
LEGAL INFORMATIVE NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

THE DOMESTIC REAL ESTATE SYSTEM AT A GLANCE – GENERAL OVERVIEW ON OWNERSHIP AND LEASEHOLD TYPES, LAND REGISTERS, TRANSFER FORMALITIES AND FINANCING

Introduction – The Italian real estate system is secure and structured with safeguards for both the buyer and the seller. The system does however differ from other Countries for those making a property purchase in Italy. The purpose of this article is to provide a general overview of the types of ownership and leaseholds, as well as on the land databases, the transfer formalities and financing of real estate deals.

§ 1 Types of ownership

Real estate law is governed mainly by the Italian Civil Code, and by special laws for specific issues. Real estate development projects and renovation works require approval by local authorities entailing administrative licenses and permits.

Real estate assets may be:

[A] Stand alone assets

[B] Part of a joint property (*condominio*). Specific provisions of the Italian Civil Code (ICC) apply to assets forming part of a co-property

[C] Part of a going concern. Rules relating to the transfer of a business apply.

There are four titles for classifying real estate assets:

[1] Full ownership

[2] Long lease

[3] Lease of business

[4] Usufruct and Right of Common.

§ 2 Land Registers

The databases of real estate registration in the Land Registers (*Conservatoria dei Registri Immobiliari and Catasto*) make available to the general public all the information regarding any real estate transaction. As a result, the information on the Registers is - by operation of the law – deemed to be known to all, making contractual rights so registered enforceable against any parties.

Registration of a conveyance deed takes place at the Land Register of the province where the real estate property is located and regards the title and a short summary of the registered deed.

§ 3 Transfer formalities

The agreements for purchasing or selling real estate properties, and creating or transferring real estate rights, must be in writing. These agreements are enforceable following registration with the local Land Register.

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A real estate sale in Italy is void unless the seller holds a valid administrative building concession for the property.

Purchase contracts can be:

[A] Preliminary contracts

[B] Final contracts

[C] Forward sale agreements.

Preliminary contracts are the most common since both parties must fulfill certain conditions (eg, the satisfactory outcome of the necessary title searches) before entering into the final contract.

§ 4 Construction

Recent Legislative Decree 20 June 2005 no. 122 has provided for a regulation aimed to protect purchasers of real estate under construction.

Real estate under construction are deemed those buildings for which the construction permit has been released and whose building procedure is ongoing or those building whose construction procedure is at stage which does not enable the release of the fitness for use certificate.

In particular the above mentioned Legislative Decree provides for:

[A] The obligation of the construction company to file a performance bond for an amount equal to the amount paid by the purchaser, the obligation for the construction company to deliver an insurance policy aimed to cover the purchaser from eventual risks for defects showed up following the execution of the purchase contract; specific provisions to be inserted in the purchase contract;

[B] A specific regulation for situations of financial crisis of the construction companies

[C] The creation of a fund aimed to provide the reimbursement of the purchasers which have suffered a loss upon bankruptcy of the construction company.

§ 5 Leasehold types and formalities

[A] **Residential agreements** - Specific provisions regulate residential rental agreements and apply to all properties except those seen as having historical, artistic, archaeological or ethnic significance.

There are two general types of rental agreements:

[1] Unregulated agreements: the parties can determine the rental rate and any periodic increase. These agreements run for four years, renewable, with some exceptions, for additional four-year terms

[2] Regulated agreements: these must comply with the standards terms and conditions, national and local, of standard agreements negotiated between landlords associations and the main tenants associations.

In both cases, tenants may terminate their agreement at any time, but must give six-months prior written notice to their landlord.

Clauses and agreements either indicating a term exceeding that set by law, or a rental rate higher than that declared in the written and registered rental agreement, or in the standard agreement, are null and void.

[B] **Rental agreements for commercial properties** - Rental agreements for commercial properties follow separate specific rules.

Commercial properties include those for industrial, commercial, tourist, business, workshop or similar use. Commercial rental agreements must be for a minimum term of six years, or nine years for hotels and similar businesses.

These are automatically renewed for another six, or nine- year term, unless either party gives the other twelve months, 18 months for hotels, prior written notice of its intention to leave.

Also, a landlord can deny renewal upon expiration of the first contractual term if he/she needs to use the property:

[1] As his/her own domicile

[2] For productive activity carried out by himself/herself or by a close relative

[3] To carry out substantial restructuring of the property.

The rent is set by the parties, subject to any periodic increase required by law.

If the landlord terminates the rental agreement other than for just cause, he/she must give the tenant compensation for the loss of goodwill, equaling 18 months rent, or 21 for hotels leases.

Compensation doubles if the landlord then rents out the same property within one year to someone in the same or a similar business as the original tenant.

There is no right to compensation if the property is for:

[1] Businesses without direct contact with the general public

[2] Professional business or temporary activity

[3] Secondary properties in railway stations, ports, airports, highways, service areas, hotels and tourist resorts.

Any provisions or agreement limiting the contractual term set by law or introducing terms favoring the landlord in violation of the rent control (*equo canone*) law are null and void.

§ 6 Real estate investment funds

The regulatory framework for real estate funds sets out:

[A] Terms and conditions for real estate assets contribution to closed-end real estate investment funds

[B] Terms of real estates assets contributions from, or sales of real estates assets to, managing company shareholders of the relevant fund, or

companies affiliated with the managing company.

The investment fund can hold, at most, real estate of its managing group equaling 60% of the fund's aggregate value and is subject to control of regulatory bodies, as such as the Bank of Italy.

It can take up loans amounting to 60% of the value of the real estate assets held. Also, it can hold interests in real estate companies active in construction.

§ 7 Financing acquisition

The acquisition of real estate assets is through a special purpose vehicle – SPV, generally Limited liability companies (S.r.l. - *Società a responsabilità limitata*), which are used especially for tax reasons.

A customary security package in a real estate acquisition would include:

[A] Pledge on the shares or quotas of the vehicle

[B] Mortgage for the acquired estate

[C] Pledge on the bank accounts of the company holding the estate

[D] Pledge on the VAT receivables for the tax authorities.

Also, under Italian banking law, mortgages granted to secure mortgage loans are not subject to claw back action if mortgage registration takes place at least ten days before the bankruptcy declaration.

§ 8 Financial Assistance Rules

Italian law prohibits financial assistance from a company to a buyer for the latter's acquisition or subscription of the company's shares.

This applies to all types of limited liability companies, making it illegal to directly use the target's assets to finance the acquisition or to secure the loan received by the buyer.

This provision remains in full force after the updating of Italian company law in 2004. With the 2004 Company Law, merger-based leverage buy-out transactions are legal in Italy, subject to compliance with the Italian Civil Code.

This applies to mergers between companies, one of which has incurred debt in order to purchase a controlling stake in the other, if, as a result of the merger, the latter's assets are an implicit guarantee or source for the repayment of the debt.

Certain formalities apply when implementing a merger between an acquiring company that has incurred debt and the target company.

The merger plan must indicate the sources of funds available to the company after the merger for meeting its obligations.

The directors must show that the surviving company has sufficient funds to repay the acquisition debt and file a business and financial plan giving details of such sources.

§ 9 Due diligence checks

Due diligence verifications in real estate transactions cover various items relating to:

[A] **Encumbrances, restrictions on the seller's freedom of sale** - Before purchasing real estate, prospective buyers should conduct an appropriate ownership (cadastral) search to ensure against encumbrances, in particular of mortgages or easements.

[B] **Archaeological restrictions** - Italy's Ministry of Culture¹ has a pre-emptive right to the sale or transfer of any real estate property in Italy with historical or archeological value or significance. Perspective purchaser of real estate properties with historical or archeological value or significance must notify the Ministry of any transfer or sale involving such properties. Statutes or contractual provisions may also establish such pre-emptive rights.

[C] **Town planning restrictions** - Each Italian municipality decides the permitted use of real estate properties under its jurisdiction in keeping with local laws and regulations.

Inter vivos (inherited) property deeds, involving partition of co-owned so-called *diritti reali* (rights enforceable against third parties), are null without a certificate from the local authorities stating the property's intended destination.

The certificate is mandatory for establishing or transferring any real estate rights, irrespective of type or destination. It must mention the intended destination of the property in accordance with local area regulations.

Any subsequent change in the destination or use of the property requires the local authorities' advance approval. The certificate provides any prospective buyer with information on the terms, conditions and limits applying to the property under sale.

[D] **Constructions Permits** - These are required only for:

[1] Construction of new buildings

[2] Urban restructuring

[3] Restructuring works modifying the structure, size and/or use of a property.

Other real estate works do not require prior authorization if the relevant local authorities receive administrative notice.

[E] **Environmental Issues** - Italian environmental regulations are for public safety. Some provisions relate to reclaiming polluted land or facilities. If pollution levels exceed the legal threshold, the owner or occupier of the polluted property is liable for the pollution.

He/she must bear all the costs necessary for reclaiming the area or implementing specific safety measures preventing future pollution. The reclamation process must respect administrative procedures and periodical reviews. Failure to implement the reclamation plan may result in fines and even criminal liability.

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