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Russia

REAL ESTATE

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This country-specific Q&A provides an overview of real estate laws and regulations applicable in Russia.

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RUSSIA

REAL ESTATE



1. Overview

- In the Russian Federation, real estate law is predominantly laid out by the federal legislation, and thus property rights are the same in all regions. Regional (there are 85 regions) and municipal legislation, however, may regulate territorial planning and zoning issues, as well as taxation.
- Russian Real estate law is largely codified. The four most important sources of Russian real estate law are the Land Code, the Civil Code, the Town-Planning Code and the Law on Registration of Real Estate Property, which are all federal statutes. Court practice also plays a significant role, especially in the form of the Plenary Rulings of the Supreme Court, which contain guiding interpretation of the relevant legislation.
- Real estate transactions in Russia are generally in line with international practice and can be structured both as share deals and asset deals depending on the specific circumstances. After the Civil law reform, which was implemented in 2015, Russian law expressly recognizes many legal concepts ordinarily used in international transactions, such as representations and warranties, indemnification clauses, as well as options.
- A distinctive feature of the Russian real estate market is that commercially relevant land is often publicly owned (about 90% of the total land in Russia), and in most cases can only be leased (rather than purchased) by private parties under long-term lease agreements. Notably, in Moscow land plots are predominantly available for lease, and not for sale, even where a construction project is implemented. In these cases, the potential lessee must generally obtain the lease right through an auction (with a number of exceptions).
- Property rights to real estate are subject to registration in the public register. However,

the public register is not sufficiently reliable, and may not reflect certain types of encumbrances of real estate (such as underground objects restricting the use of land plot, e.g. cable lines). Therefore, a specificity of Russian real estate transactions is that extensive due diligence is often required.

- In terms of real estate market, many agencies report a continuing decline. Economic growth is evident primarily in residential construction and infrastructure projects, such as the development of transport infrastructure in major cities. However, the Russian government intends to use the construction sector as a driver of economic growth, reportedly planning significant investments. Still, the acquisition costs of major assets, especially in Moscow and Saint Petersburg, remain significant.

2. What is the main legislation relating to real estate ownership?

In Russia, the main laws relating to real estate ownership are the Civil Code, the Law on the State Registration of Real Estate Property, the Land Code, the Town-Planning Code. There are also a number of statutes regulating specific real estate issues, such as mortgage of real estate.

3. How is ownership of real estate proved?

In Russia, the ownership title to real estate is proved by its state registration in the public register (the Unified State Register of Real Estate) operated by the Federal Service for State Registration, Cadastre and Cartography (known as Rosreestr).

The information from Rosreestr is largely publicly accessible and can be obtained promptly and for a low fee. An extract from the register can be obtained in an electronic form (at the official website of Rosreestr,

available at: <https://rosreestr.ru/site/en/>) or in hardcopy based on the address or cadastral number of the respective property (but not based on the owner's name/identity).

However, it is possible to challenge the validity of entries in the public register by reference to various documents, such as a real estate sales contract. Further, property rights created before 1998 are valid without registration and in this case any evidence (contracts and administrative acts) can be used to prove ownership. Therefore, the entries in the public register are not sufficiently reliable, and extensive due diligence checks based on various documents (including prior real estate sale contracts) are generally required during real estate due diligence to verify the seller's title.

4. Are there any restrictions on who can own real estate?

In general, real estate can be owned by any person or entity, save for specific statutory exceptions. Some real estate objects can be only state-owned, such as land plots in the forest reserve funds and water supplies, specially protected areas, national parks, land under airports, sea and river ports.

Further, there are restrictions for foreign ownership of real estate in Russia:

- Foreigners cannot own land in the border territories or other territories specifically designated by law (for instance, land located within the boundaries of sea ports);
- Foreigners (and Russian companies with over 50% of foreign investment) may not own agricultural land but may lease them.

Further, in some cases prior consent of the Russian authorities is required to acquire real estate. For instance, acquisition of strategic assets may require prior consent of the Russian Government.

5. What types of proprietary interests in real estate can be created?

In Russia, there are the following main types of proprietary interests in real estate:

- Freehold (ownership rights), which entitles the owner to use, possess and dispose of its real estate assets at its sole discretion for an indefinite time. Several owners may have freehold rights to property, which can be either share-based (in this case each owner

may sell its interest in the property subject to the pre-emptory rights of other owners) or joint (statutory joint ownership arises generally in cases of spousal property; in this case the owners can dispose of the property only subject to mutual agreement of the parties).

- Leasehold rights, which entitle the tenant to possess and/or use real estate. Leasehold is based on the respective contract with the owner.

For information on further interests/burdens that can be attached over real property, see also Q12.

6. Is ownership of real estate and the buildings on it separate?

In Russia, land plots and buildings are separate real estate objects. Therefore, ownership and other proprietary interests are also separate with respect to land plots and buildings. However, in principle Russian law aspires to ensure that the same person has ownership or lease rights both to the underlying land plot and the building located thereon. Generally, ownership rights to a building may only be transferred together with the rights to the land plot underlying the building. Moreover, a building owner generally enjoys a preferential right to purchase and lease the land plot under the building.

Property law reform proposals provide for unitary ownership to land and the buildings on it. However, the relevant legislative bill has been under consideration by the Russian Parliament since 2012, and the exact prospects of its adoption are unclear.

7. What are common ownership structures for ownership of commercial real estate?

Commercial real estate is usually owned by companies established specifically for this purpose. This approach allows for efficient operation of the respective real estate asset and facilitates its sale as a going concern through share deals. Until recently, foreign investors preferred to establish offshore companies to own real estate. However, due to tax changes concerning controlled foreign companies, this type of structure has largely lost its appeal. Now commercial real estate is usually owned by a Russian LLC.

8. What is the usual legal due diligence

process that is undertaken when acquiring commercial real estate?

Legal due diligence of real estate assets typically covers such matters as:

- Due diligence of the seller's legal title. The primary source of information in this regard is the excerpt from the public register of real estate. However, the public register is not sufficiently reliable, as various legal defects may invalidate even a registered title (potential risks include absence of spousal consent to a prior transfer of ownership, heirs' claims, asset withdrawal schemes). Therefore, extensive due diligence of the whole history of title is generally advisable. Further, generally all possible encumbrances and pending disputes that may result in the challenging of the ownership title are analyzed.
- Due diligence of regulatory and environmental matters. During this phase, information from the authorities on land category and permitted use, restrictions on the use of the land plot, territorial zoning documents and city planning documentation are obtained. Neighbouring land plots and safety zones of nearby facilities, such as pipelines, electricity lines and hazardous production facilities, are also reviewed to ensure that land plot can be lawfully used for the buyer's intended activities without regulatory restrictions.
- Due diligence of construction matters. When buildings, structures and premises are purchased, documents in respect of the construction history of the building (construction permits and other special permits when applicable, commissioning certificates, state approval of the design documentation, etc.) are reviewed to minimize the risk that the real estate object is forcibly demolished as an unauthorized construction.
- Due diligence of infrastructure. Access to public roads and availability of utilities (or the possibility of connecting to utilities) has to be verified in advance, since in Russia connection to utilities and/or the establishment of road infrastructure in some areas may be extremely burdensome and expensive.

9. What legal issues (if any) cannot be covered by usual legal due diligence?

Due to the deficiencies of the Russian public register

system, some encumbrances and restrictions on real estate may be not registered. For example, underground power cables, pipes or other facilities may restrict the use of the land plot (e.g. for construction purposes), but are often not registered as encumbrances in the real estate register. Further, sanitary protection zones or other restrictions may exist, but may not be reflected in any public register or publicly available documents. This risk can be reduced through an extensive due diligence, which is often performed by sending official inquiries to various parties (e.g. local grid operators, various state authorities, commercial entities that own neighbouring land plots) to obtain confirmation that there is no infrastructure that may interfere with the designated use of the land plot offered for sale, and by on-site visits.

Further, often the buyer's decision to purchase the land plot depends on the local authorities' plans with respect to further development of the area (for instance, the authorities' plans to establish a railroad near the land plot may be a deal breaker). However, usual due diligence focuses only on existing city-planning documentation and cannot assess the risk of its changes in the future. Moreover, for some areas, the city-planning documentation is unavailable (not yet developed) or may be inaccurate. Therefore, to reduce this risk, a more extensive due diligence is required, during which the local authorities would be contacted with inquiries on their specific plans with regard to the area of interest.

Moreover, historical risks in respect of the title to the privatized land plots and other real estate objects often cannot be assessed precisely due to the lack of public register system in that period and other factors (lack of the necessary documents, non-transparency of the privatization processes, etc.) that make it difficult to evaluate whether the privatization procedure was carried out in compliance with law. These risks are often regarded as remote, yet cannot be excluded completely.

Finally, where real estate is purchased from individuals (both through asset deals or share deals), due diligence cannot fully exclude the risks related to spousal consents, when the seller claims to be not married. Recent court practice shows that lack of spousal consent may be a ground for invalidation for the transaction even where the purchaser was innocent and could not know about the lack of spousal consent. At the same time, it is currently impossible to definitively establish whether an individual is married. Therefore, this risk is usually covered by representations and warranties, as well as title insurance.

10. What is the usual process for transfer of commercial real estate?

Generally, a real estate transfer involves the following steps:

- Execution of a letter of intent/memorandum of understanding with an outline of basic commercial terms of the prospective transaction.
- Due diligence procedures and negotiations on the commercial conditions.
- Signing of the sales agreement. The sales agreement has to be formalized as one document (rather than separate offer and acceptance). No notarization is required.
- Fulfilment of conditions precedent (e.g. antitrust clearance);
- Transfer of possession. Typically, a transfer document (generally called the certificate of transfer and acceptance) is executed simultaneously with the transfer of possession.
- Transfer of legal title. In order to transfer legal title to the purchaser, the parties submit relevant documents to the Russian registration authority (Rosreestr), which formally registers the transfer of title to real estate to the buyer by executing an entry into the public register of real estate. The procedure of registration takes up to 30 days, and requires the payment of a state fee.

Generally, no notarization is required for the real estate sales agreement (with certain exceptions), however, the parties are free to conclude it before a notary. The notarization of the transaction, although expensive, provides some benefits. For instance, the notary is responsible for the validity of the transaction and deals with registration formalities with Rosreestr, and therefore notarization may expedite the state registration.

One of the recent developments in the state registration process is the option to file the documents with Rosreestr in an electronic form. However, the practice of paper-based registration is still widely used.

11. Is it common for real estate transfers to be effected by way of share transfer as well as asset transfer?

In Russia, complex real estate transactions are usually implemented by selling the company that owns and operates the respective assets (share deal), rather than

via the sale of the property itself (asset deal). Share deals facilitate the sale of real estate as a going concern, which is much more difficult in case of asset deals. Moreover, share purchase agreements are VAT exempt (however, if the tax inspectorate determines that the sole purchase of the share deal is to cover an asset deal, VAT may still be applied).

However, asset deals are often used for purchasing land plots (sale of land is also VAT exempt) and/or individual real estate objects as opposed to operating businesses and complex facilities. Asset deals are also advantageous where due diligence of the seller's company revealed tax, corporate or other company-related risks, or where such information is not available.

12. On the sale of freehold interests in land does the benefit of any occupational leases and income automatically transfer?

In Russia, by virtue of law, occupational leases and future rental income automatically transfer upon the sale of freehold interests in real estate.

However, this effect may be undesirable for the new buyer, as in some cases the buyer does not wish to have tenants in the purchased property. Still, under Russian law the buyer mandatorily becomes bound by any lease agreements that exist with respect to the real estate object, and may not generally terminate them until their expiration (unless the agreement contains a change of control clause or other special grounds for termination). In such cases due diligence has to be conducted to identify leasehold rights prior to the purchase of real estate. Long-term leases (over 1 year) are subject to registration in the public register, which significantly reduces the respective risks for the buyer, since in the absence of the state registration the long-term lease agreement is deemed unenforceable against third parties. However, short-term leases (less than 1 year) at times cannot be identified in advance, but the purchaser will still be unable to forcibly eject the tenants from the purchased property until the expiry of lease.

13. What common rights, interests and burdens can be created or attach over real estate and how are these protected?

In Russia, there are various contractual and non-contractual interests and burdens that can be attached to real estate. The most common examples include:

- Easements have to be registered in the public register of real estate. However, easements in

Russia have limited scope. Formally, easements can only include the right to use another person's land plot in a limited way (e.g. for passage), but not to prohibit certain actions by a land plot owner. Thus, unlike in common law, in Russia such restrictions as the prohibition to construct more than one building on the same land plot (negative easements) do not enjoy proprietary protection. These restrictions can be imposed only as a contractual obligation, but this effect will not "attach" over the real property.

- Mortgages can be used to secure legal obligations of the real estate owner. A mortgage can arise either by virtue of law or by a mortgage agreement. In case the secured obligation is breached, the mortgagee is entitled to levy execution on the mortgaged property. As a general rule, the mortgaged property is sold off at a public auction. However, outside the cases of bankruptcy, Russian law allows the parties to agree on out-of-court taking of the mortgaged real estate in case of default (in this case the mortgage agreement shall be notarized). In order to be protected against third parties, mortgage has to be registered in the public register.
- Option to purchase (call options). After the 2015 Civil law reform, Russian law explicitly recognizes options to purchase. However, unlike in some other jurisdictions, options do not "attach" over the real estate and are instead a purely contractual (non-proprietary) tool, which is structured using the mechanism of irrevocable offer. In case the real estate owner sells the real estate to a third party, the option holder can generally only claim damages, and cannot have recourse to the asset or to the third party purchaser. Further, options to purchase cannot be registered in the public register of real estate to notify third parties of their existence. Therefore, the legal protection of options is currently limited.

However, some interests that are widely recognized by other civil law jurisdictions are not existent in Russia. For instance, Russian law currently does not recognize the proprietary right to construct buildings (building right) or the right of benefit from property (however, currently a draft bill introducing these proprietary rights is pending in the Russian Parliament, but the perspectives of its adoption are unclear). Contractual instruments (such as lease for construction purposes instead of building rights) are currently used for these purposes.

14. Are split legal and beneficial ownership of real estate (i.e. trust structures) recognised

Russian law does not recognize trust structures and does not distinguish between legal and beneficial ownership.

15. What are the main taxes associated with commercial real estate ownership and transfer of commercial real estate?

Real estate owners are liable to pay property tax for buildings and structures, and land tax for land plots.

The tax rate for buildings and structures varies depending on the specific region, but in any case cannot exceed 2.2% of the cadastral or the accounting value of the real estate.

Land tax rates depend on the municipality where the land is located. The rates cannot exceed:

- 3% of the cadastral value for agricultural, residential and farming land.
- 5% of the cadastral value for other land (primarily commercial land).

In many cases, a building is owned by a private entity, but the land is leased from a public authority. In this case only property tax is paid. Further, certain entities are exempted from property tax and land tax, such as residents of certain special economic zones.

As for the taxes associated with the sale of real estate, VAT 20% is generally payable on the sale of real estate by the seller. However, VAT does not apply to the sale of residential real estate, land, and share deals (with some exceptions). Further, in certain cases the taxpayer can be exempted from VAT.

16. What are common terms of commercial leases and are there regulatory controls on the terms of leases?

Generally, the terms of commercial leases are not rigidly regulated and are freely negotiable between commercial entities. The most commonly used terms of commercial lease are as follows:

- Leases can be indefinite or fixed-term. In case of indefinite lease, the agreement can always be terminated at will, generally by giving a three-month advance notice. In respect of fixed term lease, there are no restrictions on the length of lease between private parties

(typical length is 3 to 5 years for major real estate objects). However, in respect of publicly owned real estate, a maximum lease term is provided by law (up to 49 years depending on the specific land plot and purposes of the lease).

- Renewal rights. The tenant generally has a statutory pre-emption right to conclude a new lease upon the expiry of the initial lease term, provided that the tenant duly complied with its obligations. However, many landlords seek to exclude this pre-emption right through contractual means. Further, as a general rule, if the tenant continues to use the leased property after the expiry of the lease term without objections from the landlord, the lease is automatically renewed on the same conditions for an indefinite term. In this event, each party can terminate the lease for convenience, by giving at least three months' notice.
- Rent in commercial leases is not subject to regulatory controls. For publicly owned property, the amount of rent is established by legislation. In commercial lease, rent is usually payable on a monthly basis (rather than upfront) and usually consists of base rent (fixed monthly payment based on the leased property's area), and variable rent (services charges and payments for utilities). Typically, the base rate is fixed in USD/EUR, but is payable in local currency (Russian Roubles) at the official exchange rate. However, considering the recent Russian currency fluctuations, many tenants seek to agree on contractual arrangements that mitigate currency risks (e.g. capped currency rate or currency adjustment clauses).
- Rent review. There is no statutory rent review in commercial leases. Therefore, the parties generally agree upon a procedure for periodic increase of rent, especially in long-term lease. Usually, the rent is increased annually by a pre-agreed percentage. Other ways of reviewing rent (such as rent increase based on official inflation or certain index) are possible, but less commonly employed. For some types of commercial property (such as in shopping malls), turnover based rent is often used, where the rent level is determined by reference to the revenue generated from the business operating the leased property. For publicly owned property, the rules for rent review are established by law, generally, the rent is reviewed annually (based on official inflation) or in case of changing the cadastral

value of real estate.

- Security deposit. It is standard for Russian landlords to request a security deposit (up to three-month rent) to secure the proper performance of tenant's obligations.
- Repair, maintenance and improvements. The parties are free to agree on different responsibilities for repairs/maintenance/improvements. As a general rule, however, the landlord is responsible for major repairs, whereas the tenant ensures only current maintenance of the leased property. In case the landlord fails to carry out necessary repairs, the tenant is entitled to terminate the lease or to seek compensation of its expenses. The tenant usually has the right to perform improvements to the leased property, which can be separable and inseparable. In contrast to inseparable improvements, separable improvements can be performed without the landlord's consent and generally remain in the tenant's ownership after the termination of the lease.
- Underletting (sublease). As a general rule, sublease requires the landlord's consent. However, in some cases, the landlord's consent can be replaced by a subsequent notification, for instance, in case of a sublease of public land leased for more than five years.
- As a general rule, in Russia, the parties to a fixed-term lease can only terminate the lease agreement through litigation based on material breach, and not through a unilateral declaration. However, in practice most parties agree on out-of-court termination and on the specific grounds for termination, which typically include payment default, improper use of the leased property, etc. Parties to a lease concluded for an indefinite period have the right to terminate the agreement at any time by giving three months' advance notice unless a different period is specified in the agreement. The Land Code provides for additional grounds for early termination of the land lease agreement by a landlord, for instance, due to a use of the land in a way that is inconsistent with its land category and permitted use, an appropriation of the land by the state, or a tenant's failure to complete the construction on the land plot within the established deadlines (in Russia, land lease is the primary basis for construction on publicly owned land).

17. How are use, planning and zoning restrictions on real estate regulated?

Real estate use, planning and zoning are regulated on the federal, regional and local levels.

At the federal level the Land Code provides for the general regulation of land categories and types of permitted use of the land plots, while the Town-Planning Code establishes regulations regarding planning and zoning restrictions. The Russian Government is to approve separate regulations for each type of zone with restricted use and plans to include this information in the Real Estate Register to make it publicly available.

The regional and federal governments also participate in the planning of territories by adopting their own territorial layouts on a general scale.

The municipal (local) authorities are entitled to approve planning and zoning restrictions in respect of their territories. For instance, most major cities adopt local rules for land use and development. These rules include zoning maps where certain areas are designated for residential, commercial and industrial use and usage restrictions are imposed. Any new construction projects must strictly comply with the requirements in these local rules (e.g. the permitted use of a particular land plot, construction limitations, etc.).

The municipal authorities also approve development plans, where anticipated changes of the zoning maps are reflected.

Planning and zoning restrictions in respect of a particular land plot are usually reflected in a land plot development plan (so called "GPZU"), which contains all information on the land plot which is relevant for construction (e.g. the type of permitted use, construction limitations etc.).

All zoning and planning documentations have to be carefully considered during due diligence and are generally publicly accessible. However, since Russian real estate law is in a transition phase, for many areas planning documents are not yet developed or are only available as drafts, which creates additional risks related to the uncertainty of the public policies to be established in these areas.

18. Who can be liable for environmental contamination on real estate?

Under Russian environmental law, the person that actually contaminated, polluted or harmed the environment is liable for the respective violation. Therefore, the buyer of real estate does not generally

assume the obligation to pay fines/compensations for environmental damage that occurred before real estate transfer, unless the breach is continuing. However, in case of a share deal the buyer will be liable for environmental damage that occurred before the transaction.

In 2019, Russia adopted substantial amendments to the environmental legislation aimed at ensuring proper waste management (the so-called "waste reform"). To implement this reform, most Russian regions approved waste treatment schemes, and set regional waste treatment tariffs payable by all entities and individuals that generate waste.

In 2020, the Russian Government also launched an experiment on setting emission quotas aimed at the reduction of emissions and identification of the main pollutants. This experiment will be carried out in several industrial cities until the end of 2024.

19. Is expropriation of real estate possible?

Under Russian law, real estate objects can be forcibly expropriated (taken) for public needs. Generally, the taking of private property requires a court order, whereby fair compensation should be determined. However, in many cases the authorities undervalue the expropriated property, and it is difficult for the owner to obtain a market price compensation.

Furthermore, land may be forcibly sold off public auction in case the owner fails to use the land plot in accordance with its designated purpose (especially relevant for agricultural land plots).

There are also special rules for expropriation of incomplete construction facilities constructed on a publicly owned land plot. In Russia, construction on publicly owned land is typically based on a lease agreement with the relevant authorities, rather than a property right. In case the tenant fails to complete the construction within the timeline approved by the authorities, the public landowner is entitled to terminate the land lease agreement and expropriate the incomplete facility by its sale through a public auction. The proceeds of the sale must be transferred to the tenant. At the same time, it is possible to extend the approved timeline of construction under certain conditions.

20. Is it possible to create mortgages over real estate and how are these protected and enforced?

Mortgage is the most commonly used security that generally allows the lender to sell the mortgaged real estate, usually through a public auction, and satisfy its claims with the obtained funds.

If a building is mortgaged, the mortgage extends to the related part of the land plot underneath the building. Premises, lease rights, unfinished constructions and a share in the construction of residential property can also be mortgaged. Mortgage is used for all types of contracts, including asset deals, construction agreements and agreements on share participation in residential construction. Mortgage may arise by operation of law (for example, in case the bank lends money to buy a land plot, it may claim a statutory mortgage).

No notarization of the mortgage agreement is required, except for the cases when the parties to agree on out-of-court taking of the mortgaged real estate by the creditor in case of default.

Mortgages have to be registered in the public register.

Mortgages can be enforced either via a court procedure or through an out-of-court enforcement. In case of enforcement through a court procedure, the property

has to be sold via a public auction. Out-of-court enforcement is possible if permitted by the mortgage agreement and only outside of the debtor's bankruptcy. In case of out-of-court enforcement, the mortgage agreement may authorize either the direct taking of the mortgaged property by the creditor (the so-called *lex commissoria*) or its sale to a third party (without a public auction) to cover the debt.

21. Are there material registration costs associated with the creation of mortgages over real estate?

The costs associated with the creation of mortgages are not significant and generally depend on the number of objects to be registered. No notarization is required, and the fee for registering the mortgage in respect of one real estate object with the public register is only RUB 4,000 (approximately EUR 55).

22. Is it possible to create a trust structure for mortgage security over real estate?

No, as Russian law does not recognize trust structures.

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