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20 questions for real estate investors

The Czech Republic

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Part A

Parties and Interests

1. Parties – Who can own real estate?

Any legal “person” may own real estate. This definition will include individuals, companies, entities established by statute, (e.g. associations of individuals and/or legal entities, associations accumulating property for a given purpose, units of local self-government / self-administration) plus the Czech State itself.

Bodies that are not legal persons, such as unincorporated associations, cannot own real estate directly. Potential owners of commercial real estate include: private developers, insurance companies, banks and other financial institutions, private or public property companies, the Czech State and local authorities.

There are a number of legal restrictions preventing foreign nationals from acquiring real estate in the Czech Republic, and despite EU accession, pre-accession restrictions still apply to individuals who are neither Czech citizens nor have official residency status in the Czech Republic. However, a foreign national may acquire real estate in certain limited circumstances, including via the unapportioned co-ownership of a married couple where one spouse is a non-resident, by the exchange of real estate or by acquiring property from a spouse, parent or grandparent by inheritance. In order to avoid restrictions in respect of direct ownership of real estate by foreign nationals, acquisitions through a Czech-based company (LLC or similar) is often used.

Individuals who are citizens of EU member states may acquire all types of real estate in the Czech Republic; for acquisition of some of them they must satisfy certain conditions.

Agricultural land and forestry land may only be acquired by EU citizens who are registered as entrepreneurs in agriculture and they have permanently resided in the Czech Republic for more than 3 years. Further, in case of acquisition of other property, including residential property, EU citizens must obtain an occupancy residency permit for EU citizens issued by the Czech Foreign Police.

Citizens of Norway, Island, Liechtenstein and USA may acquire real estate in the Czech Republic under the same conditions as the EU citizens provided that they obtain a temporary residence permit or visa for a period no longer than 90 days.

Foreign companies cannot directly own real estate in the Czech Republic. There are, however, two ways in which such companies may indirectly acquire real estate. The first route is to acquire real estate through a company vehicle established and registered in the Czech Republic.

The second is to acquire real estate through a foreign company that has a branch located and registered in the Czech Republic, or through one which locates its enterprise in the Czech Republic and is allowed to carry on business in the Czech Republic.

Foreign companies are not permitted to directly acquire forestry land or land forming part of the Agricultural Land Fund, as managed by the Land Office.

2. Property – What property interests are currently sold?

Czech law recognises several forms of interest in property. These include:

- Ownership
- Rights of possession and
- Limited property rights - e.g. mortgages, easements, pledges and contractual rights, such as leases.

However, current practice dictates that only ownership interests are sold. The assignment of rights and transfer of obligations under occupational leases is relatively rare with subletting being favoured.

Much commercial property is sold by way of a share rather than an asset sale, where the real estate is owned by a special purpose vehicle and the shares in it sold. In general such sales are used to avoid real estate transfer tax and the risk of termination of some of occupational leases by tenants after a transfer.

A person who treats property as his own or exercises such right for himself is deemed to be the possessor of the property in question. If a person, taking into account all the circumstances, possesses the real property in good faith for a 10 year period, he might acquire ownership of the real estate by virtue of adverse possession (“usucapio”).

As in some other civil law jurisdictions, leases under Czech law do not create a property interest, but merely create a contractual right to use property. Rights created under leases are not registrable at the Cadastral Registry. The period for which a lease can be entered into is not limited by law, and depends on the agreement of the parties.

Generally, there are two types of leases recognised under Czech law:

- Leases of property in general, regulated by the Civil Code
- Leases of non-residential premises, regulated by Act No. 116/1990 Coll. on the Lease and Sublease of Non-Residential Premises (as amended) (Act on Leases) and by the Civil Code and the Commercial Code.

In practice the Act on Leases governs only leases of non-residential (i.e. commercial) premises where only part of a building is leased, such as multi-let office buildings, shopping centres and the like, and not to a letting of a whole building or land. The Civil Code, on the other hand, applies to leases in general.

It should be noted that in case of leases governed by the Civil Code the Civil Code stipulates explicitly that on a change of the owner of real estate, a tenant is entitled to terminate its lease agreement. This much criticized provision unreasonably favouring the tenant is, however, applicable for non-residential only if expressly agreed by the parties.

3. Ownership – What types of ownership are there?

Ownership is the highest title a legal person can hold in relation to property under Czech law. Ownership of real estate can be equated to freehold title under Anglo-American legal systems.

Most of the real estate in the Czech Republic is subject to registration at the Cadastral Registry. All land and most developments must be registered.

Ownership is freely transferable. Agreements on the transfer of ownership title must be entered in the Cadastral Registry. Ownership title passes upon execution of the decision of the Cadastral Registry but the decision takes effect retrospectively from the date on which the application to register the transfer was filed.

Ownership may also be acquired via possession. For this to occur, the property must be in the possession of a so-called "rightful possessor" who believes in good faith that the property belongs to him for an uninterrupted period of 10 years.

It should be noted that under Czech law the owner of a building is not necessarily the owner of the land beneath the building, as it is possible to have separate ownership of a building and the land plot on which it is constructed. Care must be taken to establish whether ownership of a property has been split in this manner.

Czech law distinguishes between exclusive ownership and co-ownership of land and buildings. This means that a condominium style ownership is permitted where, for example, a person may be exclusive owner of a part (unit) of a building and co-owner with other unit owners of the common areas, the structure and the land on which the building stands. Alternatively, more than one person may own the whole of a building and/or plot of land. In each case, the co-owner is said to have an "ideal" share in such common parts or the whole of the building or land plot.

4. **Matters burdening or benefiting real estate – What matters can affect real estate?**

Common matters affecting real estate include:

Matter	Effect	Example
Easements	<p>Under Czech law, easements can be personal (in personam) or connected with the ownership of real estate (in rem). A personal easement exists when a property is encumbered in favour of an individual legal entity. This right cannot be transferred and usually expires on the death or winding up of the entitled legal entity. Easements which are connected with the ownership of real estate are similar to Anglo-American easements, as the property is encumbered with the rights of the owner from time to time of the other property in question. This easement runs with the property when ownership is transferred.</p> <p>An easement must be entered in the Cadastral Registry to exist</p>	<p>A right of way; a right to construct a building on land in the ownership of a third party land; a right to use pipes and cables</p>
Mortgage	<p>A mortgage is established either on the basis of:</p> <ul style="list-style-type: none"> ➤ a written contract ➤ an agreement on the settlement of inheritance which has been approved by the court ➤ a decision made by the court ➤ a decision made by an administrative authority or ➤ law. <p>A mortgage established on the basis of a written contract must be entered in the Cadastral Registry to become effective, and once registered will give the mortgagee priority over unsecured creditors of the borrower</p>	<p>Mortgage securing receivables arising out of a loan agreement.</p> <p>Statutory mortgage of the Czech tax authority securing tax obligations</p>

Matter	Effect	Example
Adverse possession	Acquisition of ownership to real estate based on long term possession in good faith	Rightful possession of real estate for more than 10 years in good faith that the possessor is a rightful owner
Contractual rights	<p>Leases (see above). Contractual right to use the property.</p> <p>“Pre-emption right”, is a right of the seller to be offered purchase of the real estate in case the buyer wishes to sell the real estate to a third party in the future.</p> <p>Pre-emptive rights can be established either as in personam or in rem rights. In personam pre-emptive rights cease to exist with transfer of the real estate to the third party.</p> <p>In rem pre-emptive rights remain in place after a transfer of the property, and must be recorded in the Cadastral Registry</p>	Lease of land, buildings, residential and non-residential premises.

5. Occupation of real estate – Who may occupy real estate?

Real estate is usually occupied by one of the following categories of person:

- Owners – persons with an ownership right to the property
- Tenants – persons with a lease of the property or part of it. It is possible to create a sublease to a leased property. However, a sublease of the property is usually subject to approval of the owner of the property
- Rightful possessors – persons who have occupied the property for a prescribed period of time in good faith
- Persons benefiting from the right of easement – person who may use the property on the basis of in personam (personal) or in rem

Please also see our *CMS Lease Guide*.

6. **Brokers - What is the broker's role?**

Brokers in the Czech Republic are employed by any party to any transaction involving real estate. Their role may include any of the following tasks, namely:

- acting for a seller to find a buyer for a sale property, including marketing the property for sale
- acting for a landlord to find a tenant for a leasehold property, including marketing the property
- acting for a buyer to find a property to buy
- acting for a tenant to find a property to lease
- acting for any party to a transaction drafting and negotiating heads of terms
- valuing a client's existing and target properties
- day to day management of property owned by clients, including managing maintenance programmes and landlord and tenant work and
- project management of development of new buildings or refurbishments.

Brokers available in the market range from those employed by major international organisations to specialised advisers providing advice on a more restricted basis.

7. **Employees - What employment issues affect real estate acquisitions?**

Typical employment issues which may be relevant to real estate transactions include (i) the acquisition of real estate through the transfer of business enterprise of the company that owns real estate and (ii) the transfer of the shares of the company vehicle that owns real estate.

In the event of the transfer of a business enterprise of a company that owns real estate, rights and duties arising from employment relationships with employees of the enterprise pass from the seller to the buyer. The change in the entity of "employer" applies as a consequence of the transfer of enterprise.

In the event of the transfer of shares of the company vehicle that owns real estate, the "employer" remains unchanged and as consequence the rights and duties of "employees" remain unchanged.

In both cases above:

- accrued continuity of employment is preserved
- the buyer cannot unilaterally change the terms and conditions of employment agreements by reason of the transfer; the buyer can only agree on changes with the employee and
- elected representatives of the employees must be informed and consulted about the transfer of a business enterprise.

Redundancies may arise as a result of a dismissal of employees where there is a reduction in the number of employees required. Care should be taken to ensure that the redundancies are carried out in a procedurally fair manner.

Part B

Procedure and Terms

8. Procedure - What are the steps in a sale and purchase transaction?

Commercial real estate transactions usually start when proposed heads of terms are drafted, negotiated and agreed by the seller and the buyer. The heads of terms (or letter of intent or memorandum of understanding) set out the principal terms agreed between the parties and are generally expressed to be "subject to formal contract" and not legally binding. They form the basis of the documents to be drafted by the lawyers.

Once the heads of terms have been finalised, they are sent to the parties' lawyers. The seller's lawyers will usually collate all information relating to the property and send it to the buyer's lawyers together with a draft of an agreement to conclude a future transfer agreement (future agreement) with the form of transfer agreement attached. A future agreement is not required if there are no conditions to the purchase, in which case the parties proceed direct to the transfer agreement. The buyer's lawyers undertake thorough due diligence of all legal documents relating to the property (see section 10). If the purchase is made with borrowed finance, the lender of the finance may instruct its own lawyers to carry out due diligence on its behalf and negotiate loan and security documentation.

The seller arranges for the property to be valued by a court appointed valuer for tax purposes (as to which see below).

Once the form of future agreement and transfer agreement are agreed, the seller and buyer sign the future agreement. Once the conditions to the purchase (if any) are satisfied one party will invite the other to conclude the transfer agreement.

Before signing the future agreement and the transfer agreement, the buyer's lawyers will conduct a search at the Cadastral Registry to ensure that the seller still owns the property and that there are no new encumbrances affecting the property.

The signatures of the parties on the transfer agreement (but not the future agreement) must be verified by a notary. The future agreement and transfer agreement may be signed in English with a certified Czech translation of the transfer agreement prepared for registration purposes, although in practice it is better to also sign the Czech version of the transfer agreement for registration purposes.

Following conclusion of the transfer agreement, the lawyers need to deal with registration of the transfer documents at the Cadastral Registry and the seller needs to arrange for payment of real estate transfer tax, which is assessed on the higher of the price paid and the valuation carried out by the court appointed valuer. It is common practice for the purchase price to be paid into escrow (bank or notary) to be released partly on registration of the buyer as the exclusive owner in the Cadastral Register free from encumbrances and partly (equal to the amount of the tax) when the real estate transfer tax is paid by the seller.

9. **Other common contract terms - What other provisions does a real estate sale contract commonly contain?**

An agreement for the sale and purchase of property must be in writing, must contain all main terms and conditions as specified by the law, and must be signed by both the seller and the buyer; signatures of the parties must be notarised.

Provisions relating to value added tax will be included where relevant to ensure that the agreed tax position is preserved. Besides the essential terms of the sale and purchase agreement, such as the exact specification of the property and price, the document should also mention the following, namely:

- the title document under which the seller acquired ownership
- all liabilities burdening the property (mortgages, easements, pre-emptive rights, leases)
- the conditions of payment of the purchase price
- a date of a handover/takeover of the property
- a provision on which of the parties will pay the real estate transfer tax
- a provision on which of the parties will file the petition for the change of ownership
- the conditions on the basis of which any party will be entitled to withdraw from the agreement and
- a seller's warranty that it is a sole unrestricted owner of the property and that the real estate is and will remain in the (legal and actual) condition described in the agreements until registration of the transfer's title in the Cadastral Registry.

10. **Due Diligence - What investigations does the buyer normally make?**

General

The prudent buyer is likely to commission a survey of the building and in appropriate cases, soil and geological investigations, plant and machinery tests and environmental investigations.

There are three limbs to due diligence by the buyer's lawyers.

Firstly, title to the property will be investigated. The buyer's lawyers will consider the entries on the Cadastral Register and, where relevant, historic title documents.

By submitting details of the property to the Cadastral Registry, the buyer's lawyers will receive the relevant list of ownership for the seller and the property confirming whether the ownership right of the seller is registered. Additional details of the registered interests (easements, mortgages, pre-emptive rights) then need to be obtained from the Cadastral Registry. If the ownership list reveals a "P" (plomba) in the relevant section it means that there are pending proceedings regarding the property. More details about the pending proceedings can be found in the relevant Cadastral Registry.

Where the property is leased, or subject to other occupational interests, the terms of the relevant occupational documents (e.g. administrative permissions) need to be considered carefully to ensure they are not contrary to the buyer's intentions for the property. The buyer's lawyers will also need to check whether these documents require the consent of any third party to be given to the transaction.

Secondly, the buyer's lawyers will carry out due diligence, which will include conducting various searches to check the position regarding municipal land use plan and zoning plans, environmental matters, financial encumbrances etc. Where the seller is a company, the buyer's lawyers will also conduct corporate searches of the seller at the Companies Register to ascertain whether or not the company is registered or declared insolvent and / or bankrupt and therefore able to dispose of its assets freely, the current name and registered office of the company and who is entitled to act on behalf of the company.

Thirdly, the buyer's lawyers will raise additional enquiries of the seller's lawyers to obtain information regarding a large number of practical matters which may affect the property and ask any relevant questions in relation to the title to the property.

Pre-completion

Very shortly before completion the buyer's lawyers will also conduct searches at the Cadastral Registry for confirmation that there is no pending proceedings regarding the property and at the Companies Registry for confirmation that the seller has not been declared insolvent and / or

bankrupt. These searches should confirm that the information gained in the due diligence process remains unchanged just before execution of the transfer agreement.

Reporting to the client

Before the signing of agreements, the buyer's lawyers usually report their due diligence findings to their client, raising any matter of particular importance or concern.

11. Terms implied by law – What provisions are implied by Statute, Code or otherwise?

Some of the most significant issues are as follows:

Registration of ownership

To complete the process of the change of ownership, the transfer agreement must be filed with the Cadastral Registry. Ownership title passes upon execution of the decision of the Cadastral Registry. The decision of the Cadastral Registry has legal force as of the date upon which the application was filed to make an entry.

The principle of reliability

The "principle of reliability" of the Cadastral Registry, which is explicitly stated in law, presumes that the information registered after 1 January 1993 is correct and can be relied upon by third parties, unless the third party had knowledge that the information registered was incorrect. Notwithstanding this, there remains the possibility that the information on the Cadastral Registry may be incorrect. There is a procedure for rectifying the records kept by Cadastral Registry to comply with the actual state of affairs. Notwithstanding this principle, the State is not liable for damage caused simply as a result of an incorrect entry in the Cadastral Register. An unlawful act on the part of the Cadastral Office would need to be established and then a link between the unlawful act and the damage. The information registered in the Cadastral Register before 1 January 1993 are deemed to be correct unless proven otherwise.

Change of landlord

It should be noted that the Civil Code explicitly stipulates that on a sale of property which is subject to leases, although the new owner takes on the position of a landlord vis-à-vis the tenants, a tenant is entitled to terminate its lease agreement. Unless the parties expressly agree so, this provision is not applicable for the lease of non-residential premises under the Act on Leases (as described above).

12. Registration and Notarisation of real estate - What are the basic requirements?

The Czech Republic has a central land register, the Cadastral Registry. The Cadastral Registry is run through regional district land registries which are responsible for specific areas of the

country. The Cadastral Registry shows the legal status and details of the owners and other persons authorised in connection with the property. As the Cadastral Registry is accessible by the public, third parties are assumed to have knowledge of the contents of the records kept by the Cadastral Registry.

As mentioned above, the Cadastral Registry provides a record of who owns which property, the registrable rights benefiting or burdening the property and the title under which the seller acquired the property. The record is contained on an ownership list, which shows all property owned by a particular legal entity in a certain cadastral area.

- Part A of the list of ownership gives details of the registered owner of the property
- Part B of the list of ownership gives a description and location of the property by reference to land plots and identification numbers for buildings together with any rights benefiting the property and a note on protection of the property (for example national monument property). It should be noted that the street address of the property is not shown on the list of ownership for the property. It is sometimes difficult for lawyers to identify property and additional advice is taken from a "geodet"
- Part C of the list of ownership gives description of rights encumbering the property, such as mortgage right or easement or pre-emptive rights
- Part D of the list of ownership can contain various pieces of relevant information relating to the property
- Part E of the list of ownership refers to agreements or documents on the basis of which the ownership as well as other rights registrable in the Cadastral Registry were created.

The Cadastral Registry may also contain, where appropriate, a special note "P" (plomba), which might mean either a pending procedure concerning the property or a restriction of the owner's ability to deal with its ownership title without obtaining the consent of another party.

13. Disputes - How are they dealt with and resolved?

Agreements on acquisition and disposal of property as well as agreements on rights registrable in the Cadastral Registry must be governed by the Czech law. The parties can choose what method of dispute resolution they would prefer. Methods of dispute resolution could include court proceedings or, in case of property (asset) disputes, arbitration. The choice should be stated expressly in the contract. If not, disputes will be determined by the relevant Czech court.

Arbitration may be conducted by the Czech Arbitration Court attached to the Economic and Agricultural Chamber of the Czech Republic in Prague, or by another permanent arbitration court or by any arbitrators chosen by the parties.

Czech courts are perceived to be slow and judges in some cases inexperienced, and therefore arbitration proceedings are favoured particularly in cross-border high volume transactions.

Arbitration proceedings have the following advantages/disadvantages:

- except in certain limited circumstances, it is not possible to appeal against the arbitral award rendered at the end of the proceedings. The arbitral award is also enforceable by ordinary courts
- rapidity and considerably fewer formalities and
- possibility to appoint a selected arbitrator/specialist to decide on complicated/technical matters
- wide scope of enforceability of arbitration awards all over the world. In accordance with the relevant multilateral international conventions it is possible to enforce an arbitral award rendered in the Czech Republic in more than 120 countries world-wide.

When choosing the method of resolving disputes, the parties will have regard to various issues, including the following:

- The domicile/nationality and governing law of the contracting parties and any relevant statutory limitations which may inhibit such choice or the effectiveness of such a choice
- Whether or not awards can be enforced in the relevant jurisdictions. For example, is there an international treaty that will allow enforcement of an award in a particular jurisdiction? Many jurisdictions will not enforce awards that have not arisen through the consideration and final judgment of a court/judge
- The fact that obtaining the decision of an expert may be faster and cheaper than obtaining one from an arbitrator.

The Czech legal system does not provide specific regulation for nor does it legally recognise mediation proceedings.

Part C

Permits Insurance and Environment

14. **Permits - What permits are required for the use and occupation of real estate and are they personal?**

On 1 January 2007, a new Construction Act came into effect in the Czech Republic. It has partly changed the types of permits for the planning, construction and use of property as well as the procedure for their issue.

Structures or facilities and alterations thereto may be placed and their impact on the use of the area may be changed only on the basis of:

- a planning permit;
- planning consent;
- planning agreement between the applicant and construction authority; or
- if the structures or facilities are contemplated to be placed in built-up area, on the basis of a regulatory plan to the extent approved by regulatory plan, without specific planning permit.

Applications to obtain a planning permit to develop land must be filed with the local construction authority, which has responsibility for controlling the use and development of land in its area. Local construction authorities have statutory time periods within which a decision must be made as to whether a planning permit should be issued. There are various statutory rights in relation to appeals, which can be made if an application is refused. The applicant does not necessarily need to be the owner of the land so anyone can apply for a planning permit in respect of land, provided that the applicant received the approval of the owner of the land on which the applicant intends to build. During the planning permit proceedings the relevant authority considers each application with regard to (i) compliance with the zoning plan of relevant territory (ii) protection of the environment and health and safety and (iii) the standpoints of other participants in the planning proceedings. A planning permit will contain conditions which will regulate the impact of the development of the land.

In certain cases, for example, where a structure does not require a building permit or notification, the construction authority may issue a planning consent instead of a planning

permission. A planning consent is issued within 30 days of the date of notification (if the concerned authorities agree with the project).

The Construction act provides what kind of structures, technical infrastructure, pylons, aerials, facilities, conservatories or sheds, landscaping work, maintenance and construction works or alterations do not require neither building permit nor notification to the respective construction authority.

In some cases only notification to the construction authority is all that is required to construct, e.g. a residential house of up to 150m² with one basement floor and a ground floor (assuming certain other conditions are met). Permission is automatic if the authority does not prohibit the construction within 40 days of the notice.

In remaining cases construction cannot commence until a valid, effective building permit has been issued. The construction authority determines the binding conditions for implementation and use of a development in the building permit. The conditions determined by the construction authority will ensure protection of public interests during construction and use of the building, its integrity, compliance with general technical building requirements, or other regulations and technical standards, and also compliance with the requirements set by the state administrative authorities concerned, primarily the exclusion or restriction or negative impact of the building and its use on the environment. A building permit generally ceases to be valid if construction has not commenced within two years of the date on which the building permit took legal effect, although a longer period may be granted by the construction authority, or the validity can be extended on request by the applicant.

Generally, a building permit will be required for the construction of a "new build" property and for work that is proposed for refurbishment of an existing building, and where an existing use (for example office space) is to be changed to another distinct use (for example retail premises).

A new type of professional was introduced, called Authorised Inspectors, whose main role is to certify plans for new constructions, especially when the developer wants to avoid traditional construction proceedings. Notification with specific certificate made by Authorised Inspector to construction authority will be sufficient instead of building permit where apart from other things:

- the Authorised Inspector confirms that the proposed construction complies with the legislation and the planning permit,
- all affected authorities issue approving opinions, and
- all parties involved in the construction proceedings consent to the construction.

Building permit can be in some cases replaced by the construction agreement between the applicant and construction authority.

If works are to be carried out to historically or architecturally important buildings, the investor must get a positive statement from the cultural heritage protection authority before a planning or building permit will be issued.

During the consultation period that the local construction authority must undertake, interested third parties are able to put forward objections (or support) that should be considered by the authority before deciding whether a planning permit or building permit should be granted. In addition, even after a permit has been obtained, there will be a period within which third parties are entitled to challenge the validity of permits granted and this should be kept in mind by lawyers and agents acting for the developer, before any work on the permitted development begins. Once a building has been constructed or construction works completed, an application must be made to the construction authority to issue an occupancy consent. The construction authority examines whether construction has been carried out in accordance with the planning and building permits and with applicable building regulations and health, safety and environmental legislation. The occupancy consent issued by the relevant construction authority then approves a use of a building for a particular purpose.

Simple constructions can be used after merely notifying the authority.

Construction projects with building permits issued before 1 January 2007 still require occupancy permits as set out in current legislation, even if completed after 1 January 2007.

15. Insurance and Risk - What insurance will the parties effect and when does the insurance risk pass at the time of sale?

Before a sale is completed, insurance is generally the responsibility of the owner of the property. However, where such property is the subject of a lease, the terms of the lease can prescribe which party has responsibility to insure.

The insuring party should have a fully comprehensive buildings insurance policy to protect the structure and fixtures and fittings of the property in the event of damage or destruction by any of a comprehensive list of insured risks, such as storm, lightning, fire and water damage. The policy may also cover additional special heads of cover such as subsidence, earthquake and, if available, terrorism.

In certain areas of the Czech Republic, the policy usually also covers flood coverage but premiums and excesses are quite high, due to the number of claims made in recent years.

Insurance policies (the insurance contracts containing the contractual terms between the insurance company and the insured) may either comprise a single policy for one particular property or a block policy designed to cover a portfolio of properties. Larger institutional investors may self-insure.

In recent years, it has been possible to take out insurance if there is some specified defect in the title to the property. For an additional premium, the benefit of such policies may usually be claimed by subsequent owners of the property and tenants.

Insurance policies (except title policies) are personal and not transferable on sale. On a sale, timing of the transfer of risk is normally prescribed by the transfer agreement as being the date of filing the application to the Cadastral Register to register the transfer.

16. Environmental - What are the common environmental issues?

Real estate may be contaminated as a result of current and former uses. Primary legal responsibility follows the “polluter pays” principle: the person who spilled, released or discharged a substance will normally be liable for any ill-effects it causes. However, environment laws may also operate to make future owners and occupiers liable for contamination already present at the real estate when they acquire it. This can occur if:

- the substance is causing, or there is still potential for it to cause, actual harm to humans, to real estate, to personal property, to protected ecosystems or pollution of groundwater or surface waters, as each owner is obliged to maintain its property in such a state so as not to cause any loss and damage to any third person or protected ecosystem or surface waters and
- either the new owner knows about the presence of the substance but fails to take adequate steps to limit the harm it causes, or no person more directly responsible for causing or knowingly permitting the substance to be present at the real estate can be found (for example, because a more directly responsible company has since been wound up).

If development is proposed, then planning permission may be issued only after an environmental impact assessment of the construction on the environment is submitted to the building authority and the planning permission may set conditions under which the development may be carried out to prevent potential contamination.

Acquisition due diligence may involve the appointment of environmental consultants to consider documentary information and to carry out a site visit (Phase I). If considered necessary, further, intrusive investigations (Phase II) may then be undertaken. It is important to identify potential problems early so that there can be negotiation on price, the need for and scope of

any remediation and/or the need to put in place protection in respect of any existing contamination related losses that may arise in the future. Such protection may take a number of forms, including obligations to remediate any contamination discovered post-acquisition, indemnities in respect of first party loss or third party claims to cover any of these risks.

Part D

Finance and Taxes

17. Pricing/Valuation - What sets the price/valuation of real estate?

Pricing of real estate investments is a combination of the aggregate rent being paid by occupational tenants of the property and the value that investment buyers consider that a property of the specific type and location is worth at the time of valuation taking that income into account.

The rent for a particular property is likely to be assessed by multiplying the area of the property by the market rental value per square metre. The market rental value will take into account factors such as the location of the property, its type and condition, and the length of the lease term. There is no fixed code of measurement and international developers and investors active in the market tend to adopt the codes of their home countries.

In the case of retail units, it is common for the rent of the property to have an element based on the turnover produced in the unit.

Again, there is no fixed methodology for assessing the value of the property for investment purposes and the international developers and investors active in the market tend to use the methodology used in their home countries. Exchange rate risk is taken into account in valuation of leases, with leases, where the rent is quoted in Euro, even though payable in Czech Crowns, attracting a higher valuation.

Investment properties are commonly referred to as being sold on a particular yield, meaning the investment return that will be gained from the capital sum which it is necessary to pay to buy the property. For example, where a property with an aggregate rent of EUR 100,000 is sold for EUR 2,000,000, it will have a yield of 5%.

18. Financing - How is a real estate acquisition financed?

The principal ways in which real estate acquisition is financed are:

- Through the buyer's own cash resources or general corporate banking facilities
- By using the capital value of the property to raise specific finance secured on the property

A typical security package will involve the grant of a mortgage over the real estate itself together with supporting pledges over the shares of the borrower, bank accounts, insurance policies, rental income from the property and the like. Floating charges used in common law

jurisdictions are not recognised under Czech law. However, Czech law does have a concept of a pledge of an enterprise which in fact is similar to a floating charge, but it is not frequently used.

On 1 January 2008, a new Insolvency Act came into effect in the Czech Republic. Under the Act, if insolvency proceedings are commenced in the form of the bankruptcy of a borrower, an insolvency administrator is appointed by a court. A secured lender, who has security over a particular asset, may require that up to 100 % of the proceeds of the sale of such asset, less the costs of sale (no more than 5% of such proceeds) and administrative costs (no more than 4% of the proceeds), be paid to it. Set-off of receivables and liabilities from and to a bankrupt entity is permitted in some cases after the decision on insolvency is issued by the court. Set-off of receivables and liabilities from and to a bankrupt entity is permitted following the bankruptcy decision, provided that the statutory conditions for such a set-off were met before the decision on the method of dealing with the bankruptcy (i.e. prior to the declaration of bankruptcy, re-organisation or discharge from debts) is made. Final statement of profit and loss arising from the settlement of the transaction on the capital market is permitted to be set-off.

Lenders typically require floating interest rate borrowings to be hedged under separate interest rate hedging arrangements so that the interest cost is effectively fixed.

Raising finance by bond/debenture stock issue is unusual in the Czech Republic.

19. Security over real estate - How is security over real estate created and protected?

A fixed security interest over land or building is generally created under a document called a mortgage. A pledge over moveable assets, a pool of assets or over an enterprise, must be registered in the Pledge Register held by the Notary Chamber. In the case of land, buildings, apartments or other real estate property to which the title is registered at the Cadastral Registry, all mortgages must be registered in the Cadastral Registry by making the appropriate application to it. For non-registrable real estate such as minor building works, mortgages must be registered on the Pledge Register or the unregistered real estate must be handed over to the lender.

In the case of investment property, some lenders require all rental income (excluding service charge receipts) to be assigned by means of security and paid into a specific account charged to the lender and will restrict withdrawals from that account to the making of payments in respect of the financing costs and repayment of the principal sum secured on the property.

20. Taxes and Costs - What are they and who pays them?

Generally, please refer to our *CMS transaction costs guide* as to the nature and amount of the taxes and costs.

The main tax on acquisitions is real estate transfer tax (RETT) at the flat rate of 3% of the higher of the purchase price or the value of the property determined by a court appointed expert. RETT must be paid by the seller by the end of the third month following the month of completion of an acquisition. Calculation of the RETT must be included in a RETT Tax Return which must be submitted to the appropriate tax office. The seller is primarily liable to pay RETT, but the buyer guarantees payment if the seller fails to pay. It is therefore usual for an amount equal to RETT to be placed in escrow and only released to the seller when it produces evidence that the RETT has been paid. Failure to pay RETT within the prescribed time is subject to significant penalties and interest.

General value added tax (VAT) on the transfer of buildings is at the rate of 19%. Commencing on 11 January 2008 the standard rate of 19% applies to all buildings, except "social housing" (i.e. apartments up to 120 sq.m. and family houses up to 350 sq.m.) where the reduced rate 9% shall apply instead of 5% rate until December 2007.

The transfer of the following buildings is VAT exempt: (i) those which are transferred 3 years after the first occupancy permit was issued and (ii) those which are transferred 3 years after the commencement of the first use of the respective building. Generally, the transfer of land is VAT exempt, unless the land is "building land" (i.e. undeveloped land with the benefit of a building permit) when the applicable rate of VAT is 19%.

If real estate has been acquired through a share purchase, there will be no VAT on the transfer of shares.

During due diligence for an acquisition, the buyer will also pay the costs of conducting searches. The buyer will also pay for any valuations and surveys of the physical state of the property and any environmental audits or desktop studies. The seller will pay for the valuation by the court appointed expert.

It is not uncommon on commercial acquisitions for seller and the buyer to have each appointed its own broker, to whom they will pay any commission due.

Generally each party pays its own expenses. The buyer will usually be responsible for the payment of the Cadastral Registry fees associated with registration of the transfer to the buyer.

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