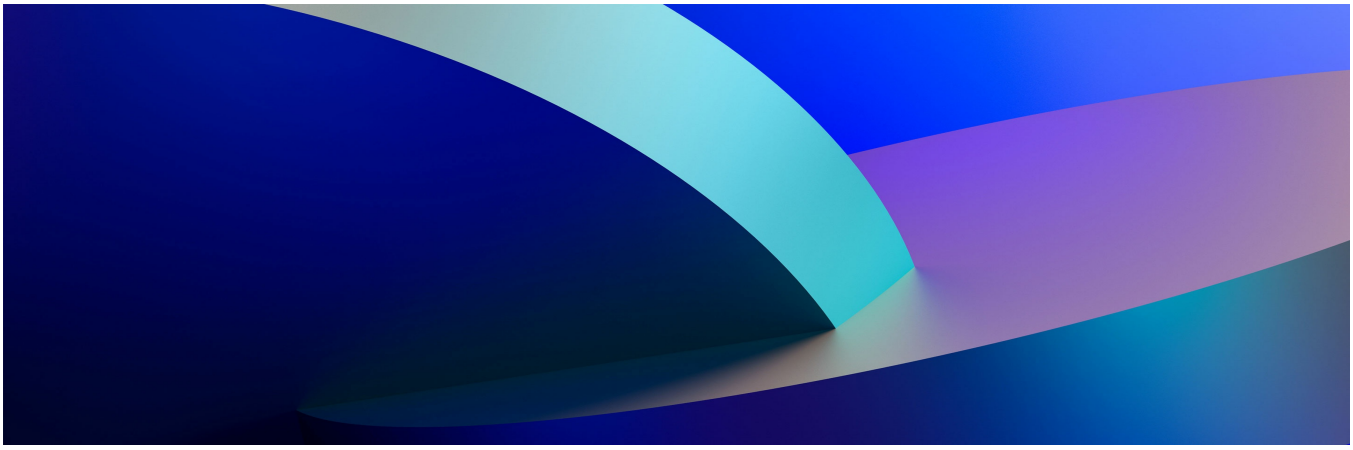

Commercial real estate law and rules in France

1. Parties and Ownership – Who can own real estate and what types of ownership are there?

Parties

In France any legal “person” may own real estate.

This includes individuals, companies, private legal entities such as companies, registered associations or associations classified as being of public interest and public legal entities such as state and local authorities and public corporations. Non-registered associations are not allowed to own real estate as although they exist in law they do not have legal capacity.

The main institutional investors include: real estate investment trusts (“Société Civile de Placement Immobilier SCPI”), property leasing companies, real estate development companies run on a lease-purchase basis (“Sociétés de Crédit-bail”) and real estate investment companies (“Société d’Investissement Immobilières Côtées SIIC”).

Foreign individual investors are permitted to directly own real estate. Foreign corporate investors may also directly own real estate provided that their legal personality is recognised in France.

Ownership

Different types of ownership are applicable in France, such as freehold ownership, (including joint-ownership), co-ownership and volume ownership.

- Freehold ownership – includes anything above or below the property plus the buildings. A freehold owner is entitled to mortgage its property, to grant easements and leases on it and to sell it at any time. Ownership can be held by several people in joint ownership. This joint-ownership may be created for a maximum fixed period of five years which is either renewable or it may be terminated at any time
- Co-ownership – is applicable for a building with at least two co-owners. The building is divided into private areas, on which each co-owner may enjoy full rights, and common areas such as land,

structure and common parts of the building, on which each co-owner has a joint right. A property manager has to be appointed by the co-owners and his functions are determined in accordance with law
- Volume ownership – the property is divided vertically as well as horizontally in three dimensional units. Different tranches of the land may be allocated to different owners, who have their own proprietary interest in their respective “volumes”. This type of ownership offers the owner of each volume the right to build within it

It should also be mentioned that according to French law, property rights may be either full property or bare property, which usually only gives rights and obligations in relation to the capital. Property rights may also be an usufruct, which gives rights and obligations in relation to the income.

2. Interests – What types of interest in real estate are sold?

An investor may not only purchase the land itself or a completed building, but other real property rights governed by French law. Because of that right, an investor may have a right to build while the ownership rights remain in the hands of the owner.

They usually take the form of long term leases, with a duration ranging from 18 up to 99 years like the “bail emphythéotique” and the “bail à construction”. Under such leases the tenant is obliged to erect buildings which finally revert to the landlord. They offer a genuine real property right, which can be mortgaged, sold or transferred.

Property interests currently sold may therefore be either the land and buildings, long term leases or shares of companies such as “sociétés d’attribution” representing a part of the underlying assets. Rights to build can be acquired through bulk and forward sales.

3. Employees – What employment issues affect real estate acquisitions?

Without prejudice of the nature of the contemplated transaction (purchase of real estate, purchase of the sole assets, transfer of a part of the activity, etc), the main issue consists in determining whether such a transaction would automatically entail the transfer of the employment contracts to the transferee or not (in this latter case, each employee’s consent would be required prior to the transaction).

Article L. 1224-1 of the French Labor Code which leads to the transfer of the employment contract to the purchaser does not always apply and must be examined on a case by case basis. For example it does not apply to the transfer of tangible assets dedicated to an activity if the activity in itself is not transferred or to the transfer of materials without the transfer of the business or the customers or to the sale of an asset without the actual transfer of the economic activity.

According to well-established case law, the provisions of Article L 1224-1 apply to any transfer of an autonomous economic entity where the operations are continued or resumed while its identity is maintained. An autonomous economic entity is defined as an organized group of persons and tangible or intangible assets allowing for the conduct of an economic activity pursuing its own objective.

Only if this condition is satisfied do the employment contracts of the employees become transferred automatically without any right for the employees concerned to oppose such a transfer.

Is should be noted that an authorization of the labor inspectorate is needed prior the transfer if any concerned protected employees (employee rep. union reps., etc) are affected by a partial transfer of activity.

If Article L. 1224-1 does apply, it will have an effect on the employment contract (transferred automatically without changes to the purchaser who takes over all the contractual employment obligations according to seniority and without any trial (probation) period) and it will also have consequences on the collective status of the transferred employees. The collective bargaining agreements, understandings and applicable practices are also transferred to the purchaser for a limited period of time and certain conditions will apply to mandatory profit-sharing schemes and incentive schemes. The employees' representative body may also be transferred under specific conditions.

Subject to the particular terms of the contemplated project, in relation to the procedure, each member of each institution (the works council of the transferring company and the works council of the recipient company, if any) may need to be given written notice of a meeting and a meeting of the health and safety committee may also be required if the transfer implies a modification of the working and/or safety at work conditions. These meetings must be held prior to any transaction being completed.

It is also important, according to the type of transaction, to take into account the commitments provided by the articles 18 to 20 of the Law n° 2014-856 of July, 31st, 2014 relating to the prior information of the employees on the contemplated selling of the company.

4. Procedure – What are the steps in a sale and purchase transaction?

Transactions formally start with a pre-contractual period, allowing the parties to discuss the main conditions of the transaction.

In order to provide the buyer with complete information regarding the building, investigations are carried out including technical and legal due diligence in relation to the property. This information enables the buyer to determine the price and the nature of any obligations to be requested from the seller.

An offer is then proposed for the property. The offer may be proposed by the buyer, or the seller. That step may be quite dangerous for both parties because the judge may consider such an offer a real contract if it possesses all characteristics of a contract such as a determined price, an acceptance and the existence of both parties.

A preliminary contract is entered by both parties, in order to prepare the notarized deed of sale. It is either a unilateral promise to sell or a bilateral promise to sell:

- Under a unilateral promise to sell the seller, referred to as promisor, undertakes to sell the property to the buyer, referred to as the beneficiary of the promise to sell, on the date when the buyer expresses the intention to buy the property. The beneficiary holds an option he may exercise for a certain period of time. The beneficiary pays a deposit which is 10% of the purchase price until completion takes place or the purchase is cancelled. When the beneficiary exercises this option to buy, the sale is completed. Failing that, the seller is released from his promise and he may sell the building to another party, when the beneficiary will have to pay the promisor compensation amounting to the deposit. The validity of the contract is subject to its registration with the tax administration within ten days after acceptance by the beneficiary
- A bilateral sale agreement is a reciprocal undertaking to sell and to buy, binding the parties. The sale is completed once conditions precedent are fulfilled. It is always drawn up as a private agreement

The purchase deed may be drafted by a notary. In some cases, the seller and the buyer may directly

sign the final notarised deed of sale without signing a preliminary contract.

Legal formalities with authorities and agencies such as the Land Registry have to be completed in order to enforce the sale against third parties. The published and registered deed may be overridden only by a judge.

5. Contract terms – What provisions does a real estate contract contain and what is implied by law?

Provisions of the contract

Both parties generally enter into a preliminary contract prior to the signature of the contract. Depending on the formula selected, both parties have more or less wide-ranging rights.

The purchaser often has an option right enabling him to acquire the building. The contract has to mention the deadline and the form in which the option must be exercised.

Generally, the contract contains an assignment clause under which the benefit of the contract may be transferred unless otherwise agreed. In practice, unilateral promises contain a substitution clause, whereby the beneficiary can be replaced by a third party who may be an individual or a legal entity.

A requirement for a deposit of between 5-10% of the purchase price on exchange of agreement is quite common for sale and purchase agreements. A contract usually provides that this deposit remains in a special account at the bank or the notary’s office.

If an option is exercised, the option fee has to be offset against the sale price of the building, whereas the fee accrues to the seller if the option is not taken up. This remunerates the seller for granting the purchaser a right of first refusal on the property.

A contract is valid only if all conditions precedent have been satisfied or if any condition exists for the benefit of one party, that party has agreed to waive it in the absence of satisfaction.

In the case of an off-plan purchase, the agreement incorporates provisions dealing with some seller’s obligations to build in accordance with an agreed specification and building permit, and provide separate collateral warranties in order to safeguard the buyer against defective design or workmanship

Terms implied by law

A sale and purchase agreement has to be in writing, drafted by a notary and be registered at the Land Registry in order to be effective against third parties.

Parties to a French property acquisition are able to vary most code provisions, which are otherwise written into the Contract.

Some things have to be stated for the purpose of registration. In addition to the provisions relating to the specific transaction, the deed has to contain various stipulations referring to:

- The names of both parties, whose identities must be checked. The contract has to state the companies’ names as well as legal form, registered office and registration number
- The property designation and the transferred rights, including a list of priority ranking of mortgages, contractual easements, town planning obligations, co-ownership regulations and rental status
- The price at which the sale is to be or may be ascertained. The deed has to specify if the price is paid in front of a notary and the origin of the sums involved. If the property sold is held in joint ownership, the undertaking has to state the exact surface area of the plot of land sold, failing which

it may be declared null and void
- Any special conditions of sale and any charges attached to the building. Appendices are often required such as energy consumption diagnosis.

Some measures have been enacted to protect buyers who are not real estate professionals. The beneficiary of an undertaking to sell concluded by private agreement is allowed to withdraw his consent within a seven day period. If the undertaking is notarized, the draft deed only becomes firm and final at the end of this seven day period.

6. Due Diligence – What investigations does the buyer normally make?

Pre-exchange of agreements

Before the signature of a preliminary contract the buyer carries out due diligence investigations. These concern legal as well as technical matters relating to the property.

From a technical point of view, matters normally covered are:

- The structure of the building
- Soil and geological investigations
- Compliance with any applicable regulations (such as labour regulation, public premises, asbestos, termites and environment)
- Particular commitments in the employment contracts if some employment contracts are automatically transferred (see above), such a golden parachute, non-competition clause, etc.
- An environmental audit

Many legal matters have to be checked, such as the following:

- The title of property and origin of ownership over the last 30 years
- Rights burdening or benefiting the property
- Type of ownership and related documents
- Administrative authorisations
- Building and operating insurance policies
- Rental situation
- Any current legal disputes
- Works and maintenance on the building

Most of the time, a town planning certificate is obtained at contract stage in order to provide the purchaser with information concerning any applicable planning restrictions and confirming the ability to build, rebuild or extend on the land and whether any particular zoning regulations apply to it.

7. Registration and Notarisation of real estate – What are the basic requirements?

Within the context of a property purchase, even if the sale may legally exist before the drafting of the notarised deed, the final deed has to be drafted by a notary in order to ensure that the transaction is carried out legally and accurately, in accordance with the proper procedures. The notary is responsible for ensuring the effectiveness of the contract. He also verifies real estate titles, informs both parties of any mortgages or liens and of any legal and tax consequences. It is advisable that such points be checked by a lawyer at the preliminary contract stage.

The notarised deed gives the purchaser full proof of ownership which may only be disputed by a legal

action. All real estate transfers, mortgages and liens must be executed in the form of a notarised deed.

The purchase deed is only enforceable against third parties after its publication in the Land Registry. The sale is then protected against third party claims, including those made by persons not stated in the deed.

All recorded documents become part of a real estate file which indicates ownership and claims. Authenticated copies of all notarised deeds are kept at the Land Registry. Most of the time, any person may obtain an abstract of the real estate file for a particular piece of property.

8. Permits – What permits are required for the use and occupation of real estate and are they personal?

Urban planning permit authorises construction according to urban regulations (locality, use, aspect, arrangement of the building).

Application for such permit includes the applicant's identity, location of land, type of works and intended use of the building. The file is filed with the town hall and has to contain, notably, a master plan of the land, an overall plan of construction and plans of the façade. The permit has to be posted on the site soon in order for it to be enforceable against third parties. It has to remain there for the entire period (ie two months) in which people are allowed to object to the permit. In addition, the permit has to be posted for the duration of the building work.

The urban planning permit is not personal and may be transferred to any new owner as part of any transfer of the land with prior authorization of the Mayor.

A permit to parcel out land is required for any division of land for building purposes resulting in the creation of more than two plots, or which may result in the creation of more than two plots over a period of up to ten years.

In situations where demolition is involved, a specific demolition permit has to be obtained (or may also be requested in the planning permission file).

A specific authorisation has to be requested in the urban planning permit file for the construction of supermarkets and shopping centres depending upon a number of factors including the size of the surface area.

Use of premises in cities having a population greater than 200,000 or in the Hauts-de-Seine, Seine Saint-Denis and Val-de-Marne departments, may not be changed from a residential use to another use without prior authorisation of the Mayor. This authorisation is personal and may not be assigned unless the change of the use was duly "compensated".

For industrial buildings, a list of classified installations for environmental protection (ICPE) has been established to list activities which may interfere with or be dangerous to the surrounding areas, public health and safety, or the environment. This list distinguishes installations requiring authorisation from the "Préfet" from those only requiring a declaration or have to be registered.

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

When a lease has been granted, the terms of the lease stipulate which party has responsibility to insure and pay for the insurance.

The tenant will generally insure the contents of the property belonging to the landlord and in some

cases certain parts of the property for which the tenant is contractually responsible. The tenant is often asked by the owner to present a certificate of insurance.

The owner normally insures the building but it is common for the tenant to pay the insurance premiums. Lease contracts often contain a reciprocal waiver of recourse clause.

Generally, buildings are insured for the reinstatement cost rather than the reinstatement value. Property owners may take out a single insurance policy for one particular property or a block policy covering a portfolio of properties. Insurance policies are transferred with the property unless both parties have agreed otherwise. Where a sale is taking place, the timing of the transfer of risk is normally prescribed by the sale agreement.

Specific insurances apply to the construction of buildings:

- A first insurance (“assurance dommages-ouvrage”) must be taken out by the owner of the building, which covers repair works to be made in case of damage to the structure for a period of ten years. This insurance policy benefits subsequent owners of the structure
- A second insurance (“assurance responsabilité civile”), which must be taken out by the builder, covers his ten year professional liability

10. Environmental – What are the common environmental issues?

Legislation governing installations classified for environmental protection (ICPE) enables the Prefecture to order operators to rehabilitate the contaminated site, and, in some cases, the owner may be requested to do such works.

The scope of this obligation depends upon the risk to the environment and public health. The seller has a duty of disclosure and has to provide the purchaser with all information concerning potential or actual contamination of the site. If the purchaser is not properly informed, he may obtain cancellation of the sale or ask for a reduction in the price.

Sellers and landlords have to informed purchasers and tenants of the existence of risks where property is located in areas covered by either a prevention of technological risk plan or of a prevention of foreseeable natural disasters plan.

Sellers or landlords have to provide a natural and technological risk report (“état des risques naturels et technologiques”) on the basis of information communicated by the administration in each department. If a seller or a landlord fails to provide such a report, the purchaser or the tenant may terminate the contract or ask for a reduction in price.

Carrying out of an environmental audit is recommended in order to analyse the risks relating to pollution and non-compliance issues.

Specific risks and diseases related to real estate have been identified by French Law in order to protect properties against termites, and their occupants against asbestos and lead poisoning. In the case of residential property, a seller has to provide specific reports related to lead poisoning or termites.

11. Pricing/Valuation – What sets the price/valuation of real estate?

The purpose of valuation is to determine the market value of a building: the average price that may be obtained for a property to be sold.

Experts are valuation professionals in the property field such as notaries and property experts, members of the French Institute for Property Valuation and chartered surveyors. Valuation fees are mainly based on the amount of time estimated to carry out the valuation.

Each valuation is performed after inspecting the property. The valuer takes several factors into consideration such as the location of the property, its type and condition, surface area, date of construction, legal and tax situation, applicable planning regulations, occupation of the property and comparison with similar transactions. A valuation report contains a description of the work done, the location and surroundings of the property, its legal status, its town-planning status, a description of the property, a general assessment, the market sector, comparison points used, an estimate and the conclusion.

The most common method of valuation in France is the comparison or analogy method. It consists of comparing transactions made in the same area in relation to buildings with similar characteristics.

12. Taxes and Costs – What are they and who pays them?

Acquisition of real estate is generally subject to registration fees calculated on the purchase price increased by additional costs and compensation paid to the seller. Registration duties are due on the date of sale and payable by the purchaser.

The purchase of a building which has been completed less than five years before the sale is subject to value added tax (VAT), which is paid by the purchaser.

French tax authorities may challenge the purchase price and substitute the price paid with the actual market value of the property sold, if it is higher.

In addition to the transfer duties, the land registrar’s fees and legal fees are applied.

Legal fees and registration taxes have to be paid. They may include costs which might have been incurred for establishing boundaries and preparing plans for the final deed. These fees are paid to the notary on the day of signature of the deed together with the balance of the purchase price. The fees of the notary have to be paid at the same time as the legal fees.

The seller pays the agent’s commission, unless the parties have agreed otherwise.

Key Contacts

Aline Divo
Paris
Partner
Vice Chairman of the firm's Advisory Board