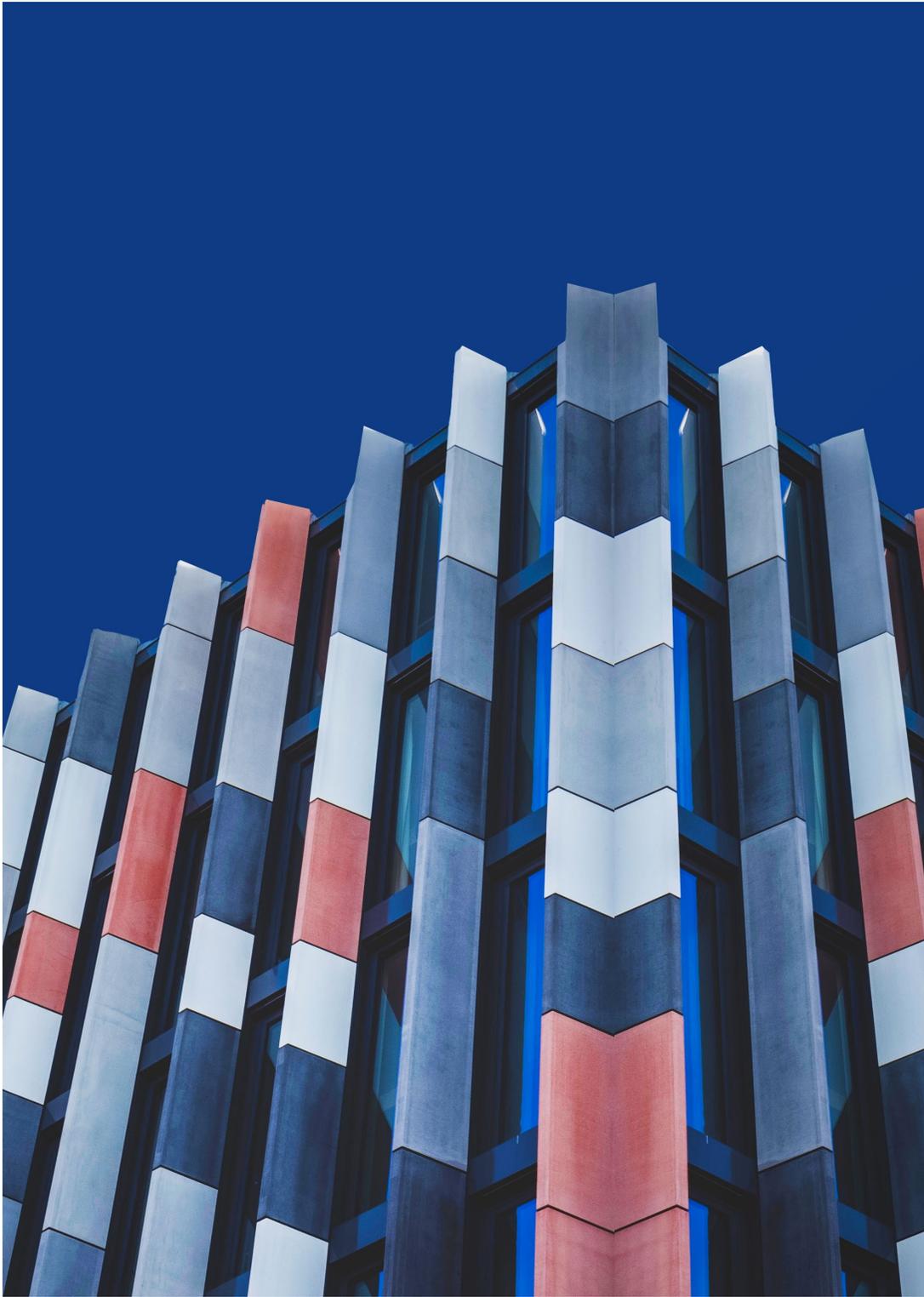


TaylorWessing

**Property Passport  
Central and Eastern Europe**







# Contents

- 4** Introduction
- 7** Why choose Central and Eastern Europe?
- 11** Selecting the right asset
- 15** Managing the asset
- 21** Financing the asset
- 25** Refurbishing the asset
- 33** The purchasing process
- 38** About Taylor Wessing

# Introduction

**The CEE property passport is a practical guide for anyone considering investing in property in Central and Eastern Europe and those who act as their advisors. It explains:**

- why the region offers attractive property investment opportunities
- how property law works in the region and the differences between six key countries
- how to select the right asset
- how to structure the deal to make your investment profitable
- how to manage the property to gain the best possible value from your investment
- how to decide on a corporate and tax structure that maximises your return.

The property passport focuses on the six countries where the main real estate investment opportunities are:

- Austria
- Czech Republic
- Hungary
- Poland

- Slovakia
- Ukraine.

## Why invest in property?

Since the late 2000s, many property investments have been made against a backdrop of global economic and political instability. At a time of economic recovery in some global markets, many investors are still cautious, wanting to find safe havens – whether by investing in gold, art or secure, well-let real estate investments.

Real estate offers competitive risk-adjusted returns, high tangible asset values and attractive income streams. Investing in real estate, rather than putting all your money into stocks or bonds, allows for diversification. Adding real estate to your portfolio can lower its volatility and provide higher returns than can be achieved with a similar risk level in bonds.

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# Why choose Central and Eastern Europe?

**When it comes to investment strategy, global investors differ in their thinking. Some look for short-term returns. Others take a long-term view, holding and managing assets for many years, if not decades, in order to secure their investments for future generations. Whatever your objectives and strategy, the CEE region can offer attractive investment opportunities.**

## Predictions of continued economic growth

The second half of 2022 saw a slowdown in CEE after the year's strong beginning and generally positive performance throughout its first six months. Poland maintained its lead among CEE countries in terms of total investment transactions. Czech Republic, Austria, and Hungary all saw declines, with the latter recording its lowest annual activity since 2015. Slovakia, on the other hand, has seen unprecedented levels of investment, particularly in retail. Overall, investors are currently taking a wait-and-see approach, which has resulted in more subdued investor activity. Supply chain disruptions, the Ukraine war, and high energy prices

all contributed to the slowdown, but with pandemic restrictions lifted, the recession is expected to be relatively brief. Economic growth will be slower in 2023, but it will recover in the long run, as will the market and transaction activity. There are many interesting assets in CEE, some of which are significantly undersupplied, presenting an excellent opportunity for foreign investors, however, Central and Eastern Europe should not be treated as a single bloc. If you're considering investing in the region, it's important to be aware of the differences between the countries in order to make the right decisions for your objectives and situation.

**Austria:** against the backdrop of various global crises and inflation, the Austrian economy GDP growth reached 4.5% in 2022 according to the Organisation for Economic Co-operation and Development (OECD). Despite the changed market situation due to inflation, an adjusted interest rate policy and its effects on the real estate market, the investment volume in 2022 amounted to some 4.1 billion euros. The volume of real estate investment should be somewhat subdued in the first half of 2023 because of uncertainties relating to further rate hikes and increase in the second half of the year.

**Czech Republic:** the Czech economy had grown in the first half of 2022 despite adverse circumstances and as expected it also went through a slight recession in the second half of the year. Nevertheless, GDP for the year 2022 increased by 2.4 %. GDP could be more or less stagnant in 2023 (estimate).

**Hungary:** in Q3 of 2022, Hungarian GDP grew by 4.1% and according to most recent calculations, in 2022 the country will be boasting about a GDP growth close to 6%. Despite the OECD forecasts a relatively slow GDP

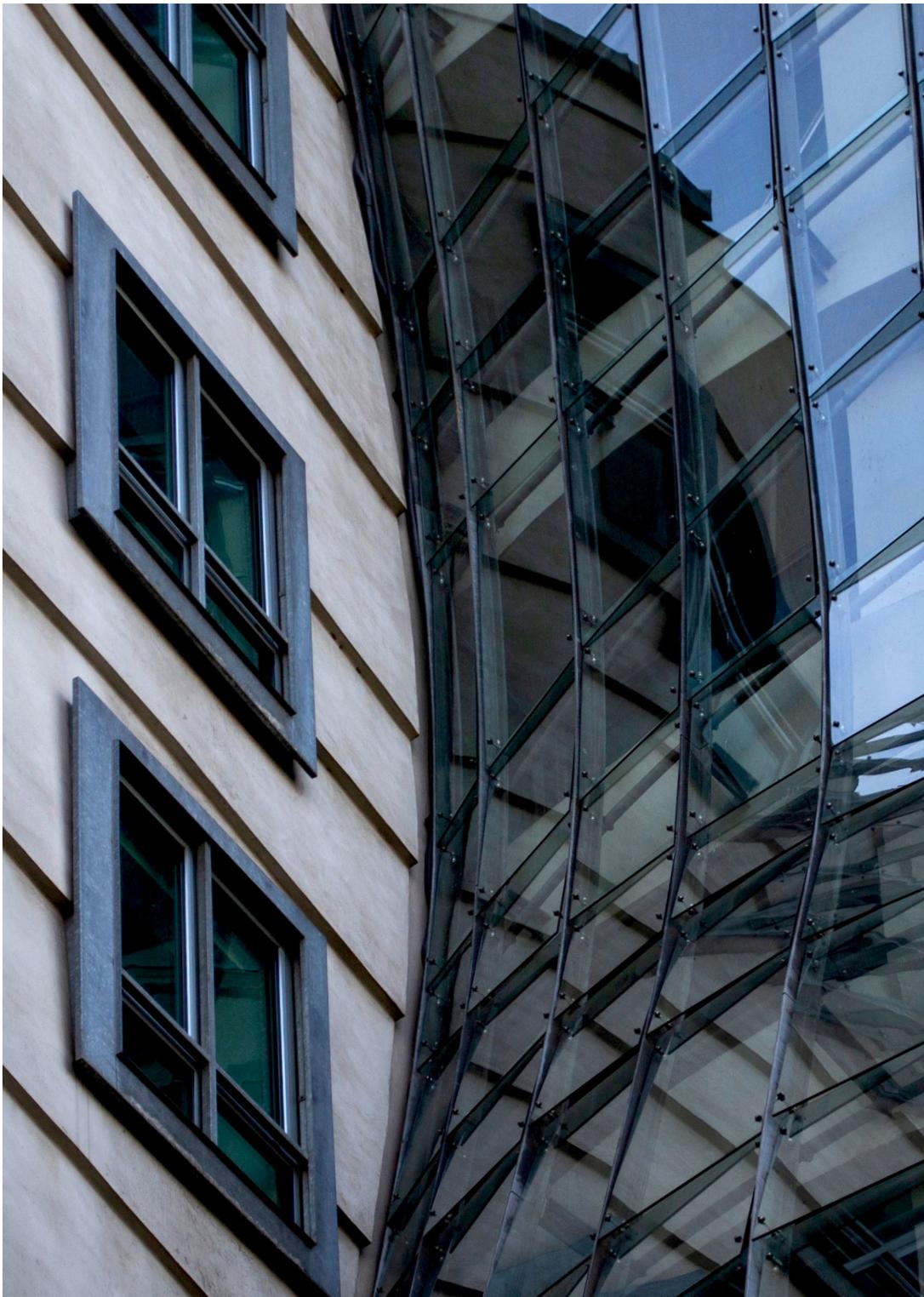
increase in most OECD countries, Hungary's performance is expected to stay above the average increase. With Hungary's government debt being relatively low and by creating a stable and investor-friendly economic environment, Hungary has benefited from a record amount of foreign direct investment (EUR 5.9 billion in 2021) thanks to the multiple giga-projects that have broken ground in recent years with investors from all over the world, not just the EU.

**Poland:** Poland has contributed significantly to the region's growth over the past few years due to its considerable stability. Poland at the end of 2020 was ranked as the third preferred location in Europe for foreign investments. In 2020, it had nearly 200 foreign investments for a total value of EUR 10 billion. The Polish economy continued on a strong growth path in 2022, supported by an expansionary fiscal stance, a favourable situation in the labour market and the large inflow of displaced persons from Ukraine. Data on the real economy suggests that economic growth in the fourth quarter weakened visibly, partly due to elevated inflation and tighter financing conditions. Nevertheless, a

strong revision of historical data led to a significantly higher starting GDP level for 2022, lifting the real GDP growth projection in 2022 to 4.9%.

**Slovakia:** this high-income economy is one of the best performing in Europe. In 2016 Slovakia doubled its transaction volume in commercial real estate. The economy has been growing steadily over the past few years and GDP growth rate reached 4% in 2018, 2.3% in 2019 and after the small dip in 2020 (due to the pandemic) it has reached 3% in 2021. The current growth is fuelled mainly by strong domestic demand and strong exports. Slovakia has a stable and flexible Eurozone market-based economy. Although a relatively small country, Slovakia is among the most attractive destinations for foreign direct investment in Europe because of its openness to foreign trade and investment. As in many CEE countries, industry (especially automotive) is a driving force of the economy.

**Ukraine:** Following Russia's aggression on 24 February 2022, Ukraine once again faced the challenge of defending its borders, improving its administrative systems and now rebuilding its war-torn economy. The government of Ukraine is actively working to improve comprehensive solutions for the wider investment community, encompassing businesses of different sizes. With additional investment-oriented services and state support, Ukraine hopes to gain, among other things, growth into an economically strong and developed European country by improving its economic, social and legal environment.



# Selecting the right asset

**The underlying factor when deciding how to invest is whether you want to hold the asset for the long term or whether you are working towards an early exit.**

For most investors, the important decisions are:

- which asset class to invest in
- location
- covenant strength of tenants
- overall timing.

There's a wide range of options, large and small, commercial and residential. From trophy assets to multi-tenanted well-let investment stock to shopping centres, complex development sites and high end flats. Professional advice and expertise is vital in deciding on the right type of asset. Get early advice from legal advisors who work closely with international firms of surveyors and other bespoke houses. They will all contribute to ensuring you select the right asset.

In the current market, competition for trophy assets is increasing, allowing sellers to control timescales. A swift process is key to a successful purchase. You can easily miss out on an excellent opportunity if another purchaser is in a position to move more quickly. Quick due diligence and parallel contract negotiation are often key to securing real estate assets.

## Key factors in the purchase process

There are many considerations in deciding whether a property is right for you. For example, it's important to get advice on:

- the title to the property – whether there are any restrictive covenants or other third-party rights that can restrict use
- searches of public registers
- resolution of pre-contract enquiries
- environmental and zoning/planning issues
- permissions, licences and consents required for development
- tenancy schedules
- soundness of occupational leases (including service charge recoverability)
- outstanding rent reviews
- ongoing tenant disputes or disputes with other parties, such as neighbours
- the build package
- tax issues including Real Estate Transfer Tax, VAT and capital allowances
- management contracts
- the form of purchase contract and ancillary documents
- vacant possession strategies (if the property is a target for development)
- dilapidation claims if a lease is nearing the end of the term.



**If you're considering investing in Central and Eastern Europe, be aware of the differences between the countries in order to make the right decisions.**



# Managing the asset

**Real estate assets have a natural life cycle and have to be nurtured throughout if you are to maximise the return on your investment. There are a number of important aspects to managing any building.**

## Attracting the right tenants

As a landlord, one of your first concerns is to ensure the covenant strength of the proposed tenants. If it's insufficient, there are a number of ways of boosting it. For example, rent deposits, or parent company or bank guarantees. The market will dictate what package you need to give tenants by way of a rent-free period or other incentives

## Allocating liability

Allocation of liability varies from country to country.

**Czech Republic, Hungary, Poland, Slovakia and Ukraine:** the allocation of liabilities follows the principle of private autonomy. As a landlord, you and your tenant can agree on your respective obligations for maintenance and repair.

If you don't do so, your tenant is automatically responsible for routine maintenance and for you to carry out other maintenance and any necessary repairs (except for Hungary, where repairs are generally the tenant's responsibility).

**Slovakia:** the tenant's right to carry out their own repairs (or fit out works) isn't statutory and needs to be agreed.

**Poland:** unless otherwise agreed, the tenant makes minor investments whereas maintenance for the use of the premises is your responsibility as landlord. If you and the tenant agree to allocate the liabilities, it's up to you whether you take factors such as the age and nature of the asset into account. In Hungary, you have to pay attention to specific rules concerning the nature of the asset (for example, if the municipality owns it).

If no agreement exists, liabilities are allocated in compliance with the subsidiary provisions laid down by the civil code, and the factors relating to the asset aren't considered. If a defect occurs that's your responsibility and that makes it difficult for the tenant to use a commercial premises, the tenant has to notify you of the circumstances.

If you fail to remove the defect within a reasonable timeframe, the tenant can repair it and claim reimbursement. In Ukraine, the tenant also has the right to terminate the lease agreement and to claim damages.

**Austria:** the scope of the mutual maintenance and repair obligations of the tenant and the landlord depends on the applicable tenancy law, which is split between the Austrian General Civil Code ('ABGB') and the 'Tenancy Act' (MRG). The ABGB allows for a greater contractual flexibility in leases, whereas the MRG is mostly mandatory, if applicable. The applicability of the MRG depends primarily on the type of contract concluded (duration, predominantly usufructuary elements?) as well as the type and age of building and should be assessed on a case-to-case basis.

Under the tenancy regime of ABGB, the landlord has far-reaching (statutory) maintenance obligations which do not only apply to the leased object itself, but also to the general parts of the building used by the tenant. However, these statutory landlord obligations can be contractually amended, limited, and transferred to the tenant. Further limitations may apply, should the tenant be a consumer within the meaning of the Austrian Consumer Protection Act ('Konsumentenschutzgesetz').

In contrast, the maintenance obligations put forth in the MRG are mandatory if the MRG tenancy regime is fully applicable. However, the MRG limits the landlord's maintenance obligations to the general parts of the building and – when it comes to the leased object – to serious damage to the house, eliminating a significant health hazard, and making the property fit for use before it is rented out.

### Flexibility

In the current economic environment, flexibility is an important issue to you as a landlord, and also to your tenants. In the **Czech Republic**, **Slovakia** and **Ukraine** it's up to you to

decide between you whether you prefer the lease contract to be for a definite or indefinite period. Five years is a common contract period and this is usually automatically extended if neither you nor the tenant wants to terminate the agreement. If you agree a longer contract period, it's a good idea to stipulate break clauses, which allow both parties to react to changes in the business environment.

**Hungary:** commercial real estate contracts are usually for a definite period of up to 10 years. After that, the tenant usually has a right to prolong the term (often by another five years). If your tenant continues to use the leased premises after the expiry of the lease term and you do not object within a given deadline, then the lease automatically becomes indefinite after the end of the definite term. Including a break option (usually after the first five years) in the contract benefitting one or both parties is also commonplace.

**Poland:** it is your decision whether you prefer the lease contract to be for a definite or indefinite period, contracts are usually from 3 to 10 years. Where lease agreements are for a definite period, both parties are entitled to terminate the lease

agreement provided this is part of the lease agreement. A lease concluded with an individual for more than ten years shall be deemed to have been concluded for an indefinite period thereafter. A lease concluded between entrepreneurs for a period of more than thirty years shall be deemed to have been concluded for an indefinite period of time thereafter.

**Austria:** It is up to the parties to decide whether the contract is fixed term or open-ended. Due to various legal limitations, it is in general advisable to conclude fixed-term contracts. Other (predominantly tax) reasons may speak in favour of an indefinite lease combined with a tenant-side waiver of the right to terminate the contract for a given time. During the contractual term of a fixed-term tenancy, termination is usually not possible unless there is a valid reason (the so-called exclusion of rights of 'ordinary' termination). Therefore, as a rule, the premature termination of fixed-term tenancies requires a separate agreement by the parties. Other restrictions apply to the termination under the MRG regime: You can usually only terminate a tenancy (commercial or residential) for certain reasons (e.g. non-

payment of rent, grossly damaging use of the premises), regardless of the agreed (fixed or indefinite) duration. In the case of fixed-term tenancy agreements relating to a residential property ('Wohnung'), however, the tenant has a right to terminate the contract after one year.

### Collecting your rent

If a commercial tenant continuously fails to pay the rent, your options vary from country to country.

**Austria:** if the property is within the scope of the MRG, you're entitled to terminate the lease agreement if your tenant defaults on payment of the rent. You must issue a written reminder and give them a grace period of at least eight days. You can terminate any lease agreement without a notice period if the tenant hasn't paid the outstanding rent by the next payment date. Again, they must have received a written reminder. You can file a claim for the payment of rent as well, and/or make use of any rent security that the tenant has provided.

**The Czech Republic:** if a commercial tenant is in delay with the payment of rent for more than one month, you're entitled to terminate the commercial lease contract with a three-months' notice period. You must first have

requested payment and given the tenant a reasonable timeframe.

**Hungary:** the parties to commercial leases are free to set the terms for termination for failure to pay rent. Where the agreement doesn't deviate from statutory rules, you're entitled to terminate the lease. You must have issued a written demand for the overdue payments and notified the tenant of the consequences. Should the tenant fail to comply within 8 days, you are free to terminate the lease within another 8 days in writing, giving an at least 15-days notice period. Enforcement of documents certified by a notary is easier and faster than the enforcement of standard private documents (direct enforcement is possible without the need for litigation). So it's common practice to incorporate lease agreements into notarial deeds.

**Poland:** if your tenant is in arrears for at least two full payment periods, you can terminate the lease agreement without observing the time limits for notice. However, the tenant should be informed in writing concerning the intention to terminate the contract by giving the tenant an additional month to pay the rent.

**Slovakia:** if the commercial tenant doesn't pay the rent for over a month,

you're entitled to terminate the lease agreement (including the agreement for definite period) through a termination notice. The statutory notice period is three months unless otherwise agreed. The parties can also agree on a withdrawal from the lease agreement under different conditions (for example, shorter delay) and with immediate effect.

**Ukraine:** under the civil code, you're entitled to terminate the lease contract if the tenant fails to pay the rent for three consecutive months. The contract is terminated from when the tenant receives the termination notice.

### Further exceptional termination rights

You can also be entitled to terminate the contract with immediate effect if the tenant breaches the lease contract substantially in other ways than non-payment (for example, severe neglect of the premises). The events that constitute a substantial breach are stipulated in the countries' civil codes. Breaches may be specifically regulated in the contractual terms. You can use the tenant's deposit to satisfy your claims and also claim damages. In the **Czech Republic**, if the contract is for a period longer than 10 years without an important reason, the court can be requested to cancel it. Such provisions are often excluded from the contract.

### General terms of termination

In most CEE countries, the terms for the termination depend on whether the contract is for a definite or indefinite period. An indefinite contract can be terminated with a notice period of between one and six months depending on the country. The termination can be for reasons stipulated in the country's civil code or in the lease contract. Where the contract is for a definite period, it can only be terminated before it expires for reasons stipulated in the lease agreement (in **Slovakia** the statutory reasons for early termination of commercial lease apply as well).

### Managing rent reviews

All six countries include a clause in commercial lease agreements that entitles you to increase or decrease the rent depending on inflation. Usually changes are settled yearly on 1 January. The model of turnover rent is widely used in the retail sector throughout the CEE region. Landlords often include additional clauses, such as obligatory store opening hours, the obligation to keep the store open throughout the year (with the exception of stock inventory, etc.) or a prohibition to open another branch of the same store within a certain radius.



# Financing the asset

**If you're considering raising a debt – either before or after purchase – lenders throughout the CEE region will expect you to meet certain criteria:**

- Before making the loan available, the bank examines your repayment ability. This includes your financial status, income, expenses and debts. The outcome of this defines their offer in terms of the optimal loan amount and the repayment schedule.
- Many properties are owned by a ring-fenced special purpose vehicle (SPV). This can provide the lender with full security, including a mortgage. The lender expects the SPV to have no other creditors and that your debt will be subordinated to their debt.
- In most cases, the lender expects to take security over the entire issued share capital of the SPV, whether it's incorporated in one of the CEE countries or offshore.
- A loan agreement is entered into between the SPV and the lender containing a number of undertakings that the SPV must comply with. These relate to how to manage the property, the rental income and the operation of the SPV.
- A lender expects to have some control over the rental income you receive so that they can ensure that it is first used to pay interest on the loan. You can provide this by granting security and signing rights to the lender for the bank account into which the income is paid. If a managing agent collects the rent, they can provide a duty of care undertaking.

**Hungary:** lenders need a special permit from the national bank for granting loans on a regular basis.

**Ukraine:** financing an acquisition by means of an SPV is uncommon.

## Securities over the asset

In all six countries, the most common security taken is a mortgage that is registered in the land/mortgage or state register. Bank guarantees or parent company guarantees are also frequently used.

**Poland:** voluntary submission to execution of the borrower provided in a notary deed which is often used as collateral as well as registered pledges on the borrower's shares and on receivables from bank accounts of the borrower and assignment of rights (under insurances or other agreements).

**Hungary:** pledges on the borrower company's shares and personal guarantees, as well as option rights on the property, are also often requested. It's common practice by creditors to request that all documents are incorporated into notarial deeds, ensuring quick enforcement in cases of default.

**Slovakia:** pledges on the borrower company's shares as well as other registered pledges are used as collateral, along with notarial deeds.

## Co-investment models

Some investors seek risk-sharing on their investments in major acquisition

or development projects. This most often takes the form of various corporate structures. This includes where the cooperation setup of the investors is reflected in a separate joint venture agreement or via a shareholding structure in a specially established entity. In Ukraine, joint ventures aren't commonly used, however we expect some new developments with regard to new legislation devoted to Concession and public-private partnership that become effective at the beginning of 2020.

Other forms of risk-sharing include a requirement for additional equity, a set of guarantees or warranties and mezzanine financing. The latter is uncommon and, with the exception of Hungary and Poland, is still finding its way on the CEE market. It allows another lender on the corporate level to provide financing alongside the bank (which is the senior lender). The subordinated position of the mezzanine lender is often transformed into the postponement of the debt service, second ranking or limited security and the necessity of an intercreditor agreement. Mezzanine financing is often used in large complex structure deals and requires thorough legal and financial analysis.

## Development finance

The lender's requirements for development finance are basically the same as for an acquisition facility, but a lender also expects:

- to appoint an independent project manager to verify that the development will be completed on time and on budget. And to sign off on invoices to be paid using the loan
- to approve the professional team appointed to complete the development. And for the professional team to provide collateral warranties.
- to approve any planning consents and pre-let agreements. And to sign off on any rights to light issues.
- to have an interest roll-up facility to service interest on the loan during the development phase (if relevant).
- the borrower to sign up to a number of other development-specific covenants and undertakings.

## Financial covenant

When determining whether to fund an asset, and by how much, the lender considers asset class,

tenant strength and the geography of the asset, as well as compliance by the SPV with a number of financial covenants:

- A loan-to-value covenant is the ratio of the principal amount of the loan expressed as a percentage of the value of the property.
- An interest cover covenant is the ratio between rental income received and interest due over a certain period.
- A debt service covenant (or debt service coverage ratio) serves a similar function to the interest cover covenant. It benchmarks the ability of the SPV borrower to service its debts through the income it receives from the property.

## Islamic finance

Real estate is predominantly a sharia'h compliant asset class so is a suitable form of security for structures where investors require sharia'h compliant financing.

**In Hungary**, especially the Budapest region, investors from Islamic nations are on the rise and an increase in the use of Islamic financial models is expected.



# Refurbishing the asset

**Whether you're looking to invest in a high-end residential property or a commercial property, your purchase can need extensive development, renovation or refurbishment.**

## Choosing the right contractual structure

In **Austria, the Czech Republic, Poland and Slovakia**, various standard contractual provisions are used in contracts relating to construction projects. Both parties often refer to their business terms and conditions in the contract.

With the exception of Ukraine, the application of FIDIC's forms of contracts has increased in recent years. These are used for large-scale construction projects in the **Czech Republic, Hungary, Slovakia and Poland**. For Slovakia and Poland, this is especially true of projects financed from public sources and PPP projects.

**Austria** relies on national frameworks using ÖNORM standardised terms, which set out the general contractual provisions for construction works.

Despite the application of the FIDIC framework for large-scale projects, **Hungary** doesn't generally apply

internationally recognised standard forms. The parties usually use the contractor's general terms and conditions as a starting point. These can vary greatly from contractor to contractor.

In **Ukraine**, the civil code has specific regulations for contracts relating to construction. Standard forms are used and there are also regulations relating to business practice.

When using standardised terms and conditions, you and the contractor need to individually agree on any unusual provisions, especially where they deviate from the local legal rules or from standard industry practice.

Otherwise, such an unusual provision which the other party could not reasonably expect is deemed ineffective. When using FIDIC's forms of contract, bear in mind that you

need to amend certain provisions (such as those regulating indemnification or a waiver of rights) in order to comply with the local legal system.

## Defects

CEE countries have similar statutory remedies for defects in material and/or workmanship. There are a few notable differences:

**Austria:** the warranty period is two years for moveable assets and three years for immovable property. The warranty period starts at handover. If the defects occur after one year, the burden of proof is on you, as the purchaser.

First you must give the contractor a chance to remedy the defect by requesting repair or replacement. If repair or exchange isn't feasible for commercial or technical reasons or if the contractor fails to comply, you can claim a corresponding price reduction or cancel the contract. You can claim damages up to three years after discovering the defect.

Other possibilities are compensation or taking the security deposit.

**Czech Republic:** the contractor is responsible for both latent defects and those obvious at handover. You

need to notify the contractor about the latent defects without undue delay but no later than five years after handover. Obvious defects must be notified at the handover or when risk of damage is transferred to you if it occurs later than the handover.

Under Czech statutory law, if the defect is a substantial breach of contract, you can:

- request replacement or repair of the defective item
- claim a corresponding reduction in price
- rescind the contract.

With a non-substantial breach, you can:

- request rectification of the defect
- claim a corresponding reduction in price.

Subcontractors, project architects and supervisors are jointly responsible with the contractor for defects in work they were involved in. You can demand that they remedy the defects either on their own or with the contractor. You can't exclude this in your contract with the general contractor, only through a three-party agreement.

**Hungary:** you and the contractor are mostly free to stipulate remedies for the contractor's defective performance. The exception is that you can't exclude the contractor's liability for certain serious damages (for example, defects caused deliberately or resulting in death or bodily harm). If you don't agree otherwise, statutory remedies apply, and you can:

- request repair or replacement (unless impossible or too burdensome for the other party compared to other remedies or the value of the work)
- request a proportional reduction in price
- repair or have the work repaired at the expense of the contractor
- terminate the agreement if the contractor doesn't repair or replace the work appropriately or if your interest in repair or replacement has lapsed. You aren't entitled to rescind the agreement for an unsubstantial defect.

You're obliged to notify the contractor of a defect without delay. For property and the land attached, the warranty rights expire after five years. For certain structural elements of newly built apartments and certain

other types of buildings, there is a statutory guarantee of three, five, or 10 years (depending on the element). You can also seek damages for breaches of contract. It's common practice to stipulate high penalty payment obligations on the contractor for defective performance.

**Poland:** where the contractor bears the liability, you can:

- pursue a claim for remedy of the defect
- demand a decrease in the remuneration agreed
- rescind the contract. You can only do this where the defect is significant.

You can decide which of the statutory entitlements to implement. The contractor is liable if you discover the defect within five years of handover.

**Slovakia:** Slovakia is identical to the Czech Republic in regulation of the contractor's responsibility for defects.

The contractor is responsible for defects which exist at the handover and for defects which occur after the handover in connection with the breach of the contractor's obligation. The statutory period of five years for claiming defects applies unless a

specific warranty period is agreed in writing. Subcontractors, project architects and supervisors are not jointly responsible.

**Ukraine:** the contractor is responsible for any latent defect discovered within a 10 year statutory warranty period. Once the contractor has been notified, they must fix the defect as agreed in the contract. Alternatively, you can fix the defect and are entitled to recoup the costs from the contractor. The contractor is responsible for all works performed by the subcontractors. A project architect or a supervisor is involved on the basis of separate contracts. So while either may be liable for defects, liability doesn't pass to other parties.

### Insurance

Insurance is critical for protecting you against liabilities to the public and resulting from issues that could arise during development. You or the contractor need to consider:

- an all-risk insurance covering any damage or loss of plant, building or construction and any component or materials

- a general liability insurance covering damage to property and health, especially caused by operating activities or defective product. This could be incurred in connection with the services provided, the ownership of real estate or the employees.

These models of insurance are common throughout the CEE region.

### Permissions and approvals for refurbishment works

Whether permission or approval is required depends on the extent of the refurbishment works. Small refurbishment works don't usually require a building permit. Larger adjustments (for example, where it could impact municipal zoning or heritage protected areas) sometimes need a permit, and may even be subject to an Environmental Impact Assessment (EIA).

In **Austria**, whether you require permissions and approvals also depends on the nature and extent of the works. With the construction of new buildings, additions and conversions (also changes in construction of the building that

affect strength, fire protection, hygiene, safety or neighbouring rights) you require a permit from the building authority. For smaller buildings, a written construction notice must be given to the municipality if the refurbishment involves the installation of fences or heating systems.

In all the CEE countries, if the refurbishment leads to a change of use, the local building authority must be notified, and a new approval or permit issued.

### Sustainable development

None of the CEE countries have a legal framework stipulating that sustainable developments are more likely to get planning permission. But in practice environmentally friendly development projects have good prospects of receiving a positive EIA (a prerequisite for the issue of a planning permit)..

### Managing disputes

Over recent years, there's been an increase in additional provisions on alternative dispute resolution methods. With the exception of Ukraine, alternative dispute resolution methods are commonly used throughout the CEE region. With ordinary court proceedings it can be

a long time before a final and effective judgment is delivered. This can hold up project completion considerably. For this reason, the contract normally includes an arbitration clause where, if you are unable to reach an amicable settlement, the dispute is referred to the Arbitration Court. In **Austria**, it's a good idea to appoint an expert arbitrator for technical issues. The Arbitration Court decision is usually delivered quickly, which makes alternative dispute resolution methods attractive, even though the costs can be higher than for ordinary court proceedings. Arbitration Court proceedings aren't open to the public, which is another reason for including the clause.

In **Ukraine** alternative dispute resolutions are uncommon.

### How to structure an acquisition

There are several ways to invest in real estate in the CEE region. It can be done:

- directly by an individual
- indirectly via a domestic corporation
- indirectly via a foreign corporation.

The corporations can either be single corporations or holding companies that are shareholders of one or more subsidiaries.

In some CEE countries, the acquisition of certain real estate is subject to limitations (for example, agricultural land). And in some countries (for example, Hungary), corporations or citizens not based in the EU or EEA have to obtain a permit from the government office. The permit can be refused if the acquisition is believed to violate public interest.

Managing liability and tax efficiency are core issues. You must ensure that you have established appropriate domestic and/or foreign corporate structures. These arrangements are bespoke and it's important get professional advice on the right structure for your situation.

### How does the tax regime impact the real estate transaction?

Tax liability varies from country to country.

**Austria:** both contracting parties are liable for land transfer tax, which amounts to 3.5% of the price in the case of an asset deal. However, the obligation is usually transferred to the purchaser. A real estate income tax

rate of 30% is generally applied to sales of property by private individuals. Property sales by corporations are taxed at a normal corporate income rate and are not subject to a separate income tax.

Separately, there is a land registry fee amounting to 1.1 % of the purchase price.

Purchases of property via share deal are more cost-effective as a rule, since the transfer tax rate is lower (0.5%, in certain cases altogether avoidable) and no land registry fee is due.

The best structure of any transaction should be determined in each individual case.

**Czech Republic:** the tax on acquisition of real estate is no longer in place since 2020. However, the seller that is also a VAT payer must pay the VAT (21 %) on sale of the real estate if statutory conditions are fulfilled (generally if it was built or reconstructed within the last 5 years or if the land plot is intended for construction). Income tax on the profit from the sale of real estate is paid by the seller.

**Hungary:** the transfer of real estate that is not newly built is exempt from VAT. However, if certain conditions are

met, the seller can decide to pay VAT in order to deduct costs. For newly built buildings the VAT payment is 27%. Subject to further conditions, newly built residential apartments are subject to a beneficial 5% VAT payment obligation.

As purchaser, you pay the 4% 'duty on quid pro quo transfer of property', unless certain exempting circumstances apply (for example, transfer of real estate between related undertakings if the purchaser acquired 50% of its turnover from letting or selling real property, or transfer of land provided that you undertake to construct an apartment building on it within four years). You and the seller are free to agree that the seller assumes this cost (this agreement is only effective between the parties and not the tax authority).

As purchaser, you pay the 4% 'duty on quid pro quo transfer of property', unless certain exempting circumstances apply (for example, transfer of real estate between related undertakings, or transfer of land provided that you undertake to construct an apartment building on it within four years). You and the seller are free to agree that the seller assumes this cost (this agreement is only effective between the parties and not the tax authority).

**Poland:** Generally, the sale of residential buildings is taxed at the rate of 8% VAT (applicable to buildings whose usable area does not exceed 300 sqm), and commercial buildings at 23% VAT. However, there are the statutory VAT exemptions that apply to all types of buildings (i.e. both residential and commercial).

**Slovakia:** there's no separate tax duty for real estate acquisitions. Certain transfers are exempted from VAT.

**Ukraine:** the seller is responsible for paying the tax.

### Tax and non-residential and offshore investors

There are no tax exemption regulations for non-residential or offshore investors throughout the CEE region. There may be certain non-residential property investments (for example, in Hungary) where special domestic legislation applies.

**Austria:** there are special regulations where the transaction involves public fund vehicles. And certain restrictions can apply to non-EEA investors, who can only acquire real estate on certain social and economic grounds.



**With the exception of Ukraine, alternative dispute resolution methods are commonly used throughout the CEE region.**



# The purchasing process

The transaction procedure only differs slightly throughout the CEE region.

## Letter of intent

Initially, you and the seller enter into a letter of intent subject to due diligence. This includes:

- the purchase price
- details of the property
- a timetable for due diligence and executing the purchase agreement
- regulations on exclusivity
- regulations on nondisclosure.

Apart from the regulations on exclusivity and nondisclosure and a related penalty for violation, the letter of intent is not binding. A purchase agreement must be notarised to be binding (in Hungary, attorneys are also entitled to countersign purchase agreements which eliminates the need for a notarial deed). If the parties don't include all commercial terms in the notarised deed, it's invalid and the transaction fails.

Instead of a letter of intent, you and the seller can agree on a memorandum of understanding which is similar in content, but binding. This is only common in **Poland**

## Due diligence

Following the signing of the letter of intent, you carry out a legal and a technical due diligence, which can include environmental issues. You can also arrange for a detailed commercial and financial due diligence. The legal due diligence covers:

- the real property (land register status, previous real estate purchase agreements, construction agreements)
- public law (building permits and zoning, public easements, environmental matters)
- lease agreements.

The seller has to answer any questions that arise.

## Purchase agreement

During the due diligence phase, an initial draft of the purchase agreement is produced – ideally by your lawyers, who can reflect on their findings from the due diligence. Once initial mark-ups of the draft purchase agreement are exchanged, you and

the seller enter into negotiations and redrafting. Both parties notarise the purchase agreement. **In Poland and Slovakia**, it's also common to execute a preliminary purchase agreement where certain conditions must be met before the purchase.

## Key regulations relating to the deed:

- **Requirements for due date of the purchase price:** certain conditions must be met before the notary confirms that the purchase price is due and payable. Among others, the city in which the property is located must waive its pre-emption right, and land charges securing the seller's loan must be deleted. As a purchaser, you ask for a priority notice of conveyance, which must be registered before the notary's payment notice. In Hungary, the notary usually plays no role in the process: the purchaser usually pays 10% of the purchase price as an earnest money on the day of or shortly after signing (usually to a deposit account held by the purchaser's attorney), and the parties request the land registry to make an entry

on the title sheet of the property about the sale. The payment of the remaining purchase price is scheduled within a short deadline of the fulfilment of the conditions precedent (e.g. waiver of pre-emption rights).

■ **Priority notice of conveyance:**

since the seller theoretically could sell the property more than once, you need to secure it with a priority notice. This is registered in the land register to demonstrate that the property has been sold. On payment of the purchase price, the notary arranges for the transfer of ownership, which will only take place if the purchaser is registered as the owner of the property. For the period between the signing of the purchase deed and registration of the new owner, the priority notice secures the purchaser's legal position as a future owner. It's deleted once the purchaser becomes the registered owner.

■ **Encumbrance authorisation:**

you can only pay the purchase price if financing is in place. The bank requires a security by way of a land charge, which is also registered in the land register. Since you're not yet the registered owner when you pay the purchase price, you must get the seller's consent in order to arrange for the land charge. The seller has to authorise your bank to register a land charge.

■ **Warranties, guarantees and obligations:** subject to the findings of the due diligence and the parties' market strength, you can agree on a catalogue of representations and warranties. If an issue is important, it might even become a payment condition.

### Transfer date

On full payment of the purchase price, all risks and benefits (costs and rent) pass to you. This is the crucial date. To ensure the full payment of the purchase price, real estate transactions in **Hungary and Slovakia** often involve escrow structures. In **Slovakia**, risks and benefits pass to the purchaser by the ownership acquisition, handover of the real property or any other date agreed by the parties (this can be the full payment date).

### Transfer of ownership

Transfer of ownership takes place when you are registered in the land register as the new owner. In **Poland**, the execution of the final purchase agreement transfers the right of ownership to the new purchaser. Where the right of public ground lease is being transferred, the entry into the land and mortgage register is required for it to be effective.

### Post-closing

Once the purchase price is paid, you enter the post-closing phase. At this stage (at the latest) you must arrange insurance, asset management, property management and related reporting. In practice, this happens before completion to meet the bank's requirements.



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