

HOW TO OPTIMIZE OFFICE REAL ESTATE FOR END- USERS' BUSINESS NEEDS

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Current Office Market Trends

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Praedium ONCOR International

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February 9th, 2012

Office Premises Breakdown by Classes, Moscow



Class A
22%



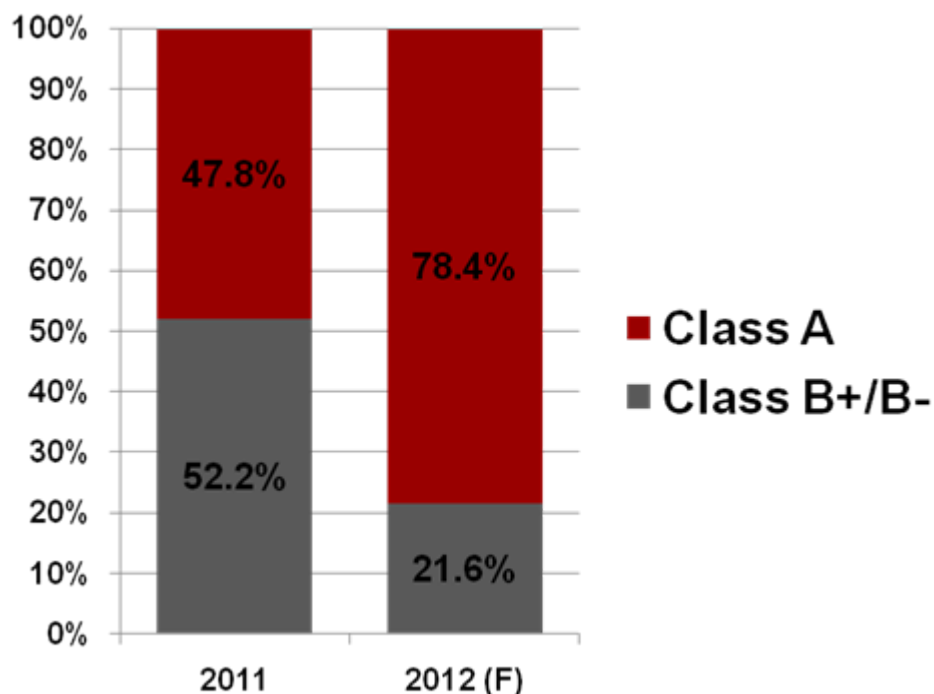
Class B+
54%



Class B-
24%



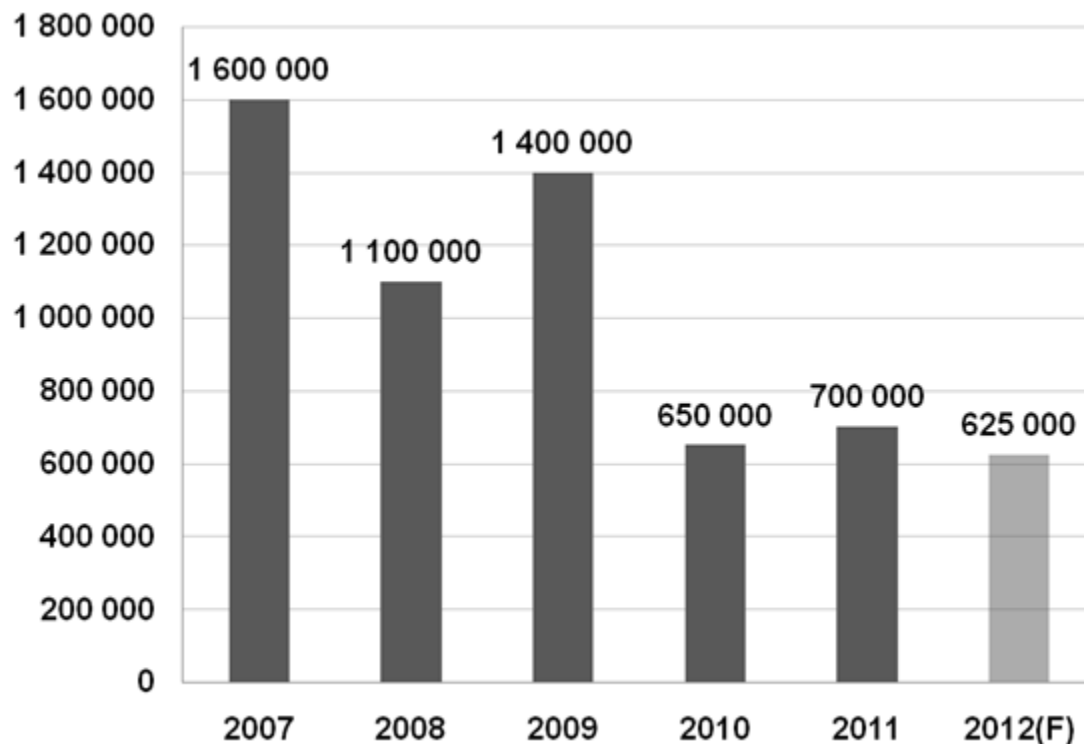
New Office Properties Commissioned in 2011 and Planned for Commissioning in 2012



Commissioned in 2011 – **700 000 sq.m**

Planned for Commissioning in 2012 – **625 000 sq.m**

New Construction Volume Dynamics, sq.m



Current Office Market Trends

Major Office Properties Commissioned in 2011

The Association of European Businesses



Imperia Tower

Total Area: **310,210 sq.m**

Leasable Area: **70,110 sq.m**

Vacancy Rate: **>50%**



Vivaldi Plaza

Total Area: **109,485 sq.m**

Leasable Area: **66,634 sq.m**

Vacancy Rate: **73%**



Olympia Park

Total Area: **71,500 sq.m**

Leasable Area: **45,019 sq.m**

Vacancy Rate: **4%**



Linkor

Total Area: **63,000 sq.m**

Leasable Area: **34,000 sq.m**

Vacancy Rate: **27%**



Diamond Hall

Total Area: **61,500 sq.m**

Leasable Area: **38,000 sq.m**

Vacancy Rate: **52%**

Current Office Market Trends

Major Office Properties to be Commissioned in 2012-2013

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Alcon

Total Area: **102,177 sq.m**

Leasable Area: **66,776 sq.m**



Mercury City Tower

Total Area: **158,528 sq.m**

Leasable Area: **86,000 sq.m**



Sky Light

Total Area: **111,240 sq.m**

Leasable Area: **77,500 sq.m**



Lighthouse

Total Area: **41,270 sq.m**

Leasable Area: **23,500 sq.m**



White Gardens

Total Area: **105,000 sq.m**

Leasable Area: **62,300 sq.m**

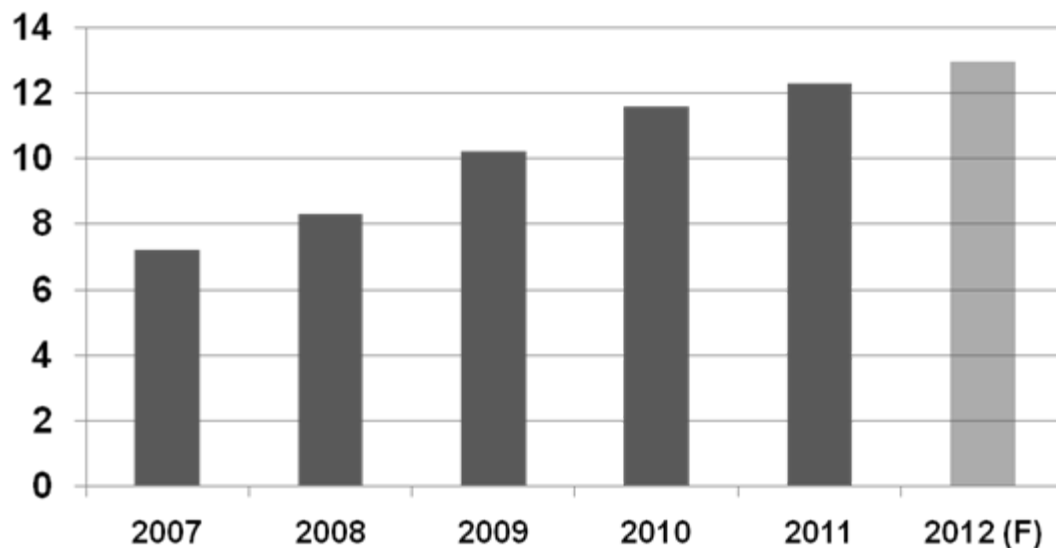


Aquamarine III

Total Area: **75,500 sq.m**

Leasable Area: **33,000 sq.m**

Total Office Supply Dynamics, mln sq.m



As of the end of 2011

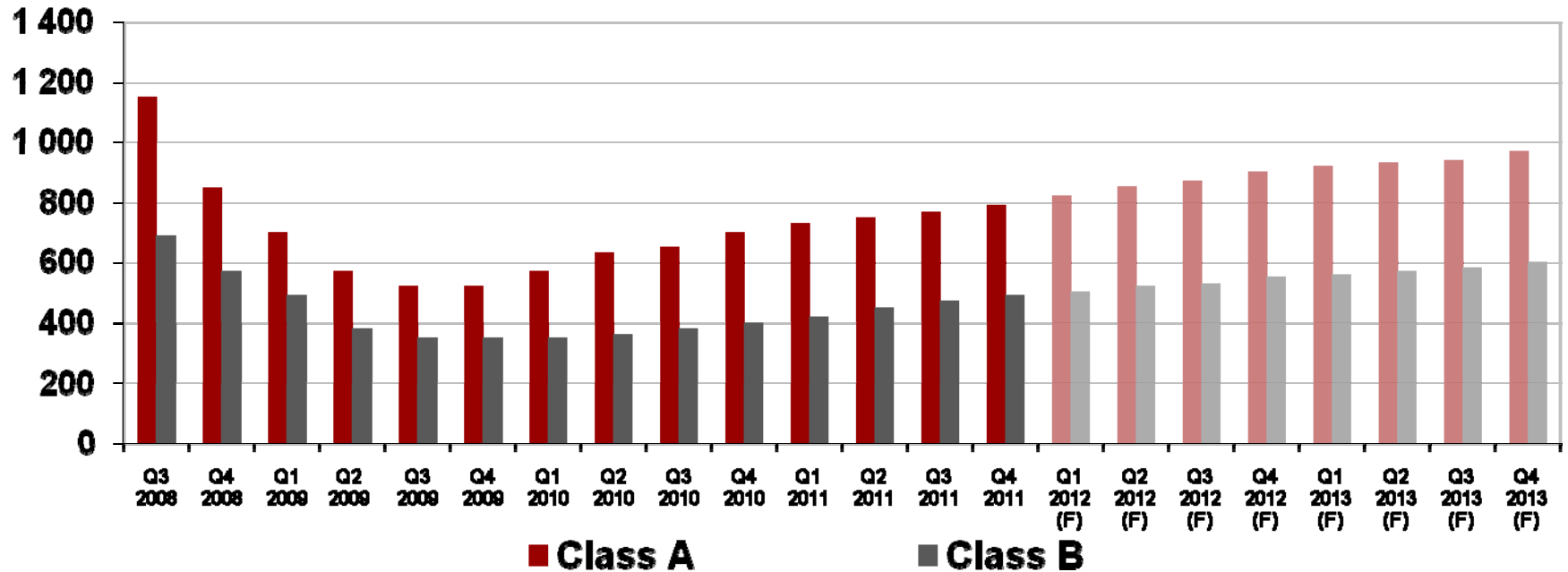
Total supply - **12.3 mln sq.m**

Forecast for 2012

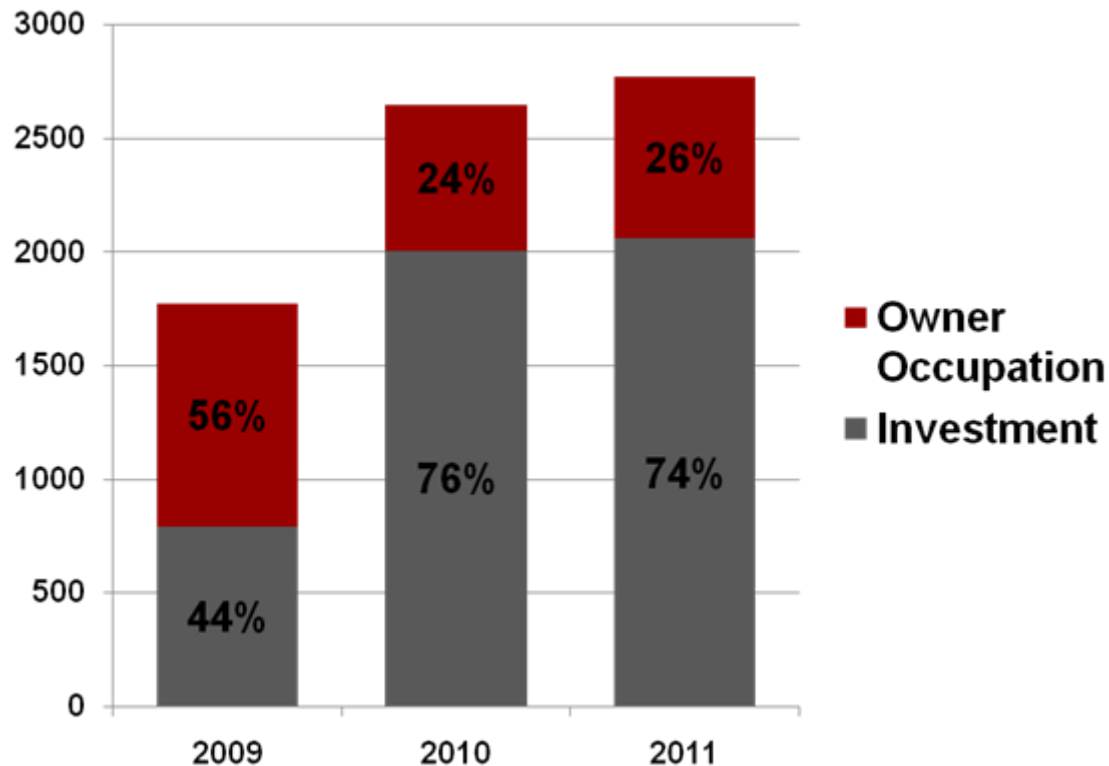
Total supply – **12.9 mln sq.m**



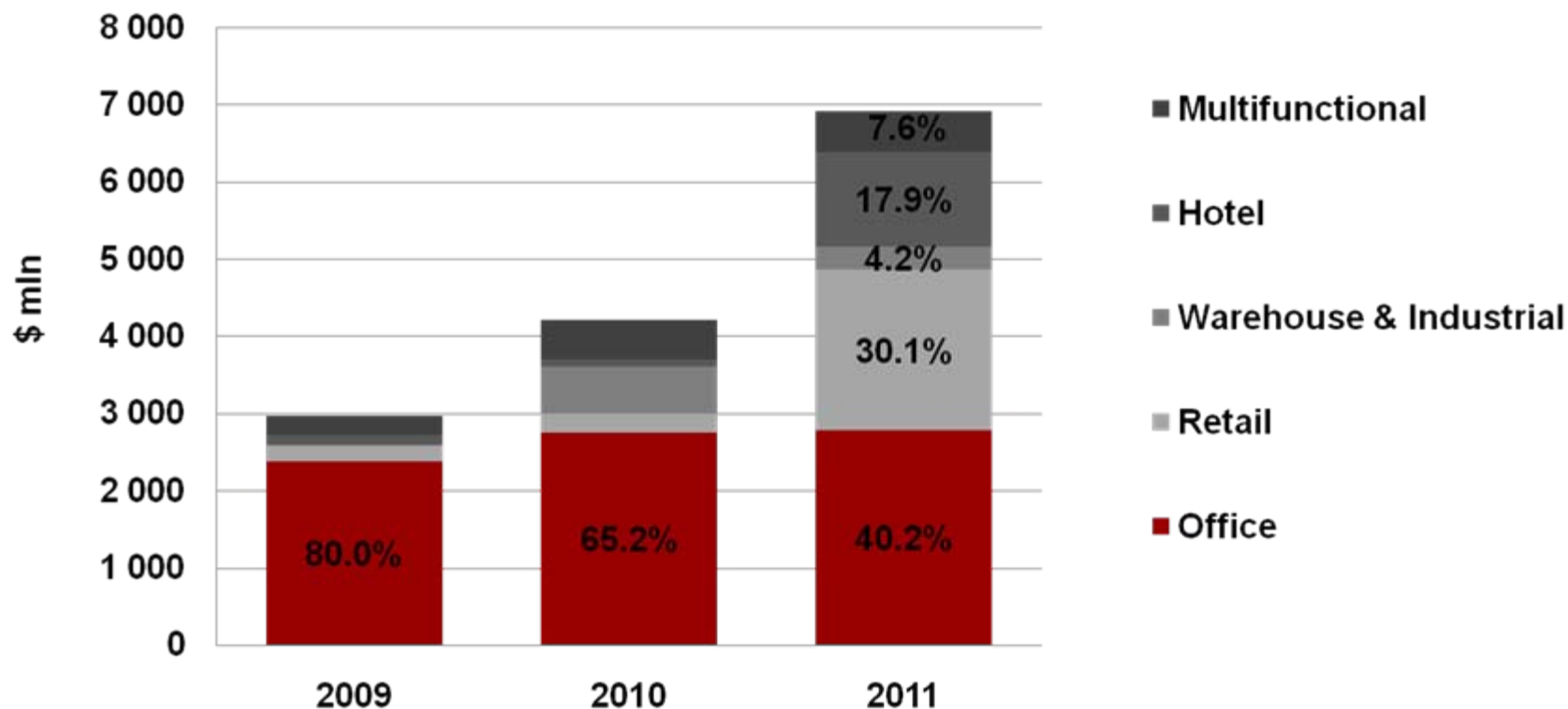
Average Base Rental Rates Dynamics, \$/sq.m per year



Office Investment Volume by Transaction Type, mln sq.m



Investment Volume Breakdown by Segments, 2009-2011



Q & A

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HOW TO OPTIMIZE OFFICE REAL ESTATE FOR END-USERS' BUSINESS NEEDS

Legal aspects of real estate ownership/rent for end-users

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Moscow, 9 February 2012

Kamil Karibov, Ph.D, Partner
BEITEN BURKHARDT Moscow

www.aebrus.ru

Content

➤ **Recent changes in the legal environment:**

- Simplification of permission procedures
- New building operating procedures and liability of building owners
- New positions of the RF Supreme Arbitration Court ("RF SAC") on real estate acquisition issues

➤ **Practical issues of real estate lease agreements**

- Preliminary lease agreement
- Lease agreement

Recent changes in the legal environment

Simplification of permission procedures

- Federal Law No. 169-FZ dated 1 July 2011
- An agency offering public services does not have the right to demand documents and information from applicants that are in the possession of this agency or any other public agency
- These rules are applicable, *inter alia*, to the receipt of construction permits, commissioning and cadastral registration of real estate assets, and state registration of rights to real estate assets
- These rules enter into effect for federal agencies from **1 October 2011**, and for agencies of the constituent subjects of the Russian Federation and municipalities – from **1 July 2012**

Simplification of permission procedures

- Federal Laws No. 215-FZ, No. 224-FZ and No. 243-FZ dated 18 July 2011
- Legislative **differentiation of reconstruction and capital repair** of buildings
- Exclusion of capital repair from the scope of the following permission procedures:
 - expert assessment of design documentation
 - receipt of a construction permit
 - state construction supervision
 - receipt of a commissioning certificate

New building operating procedures

- Federal Law No. 337-FZ dated 28 November 2011
- **From 1 January 2013** – Introduction of **mandatory requirements and procedures** on the operation of buildings and facilities
- **By 1 January 2013** – Development by building owners of **rules of safe operation** of buildings and facilities
- **From 1 July 2013** – Introduction of **new rules on the liability of the owners** of buildings and facilities for damage caused to third parties

New building operating procedures

➤ Mandatory procedures:

- operating inspection
- technical maintenance
- routine repairs

➤ Persons responsible for the operation of buildings:

- the building owner
- legal holders (tenants), if responsibility for operation has been placed upon them by the agreement
- service providers contracted by the owner or a legal holder to ensure the safe operation of the building

➤ The persons responsible for the operation of a building should keep a **building operations logbook**

New rules on the liability of building owners

- **A building owner is responsible for the damage** caused to third parties
- Liability = reimbursement of damage (based on the general norms of the RF Civil Code) + payment of **fixed compensation over and above the reimbursement of damage** (from 1 to 3 million rubles, depending on the severity of the consequences)
- **The owner has the right of regress** against the parties performing the design, construction, expert assessment of the design documentation and state supervision over construction (**joint and several liability!**), as well as against the party performing maintenance and/or building servicing work under agreement during the period of operation of the building
- If the owner's liability is insured, it will only be liable for damage to the extent that it is not covered by the insurance

New positions of the RF SAC on real estate sale and purchase issues

- Resolution No. 54 of the Plenary Session of the RF SAC dated 11 July 2011
- The parties are entitled to conclude a **sale-purchase agreement on future property** (article 455 of the RF Civil Code)
- Unless otherwise established, any agreement involving investment activity aimed at financing construction must be considered a sale-purchase agreement on future property by the courts
- If a preliminary agreement establishes the obligation of the buyer to pay a **significant part of the price** of the real estate prior to the conclusion of a master agreement, this preliminary agreement is a sale-purchase agreement on future property with a prepayment clause

Practical issues of real estate lease agreements

Preliminary lease agreement ("PLA")

Who can act as the future landlord under the PLA?

- **Legal position 1** – only the owner of the real estate
- **Legal position 2 (correct)** – the PLA is valid even if the future landlord is not the owner of the real estate at the time of its conclusion
 - *Resolution No. 402/09 of the Presidium of the RF SAC dated 14 July 2009*

Procedure for effective conclusion

- Simple written form
- The PLA does not require state registration
 - *Informational Letter No. 59 of the RF SAC dated 16 February 2001, clause 14*

How should the lease object be correctly described in the agreement?

- If the **real estate asset exists** as titled property
 - the cadastral number of the real estate asset
 - the cadastral passport
 - the floor plan

- If the **real estate asset does not exist** as titled property
 - the approximate area of the building/premises
 - the address of the building
 - the floor plan, based on the design documentation
 - a reference to the permits and title documents (construction permit, land plot lease agreement, investment contract)
 - recognition by the parties through the execution of the agreement

Term of the PLA

- **Legal term – 1 year** from the time of conclusion of the agreement. Time of conclusion of the PLA = the time when it is signed by both parties
- General rules of the RF Civil Code on determining the term
 - Indication of the calendar date
 - Timeframe (day, month, quarter, year)
 - An impending event
- Term or condition precedent?
 - If the agreement makes the appearance, amendment or termination of civil rights and obligations dependent on an event which may or may not occur, this is clearly an indication of a condition precedent

Payments under the PLA

- No lease payments under the PLA
- No advance payments
- How should certain payments under the PLA be assessed (for access, for use, etc.)?

Providing security under the PLA

- No earnest payment ("zadatok") under the PLA
 - Resolution No. 13331/09 of the Presidium of the RF SAC dated 19 January 2010
- Security deposit
- Forfeit
 - Restriction on the court's right to reduce at its own discretion the size of the penalties, etc. Resolution No. 81 of the Plenary Session of the RF SAC dated 22 December 2010

Factual use/improvements

- The PLA **does not create the legal grounds for use of the real estate** and/or making improvements for the future tenant
- The PLA **does not confer rights of owners' protection**
 - The future tenant does not have the right to file a negatory or vindicatory action against third parties or against the building owner
- The interests of the parties to the PLA in connection with the factual use of the areas can be protected based on the norms on **unjust enrichment**
 - In case of factual use, the building owner is entitled to demand payment for use as unjust savings
 - The factual user is entitled to demand reimbursement of the cost of any inseparable improvements from the building owner as unjust enrichment (if they have not been reimbursed by the building owner)

Execution of the PLA

- The PLA is a binding agreement. A claim to force an evading party to enter into the lease agreement (Article 445 of the RF Civil Code)
- Not always easily enforceable
- Impossible to file a claim to make a master lease agreement be "considered to have been signed"

Practical issues of real estate lease agreements

Lease agreement ("LA")

Mandatory requirements on LA

- **Form of the agreement** – simple written form. If the form is not observed, the agreement is deemed null and void
- **Material terms and conditions** - 1) the subject of the lease, 2) lease payment
- **State registration** – in respect of lease agreements for a term of 1 year or more. If there is no registration, the agreement is deemed not to have been concluded

Transfer of the subject of the lease

- **Transfer Deed/Act on the return of the subject of the lease**
 - Presumption of the actual transfer of the real estate (unless proved otherwise)
 - Documentation of shortcomings in the subject of the lease

Third party rights to the subject of the lease

- "Concealment from the tenant of information about the encumbrance (pledge) of a leased property may not be qualified as deceit thereof, entailing the invalidation of the transaction" (*Ruling No. BAC-6255/09 of the RF Supreme Arbitration Court dated 19 May 2009*)
- If the tenant was not warned about the encumbrances, it is entitled to demand a reduction in the lease payment or termination of the agreement

Lease payment

- Change in the lease payment no more frequently than once a year (Article 614 (Clause 3) of the RF Civil Code)
- Determination of the lease payment
 - in a fixed amount
 - for each payment term
- Mechanism for determining the lease payment or change in the lease payment?
 - The term of the agreement establishing the fixed amount of the lease payment or procedure (mechanism) for its calculation should remain unchanged throughout the year (*Resolution No. 66 of the Plenary Session of the RF Supreme Arbitration Court dated 11 January 2002, Clause 11*)
 - Indexation of the lease payment or corresponding adjustment in line with a currency peg does not constitute a change in the lease payment
 - The norm of Clause 3, Article 614 of the RF Civil Code according to the implication of law enforcement practice does not contravene the Constitution of the Russian Federation (*Ruling No. 1313-O-O of the RF Constitutional Court dated 29 November 2011*)

Termination of the tenant's access to the premises

- Legitimacy and adequacy of such a measure?
- If such a measure is stipulated in the agreement, the procedure for its application should be defined precisely. Otherwise, the tenant is entitled to terminate the agreement and demand compensation for losses

Return of the premises

- Transfer Deed
- If the tenant has departed the premises, this does not attest to the fact that the lease agreement has ceased to have effect



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Tax Aspects of Real Estate Ownership/Rent for End Users

Svetlana Zobnina, Ernst & Young

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Structuring rent relationships

- Pre-lease agreements – to take care
- Short-term lease agreements – do they still make sense?
- Rent free period – may create taxable event?
- Old songs (VAT & security deposit, structure of rent fee) – still relevant?

Fit out of premises

- Classification for tax and accounting purposes – who can help?
- Tax depreciation options – to think about
- Pre-lease and short term lease agreements – watch out! men at work

Multiple entities

- Sharing premises between multiple group entities – how to structure?



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TOP 5 TAX CASES IN 2011

How they are relevant for future tax planning

Andrey Shpak, Goltsblat BLP

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1. *Plenary Resolution No 54* (Rights for Future Things)

Investment agreement – by default is a sale and purchase agreement of a future thing (building / asset).

- The organizers (*zastroyshiki*) have and had to pay VAT on the full price of the property built
- The investment payments are considered advances and have and had to be taxed on the receipt
- The investors (as purchasers) have and had to credit VAT not under the compound (*svodny*) VAT invoice but VAT invoices for advances and the subsequent transfer of the title

Makes use of investment agreements more complicated. Casts doubt on the historical VAT treatment and required primary documents for assets constructed under investment agreements.

Plenary Resolution of the Supreme Arbitrazh Court (SAC) No 54 dated 11 July 2011

2. *Lobanova / Malkhasyan*

Due care in dealing with counterparties is recognised if the taxpayer at least checked:

- That the counter party actually existed (including verification of the validity of the tax ID number to the official information in EGRUL register);
- The personality of the counter party's signatory;
- The authority of the signatory to sign;

Provides additional guidance when defending against allegations in colluding to evade taxes if a hired contractor failed to properly pay taxes. Complicates the defense for good faith taxpayers.

SAC Resolutions Nos 10095/11 and 10096/11 dated 20 October 2011, 17649/10 dated 31 May 2011, and 17648/10 dated 19 April 2011

09 February 2012

3. *Tulatsement*

The fact that a 3rd party benefits from an operation is no reason to deprive the taxpayer of the VAT credits (in this case: a public road got repaired at the expense of the taxpayer).

Provides additional defense against challenge of recovery of input VAT /deduction of leasehold improvements-related expense on the basis of “free-of-charge transfer to another party” argument

SAC Resolution No 3844/11 dated 25 October 2011

4. *Severny Kuzbass*

Non-discrimination clauses in a double tax treaty do not prevent application of the Russian thin cap rules (“all companies with foreign participation are treated in the same way”).

Subsequently used as a basis for also denying protection under full interest deduction clause in the Protocol to the Netherlands-Russia double tax treaty.

Severely reduces tax-efficiency of financing real estate construction or acquisition by Russian entities with debt from affiliated entities.

SAC Resolution No 8654/11 dated 15 November 2011, and SAC Ruling No 17705 dated 13 January 2012

5. *Transneft-Service*

Denying refund of a part of the VAT claimed is no reason to postpone the refund of the part not challenged – taxpayers are entitled to interest if it so happens.

Check whether the tax authority owes you any interest in case they denied recovery of part of your construction-related input VAT.

SAC Resolution No 14883/10 dated 12 April 2011

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