied. The term for a suspension of a registration upon the request of person applying for state registration was also extended from three months to six months.

Corporate Documents of Russian Legal Entities No Further Required

It is no longer required to provide statutory documents of Russian legal entities registering their rights to real estate. Previously, such statutory documents formed a huge part of the set to be submitted to the registration authorities. Now, the registration authorities request statutory documents of Russian legal entities directly from the Legal Entities Register. This rule does not affect non-Russian legal entities which have to submit their statutory documents together with an application for state registration of their rights to real estate.

/ Town Planning

Mandatory Membership in Self-Governing Organizations

Until 30 June 2017, the performance of certain activities conducted by service providers in relation to the construction of a building or a plant, in particular, engineering, designing and constructing ("**Service Providers**"), required a license (*dopusk*) which was issued by so called self-governing organizations (*samoreguliruemie organizatsii*) ("**SRO**"). With effect from 1 July 2017, the license requirement was replaced by the requirement of a membership of the Service Providers as explained below in more detail:

The entering of the Service Providers into agreements with the following persons aimed at constructing a building or plant requires the membership of the Service Providers in an SRO:

- Developer (*zastroyschik*), i.e. owner or lessee of a land plot,
- Technical customer (*tekhnicheskiy zakazchik*), i.e. organization that provides all documents required from the Developer for the conduct of all services with regard to the construction of the building or plant,
- Organization operating the building or plant,
- Organization permitted to use a state or municipal land plot to perform engineering surveys.

However, the following businesses are exempted from mandatory membership of the Service Providers to an SRO:

- Unitary enterprises, state and municipality offices, legal entities with state interests acting under agreements with state or municipality bodies as well as state corporations,
- Contractors performing construction and installation works in amounts of no more than three million rubles.

Taking into account the above mentioned, SRO membership is not obligatory for rendering services and execution of works under a subcontractor agreement. In this event, the membership of the general contractor at an SRO is sufficient.

An important function of the SRO is providing security to the customers of services in relation to construction projects: the SRO entertain a compensatory fund which is financed by duties to be paid by its members.

Development Plan

With effect from 1 July 2017, the framework for the determination of the contents of the so called development plan (*gradostroitelnij plan zemelnogo uchastka)*(“**Development Plan**”) was amended. Previously, the Development Plan was a document (belonging to the documents on the planning of a certain territory) which contained the limitations and conditions for the development of a land plot. Limitations and conditions for development of each land plot were established by the competent municipal authorities.

Now the limitations and conditions are part of the so called Land Use and Development Rules (*pravila zemlepolzovanija i zastrojki*)(the “**Rules**”). According to the law, the Rules must be established by municipal authorities regarding the territory of each settlement of the Russian Federation. Where the Rules are adopted, an extract from the Rules regarding a certain land plot is considered the Development Plan.

Unfortunately, although the legislator has extended the term for the establishment of the Rules several times, there are many settlements for which still no Rules have been adopted. In such settlements, limitations and conditions for development are determined according to the so called type of use of a land plot and by the requirements provided by federal law. However, starting from 1 January 2018, land plots in settlements without Rules may not be allocated for construction, and no construction permits may be issued.

The City of Moscow has adopted its Rules only on 28 March 2017. In the Moscow Region Rules are established regarding the majority of the settlements.

A Development Plan determines the limitations and conditions for development with binding effect for building permits which will be applied for within a term of three years since the date of issuance of the Development Plan.

Notably, Development Plans are not issued for land plots which are intended for the use of constructing and operating infrastructure lines (roads, communication lines, pipelines, etc.). Such use requires the establishment by the relevant authority of a project for the planning and a boundary setting plan of the concerned territory.

/ Investing in Shared Construction of Residential Houses

In Russia the construction of residential houses is usually financed by the future owners of the premises. Usually, the future owner is a private investor ("**Private Investor**"). Prior to and during the construction of the residential house ("**Residential House**"), the Private Investor and the developer ("**Developer**") enter into an agreement under which the Private Investor pays a certain amount of money to the Developer and acquires the right to receive ownership of certain premises after the completion of the Residential House *(dogovor dolevogo uchastija)* (Agreements on Participation in Shared Construction of the Residential Houses, the "**PSC Agreements**").

The Private Investors are running the risk that the Developer is unable to complete the Residential House or otherwise to satisfy its contractual obligations towards the Private Investors. Since in the past Private Investors often lost their investments without having received ownership to the concerned premises, the Russian legislator enacted the following amendments to the Federal Law on Investing in Shared Construction of Residential Houses No. 214-FZ. The amendments took effect from 30 July 2017.

Compensatory Fund of Developers

The Compensatory Fund of Developers is deemed, in the event of an insolvency of the Developer, to (i) cover damage compensation claims of Private Investors who have received neither ownership of premises nor reimbursement of their investments, or (i) to finance the completion of the respective Residential House. The Fund will be financed from payments to be made by the Developers in the amount of 1.2% of the investments made by the Private Investors under the PSC Agreements.

Requirements to Developers

The status of a Developer may be obtained only by businesses which have been involved in the construction of Residential Houses for not less than three years and has been commissioned with a total area of not less than 10,000 square meters.

The following limitations apply to Developers:

- Developers may not participate simultaneously in the construction of more than one Residential House and/or other objects. Therefore, a Developer may have only one building permit for building one Residential House at a time.
- For settlements Developers may hold only one bank account, which must be opened at a Russian authorized bank.

The Developer, the technical customer (cf. section **Mandatory Membership in Self-Governing Organizations** above) and the general contractor must hold bank accounts at a Russian bank and may only make payments from such bank accounts.

The Developer may enter into a PSC Agreement and collect funds from Private Investors only if it has by this time:

- approved project documentation,
- its own funds in the amount of 10% of the cost for the construction of the Residential House (as mentioned in the project documentation),
- no obligations under loan or credit agreements, except for those for the financing of the Residential House in question,
- no other obligations exceeding the amount of 1% of the cost for the construction of the Residential House (as mentioned in the project documentation) except for obligations for construction,
- no assets which are used as security for obligations of third parties.

Collecting of Private Investors' Funds on Special Accounts

Starting on 1 July 2018, a finance system will be established under which the investments of all Private Investors regarding one Residential House will be collected on one account (e.g. an escrow account) ("**Special Account**"), the funds of which are not at the disposal of the Developer. The collected funds will be transferred to the Developer only after commissioning of the concerned Residential House.

If the system is established, regarding the financing of a Residential House, the following agreements will be entered into:

- PSC Agreement between the Private Investor and the Developer under which the Private Investor is obliged to make payments to the Special Account,
- Agreement on the Special Account between the Private Investor, the Developer and the bank with a term expiring six months after the end of the PSC Agreement,
- Loan agreement on the financing of the Residential House between the Developer and the bank.

The new finance system will be established in the following phases:

- from 1 January to 30 June 2018 (preparatory stage): establishment of suitable legal framework,
- from 1 July 2018 to 30 June 2019 (transitional stage): collecting funds from Private Investors permitted according to both the existing and the new legal framework,
- from 1 July 2019 to 31 December 2020 (final stage): final transition to new legal framework, at the end of the final stage: collecting funds from Private Investors from the Developer will be prohibited.

/ Financing

On 26 July 2017, the below amendments to the Civil Code of the Russian Federation were published. The amendments which take effect on 1 June 2018 are aimed at making settlements in real estate transactions safer and more transparent and reducing risks related to the default in payments or improper fulfilment of other obligations by the parties.

Letter of Credit

Under the new law, a letter of credit may not only be used for making payment to a payee or acceptance, payment or discounting of a bill of exchange issued by a beneficiary, upon the fulfilment of certain conditions, but also for other purposes.

A letter of credit is irrevocable by default unless otherwise stated in its text.

The concept of a transferable letter of credit as provided by ICC Uniform Rules and Customs for Documentary Credits, 2007 Revision No. (UCP 600) has been introduced. A transferable letter of credit is one that allows for performance to a third person designated by the payee if such performance is permitted by the conditions of the letter of credit and the executing bank has expressed its consent to such performance. However, the transfer of a letter of credit to another recipient would take place not at the will of a nominated bank, as in UCP 600, but only with its consent. As the transfer of a letter of credit is a payment to a third party, rather than a transfer of rights to such third party the rules on assignment do not apply to the transferable letter of credit and the third party is not permitted to re-assign the letter of credit to a further party.

Also new is the rule concerning the joint and several liability of the issuing bank and the confirming bank for the non-performance or improper performance of a letter of credit provided that the payee presents documents required by the letter of credit and complies with other conditions of the letter of credit.

Escrow Agreement

Under an escrow agreement

- the depositor undertakes to deposit an asset with an escrow agent for the purpose of fulfilment of the depositor's obligation to transfer the asset to the beneficiary, and
- the escrow agent undertakes to
  - safekeep the asset, and
  - hand the asset to the beneficiary if and when the requirements agreed in the escrow agreement are satisfied. Unless otherwise stipulated by the agreement, the escrow agent's obligation to review the satisfaction of the requirement is limited to make a visual inspection of the documents presented to him.

The escrow agreement may have a term of up to five years and must be notarized.

Regarding the below features, the concept of the escrow agreement under the new laws differs from the current concept:

- deposited assets may not only be cash, but also other movable items, certified and non-certified securities and non-cash funds,
- escrow agent may be any person (including individuals) and not only banks.

An escrow agreement will be governed by the provisions of the Civil Code on deposit agreements as well as on bank account agreements.

Mortgages

Electronic Mortgage Bond

Starting from 1 July 2018, it will be possible to execute mortgage bonds in electronic form via a special website. Previously, the mortgage bonds were executed only in paper form. Corresponding procedural changes regarding execution and storage of the electronic mortgage bonds were introduced in the Federal Law "On Mortgage (Pledge of Real Estate)" No. 102-FZ dated 16 July 1998 and the Federal Law "On State Registration of the Real Estate" No. 218-FZ dated 13 July 2015.

When issuing an electronic mortgage bond instead of a paper mortgage bond the previously issued paper mortgage bond will be cancelled. It is not allowed to issue a paper mortgage bond instead of an electronic mortgage bond.

Managing Mortgage in the Interest of Several Mortgagors

The new law permits the registration of a so called mortgage manager. The mortgage manager has the task to manage real estate which is mortgaged in favor of several mortgagees who have entered into a syndicated loan agreement with a mortgagor (Art. 356 of the Civil Code). Despite the fact that the possibility of a syndicated loan and establishing a mortgage management agreement was introduced into the Russian Civil Code in 2014, the detailed regulation of the respective relationships has entered into force as late as on 1 February 2018 (new Federal Law "On Syndicated Credit (Loan)" No. 486-FZ dated 31 December 2017).

/ Court Practice: Lease

Invalidity of Lease Agreement

Ruling of the Supreme Court No. 305-ES17-16281 dated 3 November 2017 in case No. A41-35746/2016 re. Svyaznoy-Logistika vs. Skladi 104

Svyaznoy-Logistika has leased a warehouse from Skladi 104 (a company belonging to Radius Group) under a long term lease agreement. It brought a lawsuit to the competent Russian Arbitrazh Court aimed at declaring the lease agreement invalid for the following reasons:

- The rent rates significantly exceed existing market rent rates,
- The lease agreement unfairly restricts the termination rights of Svyaznoy-Logistika.

The claim raised by Svyaznoy-Logistika was granted in all instances as it was considered that the long term lease agreement was in breach of the principle of bona fide (Article 10 of the Civil Code of the Russian Federation). The courts have taken into consideration that the parties initially intended to enter into the lease agreement on other terms and conditions (which were expressed in so called "side-letter"), but have not done so due unlawful actions of the previous general director of the lessee. However, in public the case was discussed very controversially.

Sudden Break-Off of Negotiations

Resolution of the Arbitrazh Court of Moscow District No. F05-16349/2017 dated 29 November 2017 in case No. A41-90214/16 re. Dekort vs. Auchan

The parties discussed entering into an agreement under which Auchan desired to lease premises for a food market in the Moscow Region. When the parties had agreed all terms and conditions of the lease and the agreement was ready to sign, Auchan broke off the negotiations with the argument that the required corporate approval of the Auchan group had not been granted. Dekort claimed from Auchan compensation for the damages suffered from the break-off of negotiations under Article 434.1 of the Civil Code of the Russian Federation. In particular, in expectation of the entering into a lease agreement with Auchan, Dekort had not extended the existing lease of the premises and therefore suffered the loss of the lease payments under such lease.

All Arbitrazh courts (Arbitrazh Court of Moscow Region in first instance, Tenth Arbitrazh Appellation Court in appellation instance and Arbitrazh Court of Moscow District in cassation instance) supported the position of Dekort. The lack of the required approval by the Auchan group was not recognized as justification, because the requirement of an approval by the Auchan group was not provided for in the corporate documents of Auchan and was not subject of the negotiations between Auchan and Dekort. Furthermore, all courts have mentioned that Dekort may claim any damage which it suffered from the break-off of negotiations includ-

ing the payments lost due to non-extension of the lease until the date on which Dekort manages to lease out the premises to a third party.

No Withdrawal of Lessor's General Consent to Sublease

Ruling of the Supreme Court No. 303-ES17-13540 dated 22 January 2018 in case No. A73-5337/2016 re. Promsvyaz vs. Arenda Center

Promsvyaz and Arenda Center are parties to a lease agreement in which Promsvzaz has granted its general consent to Arenda Center to sublease premises to third parties. Referring to Article 157.1 of the Civil Code of the Russian Federation, Promsvyaz declared the withdrawal of its general consent and demanded from Arenda Center the termination of the sublease. However, the Arbitrazh Court of Khabarovskij Kraj dismissed Promsvyaz' lawsuit arguing that the lessor's general consent was sufficient to permit the lessee to enter into sublease agreements with third parties and that the general consent may not be withdrawn unilaterally. Furthermore, the court mentioned that Article 157.1 of the Civil Code which deals with certain aspects of the granting of consents did not apply to withdrawals of granted consents. The decision of the Arbitrazh Court of Khabarovskij Kraj was supported by the Sixth Arbitrazh Appellation Court, then dismissed by the Arbitrazh Court of the Far-East District and thereafter reinstated by the Supreme Court.

Financial Problems of the Lessee's Bank No Justification for Non-Payment of Lease Rent

Resolution of the Arbitrazh Court of Moscow District No. F05-633/2017 dated 9 March 2017 in case No. A40-191965/2015 re Department of City Property of Moscow vs. A.R.S. Project

Under a lease agreement with the Department of the City Property of Moscow, A.R.S. Project has failed to pay the rent more than twice in a row due to the fact that its bank was in the pre-bankruptcy stage and, therefore, has not transferred the money to the lessor in time. The court of the first instance had dismissed the lessor's claim on termination of the lease agreement, but the courts of the appellation and cassation instances supported the claim arguing that financial problems of the lessee's bank may not be considered as valid ground for the failure to pay the rent.

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