Real Estate Investment, Development & Law

in Emerging Markets

An insightful and highly practical compendium of best practice in real estate investment, development and law for professionals and academics

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PEI

London | New York | Singapore

www.peimedia.com

Published in October 2010 by
PEI Media Ltd
Second Floor
Sycamore House
Sycamore Street
London EC1Y 0SG
United Kingdom

Telephone: +44 (0)20 7566 5444
www.peimedia.com

ISBN 978-1-904-6986-79-7

THE QUEEN'S AWARDS
FOR ENTERPRISE
2009

PEI Media editor: Anthony O'Connor
Sub editor: Vicky Meek
Production editor: William Walshe
Cover design: Joshua Chong
Printed in the UK by: Hobbs the Printers (www.hobbs.uk.com)

Cover image: Courtesy of iStockphoto

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In certain parts of the former Soviet Union, *podmazot* ('benevolent' bribery) is considered locally to be an integral part of doing business. While this attitude is slowly and steadily changing, it has, by no means, disappeared. So what is the best course of action when faced with officials demanding bribes, unusual fees, interests in deals, *baksheesh* and the like? The business culture in many emerging markets has embraced bribery for so many generations that is virtually the only way to get things done. To the fullest extent possible, participants should resist the temptation to offer or agree to pay money to do things that should be done as a matter of course, such as obtaining permit reviews or approvals, registering deeds or arranging crucial meetings with officials.

One way of pushing back is to advise that in your country, and in most of the first world, bribes are insulting to both the giver and the taker. Be prepared to wait. People who are still thriving within the podmazot culture will not be impressed with such an opinion. A serious part of the problem is that, in some countries, the salaries of municipal officials are so abysmally low that the only way they can support their families is from additional income derived from monetary incentives given by people who need something done. This does not mean that you must always pay an incentive fee to get your permit processed or a meeting scheduled, but if you do not, be prepared for a long wait.

If you find no alternative, it may be better to withdraw and find another avenue to reach your goal, such as contracting with a local consultant and building the incentives into his professional fees. Make sure that the consultant understands that this is not an agreement to pay bribes or buy influence, but a payment for the consultant's expertise.

The Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (FCPA) is the US law that governs and provides sanctions for bribery. The anti-bribery provisions of the FCPA make it unlawful for a US person and certain foreign issuers of securities, to make a corrupt payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. Since 1998, the provisions also apply to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the US.

As an aside, the 1988 Trade Act (FCPA) directed the Attorney General to provide guidance on the Department of Justice's enforcement policy of the *Foreign Corrupt Practices Act of 1977* for potential exporters and small businesses that were unable to obtain specialist counsel on issues related to the FCPA. The guidance is limited in that it provides only responses to requests under the Department of Justice's FCPA opinion procedure as well as general explanations of compliance responsibilities and potential liabilities under the FCPA.

Anyone considering making a real estate investment or participating in a development project abroad, should become familiar with the FCPA. In general, it prohibits corrupt payments to foreign officials for the purpose of obtaining or keeping business. In addition other statutes, such as the mail and wire fraud statutes and the Travel Act, which stipulates federal prosecution for violations of state commercial bribery statutes, may also apply to charges of bribery. The Department of Justice is the chief enforcement agency, with a coordinate role played by the Securities and Exchange Commission (SEC) in the US.

History of questionable and illegal payments

As a result of SEC investigations in the mid-1970s, over 400 US companies admitted making questionable or illegal payments in excess of $300 million to foreign government officials, politicians and political parties. The abuses comprised a range of incidents from bribery of high-ranking foreign officials to secure some type of favourable action by a foreign government, to so-called facilitating payments that were allegedly made to ensure that government functionaries discharged certain ministerial or clerical duties. US Congress enacted the FCPA to bring a halt to the bribery of foreign officials and to restore public confidence in the integrity of the US business system.

The FCPA was intended to have – and has had – an enormous impact on the way US firms do business. Several firms that paid bribes to foreign officials have been the subject of criminal and civil enforcement actions, resulting in large fines and suspension and debarment from federal procurement contracting, and their employees and officers have been sent to jail. To avoid these consequences, many firms have implemented detailed compliance programmes intended to prevent and detect any improper payments by employees and agents.

Following the FCPA's passage, US Congress became concerned that US companies were operating at a disadvantage compared with foreign companies that routinely paid bribes and, in some countries, were permitted to deduct the cost of such bribes as business expenses on their taxes. This was, and continues to be, a major competitive issue in most emerging markets. In response to this concern, in 1988 Congress directed the executive branch to commence negotiations in the Organisation of Economic Cooperation and Development (OECD) to persuade the US's major trading partners to enact legislation similar to the FCPA. In 1997, almost ten years later, the US and 33 other countries signed the *'OECD Convention on combating bribery of foreign public officials in international business transactions'*. The US ratified the convention and enacted implementing legislation in 1998. That was helpful, but does not address the very real problem of having to compete against local companies in emerging markets that continue to pay bribes with impunity.

Enforcement

The Department of Justice in the US is responsible for all criminal and civil enforcement of the anti-bribery provisions for both domestic concerns (see below for definition) and foreign companies and nationals. The SEC is responsible for civil enforcement of the anti-bribery provisions for issuers of securities.

Anti-bribery provisions

Basic prohibition

The FCPA makes it unlawful to bribe foreign government officials to obtain or retain business. A total of five elements, listed below, must be met to constitute a violation of the Act.

Element 1 (to whom it applies):

The FCPA potentially applies to *any* individual, firm, officer, director, employee or agent of a firm and any stockholder acting on behalf of a firm. Individuals and firms may also be penalised if they order, authorise, or assist someone else to violate the anti-bribery provisions or if they conspire to violate those provisions. Under the FCPA, US jurisdiction over corrupt payments to foreign officials depends on whether the violator is an issuer, a domestic concern, or a foreign national or business.

An issuer is a corporation that has issued securities that have been registered in the US or that is required to file periodic reports with the SEC. A domestic concern is any individual who is a citizen, national, or resident of the US, or any corporation, partnership, association, joint-stock company, business trust, unincorporated organisation, or sole proprietorship that has its principal place of business in the US, or is organised under the laws of a state of the US, or a territory, possession, or commonwealth of the US.

Issuers and domestic concerns may be held liable under the FCPA under either territorial or nationality jurisdiction principles. For acts within the territory of the US, issuers and domestic concerns are liable if they act in furtherance of a corrupt payment to a foreign official using the US mails or other means of interstate commerce. These include telephone calls, facsimile transmissions, wire transfers and interstate or international travel. In addition, issuers and domestic concerns may be held liable for any act in furtherance of a corrupt payment taken outside the US. Thus, a US company or national may be held liable for a corrupt payment authorised by employees or agents operating entirely outside the US, using money from foreign bank accounts and without any involvement by personnel located within the US.

Before 1998, foreign companies (with the exception of those who qualified as issuers) and foreign nationals were not covered by the FCPA. The 1998 amendments expanded the FCPA to assert territorial jurisdiction over foreign companies and nationals. A foreign company or person is now subject to the FCPA if it causes, directly or through agents, an act in furtherance of a corrupt payment to take place within the territory of the US. There is, however, no requirement that such act make use of the US mails or other means of interstate commerce.

Finally, US parent corporations may be held liable for the acts of foreign subsidiaries where they authorised, directed, or controlled the activity in question, as can US citizens or residents themselves who were employed by or acting on behalf of these foreign-incorporated subsidiaries.

Element 2 (corrupt intent):
The person making or authorising the payment must have a corrupt intent and the payment must be intended to induce the recipient to misuse his official position to direct business wrongfully to the payer or to any other person. The FCPA does not require that a corrupt act succeed in its purpose. The offer or promise of a corrupt payment can constitute a violation of the statute. The FCPA prohibits any corrupt payment intended to influence any act or decision of a foreign official in his or her official capacity, to induce the official to do or omit to do any act in violation of his or her lawful duty, to obtain any improper advantage, or to induce a foreign official to use his or her influence improperly to affect or influence any act or decision.

Element 3 (payment):
The FCPA prohibits paying, offering, promising to pay (or authorising to pay or offer) money or anything of value.

Element 4 (recipient):
The prohibition extends only to corrupt payments to a foreign official, a foreign political party or party official, or any candidate for foreign political office. A foreign official means any officer or employee of a foreign government, a public international organisation, or any department or agency thereof, or any person acting in an official capacity.

The FCPA applies to payments to any public official, regardless of rank or position. The FCPA focuses on the purpose of the payment instead of the particular duties of the official receiving the payment, offer, or promise of payment and there are exceptions to the anti-bribery provision for facilitating payments for routine governmental action *(see below)*.

Element 5 (business purpose test):
The FCPA prohibits payments made to assist the firm in obtaining or retaining business for or with, or directing business to, any person. The Department of Justice interprets obtaining or retaining business broadly, and so the term encompasses more than the award or renewal of a contract. It should be noted that the business obtained or re-

tained does not need to be with a foreign government or foreign government agency.

Third-party payments

The FCPA prohibits corrupt payments through intermediaries. This is of particular significance to US real estate development companies looking to engage in projects in emerging markets, as they are constantly approached by individuals seeking to 'represent' them with government officials who have the power to grant contracts, approvals and permits. Sometimes this is appropriate and sometimes it could land you in jail. According to the FCPA, it is unlawful to make a payment to a third party if you know that all or a portion of it will go directly or indirectly to a foreign official.

The term 'knowing' includes conscious disregard and deliberate ignorance. The elements of an offence are essentially the same as described above, except that in this case the recipient is the intermediary who is making the payment to the requisite foreign official.

Intermediaries may include joint venture partners or agents. To avoid being held liable for corrupt third-party payments, US companies are encouraged to exercise due diligence and to take all necessary precautions to ensure that they have formed a business relationship with reputable and qualified partners and representatives. This may include investigating potential foreign representatives and joint venture partners to determine if they are qualified for the position, whether they have personal or professional ties to the government, the number and reputation of their clientele and their reputation with your relevant embassy or consulate and with local bankers, clients and other business associates. In addition, in negotiating a business relationship, the US firm should be aware of so-called *red flags*.

These include: unusual payment patterns or financial arrangements; a history of corruption in the country; a refusal by the foreign joint-venture partner or representative to provide a certification that it will not take any action in furtherance of an unlawful offer, promise, or payment to a foreign public official and not take any act that would cause the US firm to be in violation of the FCPA; unusually high commissions; lack of transparency in expenses and accounting records; apparent lack of qualifications or resources on the part of the joint venture partner or representative to perform the services offered; and the joint-venture partner or representative being recommended by an official of the potential governmental customer.

Permissible payments and affirmative defences

The FCPA contains an explicit exception to the bribery prohibition for facilitating payments for routine governmental action and provides affirmative defences that can be used to defend against alleged violations of the FCPA. This provision can be a saving grace.

There is an exception to the anti-bribery prohibition for payments to facilitate or expedite performance of a routine governmental action. The statute lists the following examples: obtaining permits, licences or other official documents; processing governmental papers, such as visas and work orders; providing police protection, mail pick-up and delivery; providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products; and scheduling inspections associated with contract performance or transit of goods across a country. Routine governmental action does not include any decision by a foreign official to award new business or to continue business with a particular party.

Actions similar to these are also covered by this exception: if you have a question about whether a payment falls within the exception, consult with your attorney. You should also consider using the US Justice Department's FCPA opinion procedure. There is more information about this on its website.

Affirmative defences

A person charged with a violation of the FCPA's anti-bribery provisions may assert as a defence that the payment was lawful under the written laws of a foreign country or that the money was spent as part of demonstrating a product or performing a contractual obligation. Yet it may be difficult to determine whether a payment was lawful under the written laws of a foreign country. Consider seeking the advice of local counsel or using the US Department of Justice's FCPA opinion procedure when faced with the issue of whether or not a payment is legal.

Moreover, because these are 'affirmative defences', the defendant is required to show in the first instance that a payment met these requirements. The prosecution does not bear the burden of demonstrating in the first instance that it did not constitute this type of payment.

FCPA sanctions against bribery

Criminal penalties

The following criminal penalties may be imposed for violations of the FCPA's anti-bribery provisions: corporations and other business entities are subject to a fine of up to $2 million; officers, directors, stockholders, employees and agents are subject to a fine of up to $100,000 and imprisonment for up to five years. Moreover, under the Alternative Fines Act, these fines may be much higher – the actual fine may be up to twice the benefit that the defendant sought to obtain by making the corrupt payment. In addition, fines imposed on individuals may not be paid by their employer or principal. Recently, financial penalties have been far in excess of $2 million.

Siemens, which in 2006 disclosed that it had discovered more than $1 billion in bribes that might have been paid in a dozen different countries over six years to help the company win orders, said that it was putting aside about $1.3 billion in preparation for settling the case with US and German regulators.

A settlement of that size would easily surpass the biggest FCPA penalty to date, which occurred when the oil and natural gas services company Baker Hughes paid $44.1 million in 2007 to settle charges of bribery and other improper practices in six countries.

Civil penalties

The Attorney General or the SEC, as appropriate, may bring a civil action for a fine of up to $10,000 against any firm as well as any officer, director, employee, or agent of a firm, or stockholder acting on behalf of the firm, who violates the anti-bribery provisions. In addition, in an SEC enforcement action, the court may impose an additional fine not to exceed the greater of (i) the gross amount of the pecuniary gain to the defendant as a result of the violation, or (ii) a specified dollar limitation. The specified dollar limitations are based on the egregiousness of the violation, ranging from $5,000 to $100,000 for a natural person and $50,000 to $500,000 for any other person.

The Attorney General or the SEC, as appropriate, may also bring a civil action to enjoin any act or practice of a firm whenever it appears that the firm (or an officer, director, employee, agent, or stockholder acting on behalf of the firm) is in violation (or about to be) of the anti-bribery provisions.

Other governmental action

Under guidelines issued by the Office of Management and Budget, a person or firm found in violation of the FCPA may be barred from doing business with the federal government. Indictment alone can lead to suspension of the right to do business with the government. The president has directed that no executive agency can allow any party to participate in any procurement or non-procurement activity if it has debarred, suspended, or otherwise excluded that party from participation in a procurement or non-procurement activity.

In addition, a person or firm found guilty of violating the FCPA may be ruled ineligible to receive export licences; the SEC may suspend or bar persons from the securities business for violations of the FCPA as well as impose civil penalties on persons in the securities business; the Commodity Futures Trading Commission and the Overseas Private Investment Corporation both consider suspension or debarment from agency programmes for violation of the FCPA; and a payment made to a foreign government official that is unlawful under the FCPA cannot be deducted under the tax laws as a business expense.

Private cause of action

Conduct that violates the anti-bribery provisions of the FCPA may also give rise to a private cause of action for treble damages under the Racketeer Influenced and Corrupt Organisations Act (RICO), or to actions under other federal or state laws. For example, an action might be brought under RICO by a competitor that alleges the bribery caused the defendant to win a foreign contract.

Guidance from the government

The Department of Justice has established its FCPA opinion procedure through which any US company or national may request a statement of the Justice Department's present enforcement intentions under the anti-bribery provisions of the FCPA. The details of the opinion procedure may be found at 28 CFR part 80, which is available online. Under this procedure, the Attorney General will issue an opinion in response to a specific inquiry from a person or firm within 30 days of the request (the 30-day period does not run until the Department of Justice has received all the information it requires to issue the opinion).

Where the Department of Justice has issued an opinion stating that conduct conforms to current enforcement policy there is a presumption, in any subsequent enforcement action, of conformity with the FCPA. Copies of releases issued regarding previous opinions are available on the Department of Justice's FCPA web site.

The SEC is expecting to impose larger penalties than in the past on a number of companies that have allegedly violated the FCPA, reminding lawyers and companies that the government is taking a tougher stance on international bribery. According to Scott Friestad, the SEC's deputy director for the Enforcement Division, the dollar amounts in the cases up for consideration over the short term will dwarf the disgorgement and penalty amounts that have been obtained in previous cases.

Over recent times, the SEC has dramatically increased the number of cases filed against companies under the 1977 law. In the late 1990s, it handled about one a year; last year, it handled many cases. The globalisation of business is partly responsible for the increase is size and number of cases, but so is the stronger enforcement power that the SEC and the US Justice Department have achieved through increased co-operation from other countries.

Some cases take several years to conclude. Examples of major FCPA cases that have been under investigation for years include those of Halliburton Co and DaimlerChrysler AG. Halliburton disclosed in 2003 that regulators were probing $2.4 million in payments by one of its subsidiaries for favourable tax treatment in Nigeria. The DaimlerChrysler probe was triggered when a former employee alleged in a now-settled 2004 whistleblower lawsuit that the company had secret bank accounts for bribing foreign officials.

More aggressive US regulatory actions follow the implementation of tougher anti-bribery laws in other countries since the signing of an OECD agreement in 1997. The implementation of new foreign laws has allowed the US to take more enforcement actions because of better co-operation from other countries. Among other areas, the OECD has taken a role in coordinating international action on corruption and bribery and creating the OECD Anti-Bribery Convention, which came into effect in February 1999, which it has been ratified by 30 countries. Other countries are also involved either as prospective members or participating countries. These include Chile, Estonia, Israel, the Russian Federation, Slovenia, Brazil, China, India, Indonesia and South Africa.

Disclosure and transparency in negotiations

How much to disclose and to whom

How much you should disclose to the business community in the target country about budget, authority and readiness to conclude a deal and what you disclose to a counter-party during a negotiation, are highly subjective determinations.

Obviously, the type and amount of information to disclose will vary from situation to situation. The best rule of thumb is 'less is more'. Do you have the authority to sign a contract, close a deal and bind your company to monetary or performance obligations? Tactically, it is often best to have a higher authority waiting back home to give the final sign-off. Whether such a higher authority exists is not important; it is always best to be able to say: *'Wait a minute – let me call back to the US and get an okay.'* This technique buys you time to think over what you are about to do.

The use of misinformation

You never want the other side of a negotiation to know that its deal is the only one on the table. It is often useful to manufacture a competitive deal or, even better, raise another (discarded) deal to the status of a contender. This works best when the owner of the target property really wants or needs to sell or buy. For someone who is not so motivated it has little effect.

Keep in mind that in sensitive deals in certain countries, the threat of technical interference from competitors is a real possibility. This might entail eavesdropping, room or phone-bugging, placement of deal spies that pretend not to speak English in positions such as housekeepers and drivers or miniaturised digital photography. This all may sounds like a James Bond movie, but it is a real threat.

For example, in a difficult real estate negotiation that the author led with the mayor of a municipality in a former Soviet country, the negotiating group was under constant surveillance. This became apparent when, during a negotiation session, the phone on the mayor's desk rang whenever progress was made on a deal point. After a brief conversation, the mayor would change his tactics. Finally the outside 'coaching' became so obvious, that the author slammed his notebook on the table, simulating an explosion. When the phone immediately rang and guards rushed in, the ruse was exposed. Always check with the embassy in technically sophisticated countries for a business-threat assessment.

Despite what locals may say about how business is done in their country, always take the high road. Be ethical. Behave like a transparent businessperson. ■

Bulgaria

Bulgaria is a typical emerging market. Its history and current conditions are emblematic of those that create a template of an emerging market ripe with opportunity for savvy investors.

Some two decades ago, at the time the break-up of Communist countries in Eastern Europe occurred, the entire Eastern Bloc underwent a difficult period of political and economic turmoil. Bulgaria was no exception to that rule and, as a result of the economic mismanagement during the first half of the 1990s, the country was thrown into a full-blown economic and financial crisis.

In 1997, the International Monetary Fund (IMF) intervened and a currency board was introduced in Bulgaria on the basis of a Currency Board Arrangement (CBA). The conservative fiscal policy (led by the IMF through the currency board) was supported by a wide range of reforms in a variety of sectors. These included reform of the social sector and the restructuring of the financial, agricultural and energy sectors along with divestiture of state-owned enterprises (SOEs). The privatisation of these industries boosted the Bulgarian economy, bringing it to meet the requirements of one of the most demanding political and economic formations – the European Union.

Bulgaria can now be characterised as having a competitive market-driven economy with a stable government. Globally respected institutions, such as Deutsche Bank and the Eurasia Group, have ranked Bulgaria in the top-five most stable emerging markets worldwide. In less than a decade, Bulgaria has succeeded in its transition from being a centrally planned economy following the Communist model to a free market economy based on the principles of democracy. Having realised the benefits of a low production cost region, Bulgaria has attracted the attention of international corporations and is now hosting a global array of these companies. Since January 2007, Bulgaria has been a full legitimate member of the European Union (EU), evidence that the full potential of the country – both economic and political – is being appreciated and geopolitically respected.

Real estate investment opportunities

Why invest in real estate in Bulgaria?

There are numerous reasons that suggest Bulgaria as an advantageous investment country including:

- a stable and predictable business and political environment;
- Bulgaria's accession to the European Union;
- the acquisition of land through corporate vehicle;
- 58 Treaties for avoidance of double taxation;

- 56 agreements for mutual protection and encouragement of foreign investments;
- attractive real estate prices which are also highly competitive compared with those in other EU member countries;
- low operation costs – construction and building services are rendered at European quality but at far more advantageous prices than those for identical services rendered in the European Union; and
- huge demand from foreigners for real estate in Bulgaria, comprising residential, industrial and business.

Ownership of property: present legislative framework

One of the main legislative principles embodied in the constitution of the Republic of Bulgaria and the Property Act is that foreigners are allowed to own buildings and limited real rights to real estate in Bulgaria. However, foreigners are allowed to acquire ownership over land only under the terms of an international agreement ratified by the Bulgarian parliament and in cases of legal succession. Citizens and legal entities of EU Member States or of Member States under the European Economic Area Agreement may acquire a right of ownership over land in accordance with the requirements laid down in the Treaty concerning the Accession of the Republic of Bulgaria to the European Union, (that is, after January 1, 2014).

Notwithstanding the provisions above, property may be purchased through a corporate vehicle, (that is, a Bulgarian company incorporated under the Commercial Act), that is allowed to be 100 percent-owned by foreigners (either natural or legal persons).

Land resolution laws

Bulgaria was originally a rural nation of small land owners with 93 percent of holdings under 25 acres. Then most agricultural property was seized by the communist regime and held by the state. As with other (former communist) Eastern Bloc countries, Bulgaria made provision for the return (restitution) of property to owners whose property was confiscated under the communist regime. Land restitution was finalised in 2000 and the process of restitution of agricultural land was completed in 2001. A land register has been established and the second phase of land reform, which is the consolidation of land, is completed. Currently, over 90 percent of woodlands and forest have been restituted.

The restitution of real property has made for some strange bedfellows. During the process of acquiring land for the new US Embassy in Sofia, the author had to negotiate with over 50 individuals, each owning shares in the same large parcel of land that had been restituted by the Bulgarian military. The elder of the group was a particularly cantankerous old woman, always adorned in black who would veto virtually every small step that was reached in the agreement process. She was one of the toughest negotiators we ever encountered.

Property taxation, fees and VAT

VAT for property transactions and on development costs is normally charged at 20 percent. Land transfers are VAT-exempt. Real estate tax is paid annually and currently is between 0.5 to 2 percent of the tax evaluation of the property which, in the case of properties owned by legal entities, is the book value of the respective property. The real estate tax applies to land and buildings; agricultural land and forests are exempt. The tax is paid regardless of whether the immovable property is used or not. The tax liability is on the owners of the immovable property.

There is a tax paid upon the acquisition of immovable property; this so-called ‘transfer tax’ is between 1.3 to 2.6 percent and is based on the value of the property. There is an annual waste-collection fee that is determined by the municipality in which the real estate is located and is calculated on the basis of the quantity of the collected waste. Where notary certification is necessary for the transfer of property, there is a notary-transfer fee. It is calculated on a regressive scale depending on the value of the property that is to be transferred.

The maximum fee payable is Lev 3,000. There is also a fee of 0.1 percent of the value of the property which is payable on registration of the Notary Deed evidencing acquisition of the property with the land register.

Common practices for investment in Bulgaria

There are two main types of investment instruments by which most foreign investors intending to engage in substantial real estate projects (acquisition of real estate property, development of acquired property, marketing the developments constructed on selected land plots, management of residential and business complexes, etc.), choose to participate:

A special purpose vehicle company (SPV) – a company 100 percent-owned by the foreign investment company and registered in Bulgaria – which, in turn, becomes involved depending on the type of the relevant transaction:

- Directly through the investment company; however, using this concept would put a limit on the potential acquisitions. Since there is still a ban on foreign persons (either natural or legal) purchasing land, then the foreign investment company would be limited to acquisition of buildings and related improvements without being entitled to purchase the land underlying these improvements. This concept is also not as attractive as the other (the SPV) because of possible tax implications that may arise (for example, the possibility of the foreign investment company being subject to double taxation).

According to the type of the intended investment, the SPV may:

- Acquire real property:
  - Land, being either (i) regulated land, that is, land which falls within the boundaries of built-up areas (towns and villages) or (ii) agricultural land. The difference is that the regulated land might be immediately used for construction purposes, whereas the agricultural land must be re-zoned for development.
  - Buildings, either for residential or business purposes. Following acquisition of the buildings, the SPV may retain possession of them for investment purposes (appreciation in value and subsequent sale) or managing or operating them in a way that generates regular income (that is, leasing them to third persons).
- Participate in development projects. The SPV might choose from a variety of options to be engaged in certain development projects:
  - Direct development of the acquired property – according to this scenario the investment company solely develops the property and is in charge of the entire process including design, obtaining all necessary permits and approvals, hiring subcontractors, project management and sale or lease of the completed project.
  - Joint development – according to this scenario, the SPV may team up with a partner company, with whom it will develop the intended project. The most commonly used types of joint venture structures are as follows:

    1. The SPV and the partner company incorporate a joint company which, in turn, becomes the manager of the intended project. The SPV and the partner company, in their capacity of shareholders of the joint company, establish the main principles of the partnership in the respective corporate documents (articles of association, bylaws, shareholders agreements, etc.) and outline the key points in their joint business – that is, who is in charge of direct implementation and supervision of the project, share participation ratio between the shareholders, type of participation of each shareholder (monetary contribution or contribution in-kind), distribution of the profit (distribution of dividends, liquidation quotas), as well as the exit strategy of the joint venture partnership – (winding up of the company).

    2. The SPV and the partner company (partner) may establish their partnership on a contractual

basis. The SPV and its partner may enter into an option agreement, whereby the partner company grants the SPV the option (but not the obligation) upon fulfilment of certain 'conditions precedent' (whose purpose is to make the SPV comfortable in participating in the project as a contracting party) to enter into agreements for sale of the units or buildings of the intended project. Both parties are allowed to identify and contract with end-users for the buildings and arrange their sale at a profit. The profit generated from the sale of the buildings would be shared between the two contracting parties pursuant to a profit and cost-sharing agreement, agreed to in advance.

3. The SPV may simply appoint the partner company to act as developer of the project initiated by the SPV on the basis of a contractual agreement, whereby the SPV assigns to the partner company all tasks and functions for a pre-determined fee. In addition, the SPV may negotiate with the partner to allow it to identify end users or buyers for a marketing fee, which would be agreed upon in an agency agreement concluded between the partners.

- Manage and operate completed development projects. The SPV may acquire completed development projects (either residential or commercial) and start managing them with the purpose of collecting the net operating income generated by them:
  - Management of residential development projects. The SPV may acquire an entire fully developed residential complex either (i) with the houses and apartments for sale and or (ii) with pre-sold houses or apartments to be leased to third parties and provide management services to the tenants and the owners for rental, management and service fees.
  - Management of business development projects. The SPV may also acquire fully developed business complexes – such as business parks and enterprise-business buildings and start collecting the net operating income of the development generated from the rental fees, property management and service fees, as well as fees for provision of additional ancillary services – phone, Internet, concierge services and security.

Transaction implemented on an option-agreement basis

As referenced above, one of the potential activities of the SPV (and probably the most profitable and advantageous) is to participate in development projects. Due to the complexity of shareholder relations, as well as the potential problems that may arise (that is, deadlock between the two shareholders with regard to making decisions that are crucial to the implementation of the project), a joint venture established on the basis of a contractual arrangement between the SPV and the partner company is regarded as the safest and most straightforward method to be followed. Therefore, a brief outline (in terms of structure and timing) is given for two examples of a joint venture scheme between a special purpose vehicle company incorporated by the investment company (SPV) and the partner company that acts as the developer of the intended project.

Scenario one: the SPV acquires title of the property

According to this scenario, the SPV enters into a contractual arrangement with the partner company, which is designated to act as developer. The framework of the arrangements between both parties is set forth in an option agreement in which the SPV is granted the option (but not the obligation) to require the developer to enter into a preliminary sale agreement (PSA) regarding the units to be developed. The SPV is entitled to exercise this option within a certain period ('option period') which starts to run from the moment the developer has delivered to the SPV an entire set of documents evidencing feasibility of the intended development, that is, notary deeds, drawings, certificate of lack of encumbrances, design visa, architectural plans and building permit, ('design') and ends within a certain timeframe, (for example, 30 days). The actual exercise of the option by the SPV (thus requiring the developer to enter into the PSA is effected by sending the developer a notice in an agreed form ('option notice') informing him that the SPV would like to take advantage of the option granted to it and exercises it accordingly. The developer is then required to enter into the preliminary sale agreement with the SPV within a certain time frame (for example, ten days following receipt of the option notice).

The PSA itself should be detailed and extensive with regard to the main terms of the deal. The PSA must identify, among other things, the parts to the agreement, the exact purpose of the agreement (construction of a certain property by the developer within a certain period of time, at a certain quality level and at terms and conditions as stipulated in the agreement) and the price for acquiring title of the land to be developed. The term of the PSA should be at least equal to the term estimated for completion of the construction. When construction of the development is completed and is evidenced by issuance of a utilisation permit (that is, this is the final approval that a construction is utilisable pursuant to Bulgarian legislation), then both parties shall conclude a final agreement for the sale of the property in the form of a notary deed, whereby the developer shall transfer title over the property to the SPV. Once the SPV gains possession over the property, it may at its own discretion either resell it to third parties with a profit, or lease it to third parties and provide fee-based management services.

Scenario two: novation of the PSA to a third party that concludes the final agreement

Novation is the substitution of a new contract in place of an old one. This scenario coincides to a certain extent with scenario one. However, in this case the SPV does not turn out to be the ultimate buyer of the property developed by the developer. According to scenario two, after the option agreement is executed between the SPV and the developer and within the option period (starting with the delivery of the design documents as referenced above) the SPV is entitled to exercise its option to conclude a preliminary sale agreement with the developer by serving an option notice to the developer. As soon as practical after serving of the option notice, the SPV should conclude a preliminary sale agreement pertaining to the units to be constructed with the developer. Pursuant to the preliminary sale agreement, the SPV undertakes the obligation to conclude a final sale agreement for the property (and the units to be constructed thereon) thus acquiring title to them. However, the peculiarity of the preliminary sale agreement in this case is that it contains provisions the SPV to transfer, assign, novate or otherwise dispose of its rights to third parties prior to conclusion of the final sale agreement. According to this concept, the SPV is granted the opportunity by the developer to allow a third party to step into its shoes in the PSA and assume the SPV's obligations and become entitled to conclude the final sale agreement for a certain unit (or units) from the property (and become the owner thereof). Once the transfer of the benefit of the preliminary sale agreement from the SPV in favour of the third party takes place, both the SPV and the third party (ultimate buyer) should inform the developer so the developer is aware of the identity of the ultimate buyer.

Transaction implemented on an assignment-agreement basis

This scenario involves the aforementioned concept for joint venture activity, whereby the SPV assigns the partner company to act as the developer of the SPV's project. According to this concept, the SPV must have already acquired the property intended to be developed, that is, the SPV represents the legitimate owner of the property holding freehold title.

Relations between the two partner companies (that is, the SPV and the developer) with regard to the acquired property and the prospective development are regulated by a specific agreement ('assignment agreement'), whereby the SPV (in its capacity of assignor) assigns the developer ('assignee') with a complex task – to perform all activities related to the development of the property, including without limitation to: perform (or arrange to be performed) all construction engineering, logistics and other activities that are required in order for the development project to be completed. The developer (assignee) should also be authorised and empowered to subcontract and engage at its own discretion (or after prior approval by the SPV) third parties that would also be involved in developing the property. In addition, the developer may also be assigned to undertake all necessary measures so as to put the to-be-constructed properties into operation, including arranging for the execution of all necessary tests and obtaining all approvals and permits including the 'utilisation permit'.

Once constructed and completed, the development (consisting of the properties and subsequently constructed buildings thereon) remains under the SPV's ownership. Thereafter, the SPV is entitled to conclude all types of contractual arrangements with regard to the newly developed properties such as sale agreements, agreements for exchange of property with other properties and rental agreements, thus generating profit from its investment in the development.

A peculiar feature in this scenario (commonly used today in Bulgaria) is the possibility for the SPV (the current owner of the land plot and future owner of the improvements) to dispose of the prospective properties in advance of their completion. This is referred to as an 'off-plan sale'. This off-plan sale is conducted on the basis of preliminary sale agreements between the off plan buyers and the SPV. In this case, the SPV undertakes to transfer title over the future constructions to the off-plan buyers upon completion of the development.

This option is usually preferred by companies which are in the position of the SPV, as well as the persons acting as off-plan buyers for the following reasons: (i) conclusion of such preliminary sale agreements will lead to receipt by the SPV of 'fresh' proceeds (as a portion of the purchase price for a certain property (for example, 10 to 30 percent) will be paid in advance upon conclusion of the PSA) and such proceeds will reduce the necessity for the SPV to provide additional funding for the development (usually bank debt financing); (ii) off-plan buyers receive a discounted purchase price that is less than the price they would have to pay, had they waited to pay the entire price until completion of the development.

In addition, the developer company may also be appointed as sales agent of the SPV thus being entitled to agency fee for attracting potential buyers of the developed property. The agency relationship is established with an agency agreement between the SPV and the developer, in which all main terms and conditions (including the agency fee) are stipulated in detail.[1] ■

[1] With permission. Sergey Penev, Penev & Partners, Sofia, Bulgaria

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