

Growing certainty

Wolfgang Müller and Alexander Vogel assess recent amendments to Swiss real estate law

Despite the worldwide financial crisis and economic outlook remaining highly volatile, Switzerland's real estate market has turned out to be quite robust. It has remained astonishingly stable throughout most of the last 30 months. Even in areas that experienced a substantial increase of price levels over the last five to ten years (such as the Zurich or Geneva regions) price corrections, if any, were quite moderate and below what had been predicted by real estate experts and feared by some real estate owners. Even pricing for office space in attractive locations has not decreased significantly, although the demand for office space declined moderately in 2009.

There are three main factors for the relative strength of the Swiss real estate market. Firstly, the Swiss economy has been less affected by the current economic crisis than other economies. This had a direct positive effect on the Swiss real estate market as a whole and the market demand for commercial property in particular. Secondly, in view of the still comparatively attractive labour market in Switzerland, the residential market continues to be positively influenced by the ongoing and relatively high levels of inflow of foreign employees and their families. Thus prices for residential properties have – even though quite high in suburban areas and in particular around Zurich and Geneva – remained stable or even further increased. Thirdly, interest rates in Switzerland for mortgages remain at rock-bottom levels and there are not yet any concrete signs of an imminent rise. On account of the strong Swiss franc, the Swiss National Bank is unlikely to raise interest rates in the coming months. A recent report by a Swiss consumer rating agency showed that average mortgage rates, although already quite cheap, fell even lower in the second quarter of 2010 from the previous three-month period and have now reached a historic 30 years low. Officials of the Swiss National Bank, however, recently cautioned against an unreflecting rush into investments in real estate and expressed

their wariness of a new real estate bubble beginning in view of the still increasing levels of residential properties in Switzerland. In view of these current trends, no short term changes are expected regarding real estate development projects, even though the number of building permits decreased significantly in 2009.

Rights over land

Ownership is the most comprehensive legal title with regard to a given asset but there are also other rights *in rem*, namely servitudes and easements and liens or mortgages, as well as rights annotated in the land register. Under Swiss law ownership rights can be divided into three categories: individual ownership, joint ownership and co-ownership. In cases of individual or sole ownership, the property is held by one individual or legal entity. Joint ownership is based on an underlying personal or contractual relationship (eg, a community among heirs or a partnership); the joint owners may only unanimously dispose of the property ie, the individual joint owners cannot dispose of their own share and are only entitled to a share of the net liquidation proceeds or an alienable proportioned interest in the property itself if and when the joint ownership relationship has come to an end. Co-ownership is based on an agreement of the co-owners. Each co-owner owns a mathematical fraction of the property with individual rights and obligations of an owner for such share of the property while the property itself is not divided up. Absent special provisions, all co-owners may dispose of their share in the property individually.

Specific regulations govern the condominium ownership which is a special form of co-ownership of the land supplemented by the right to exclusively use a particular part of the building which must be self-contained and have its own entrance or access (eg, an apartment including ancillary rooms or a whole floor in a building). Each condominium owner's share in the entire property is indicated in hundredths or thousandths and recorded in the real estate register. The condominium

owners form a condominium association and each owner has to contribute to a renovation fund for the entire property. The condominium association is in charge of all decisions about the building as a whole and the land; it is represented in internal and external matters by an elected administrator or condominium owner. To split a building up into condominium property, a public deed is required and condominium association regulations need to be drawn up which set forth the rules applicable among the several condominium owners and detail the exclusive rights of each condominium owner.

Servitudes and easements to which a property owner may agree in favour of a third party include, among others, the usufruct, the right of residence or life estate (*Wohnrecht*) and the building lease or leasehold (*Baurecht*) ie, the right to build on a parcel of land or part of it. Such rights are entered in the land register in most cases in order to give the holder of such right an absolute entitlement which can be enforced against any third party and thus protect them against any transfers of the encumbered property without assumption of the respective obligations by the new owner. While the usufruct entitles the beneficiary to use the property (including renting it to a third party), the right of residence allows an individual to inhabit a house or a part of a house itself, in most cases, for the lifetime of the holder of the right. The leasehold grants the holder the right for a specified period of time to use a parcel of land and to construct a building, use such building and, to the extent the leasehold is transferable, dispose of it without acquiring and thus owning the land on which the building is built. In return the holder of the leasehold has to pay a ground rent to the owner of the land. Leaseholds can be created for a period of up to 100 years, and to the extent granted for at least 30 years (and not connected to a specific property or a specific person) they can be entered into the land register as a separate folio. Upon expiration of the contractually agreed period of the leasehold, the right to build lapses and the building reverts automatically to the owner of the land against payment of a contractually agreed consideration. Since the statutory provisions only provide that the holder is entitled to a fair consideration without giving any guidance on how to determine such fair consideration, it is important that the leasehold agreement sets forth how to determine such consideration in detail.

Securities interests in real property may

be established in the form of a simple mortgage registration (*Grundpfandverschreibung*) or a mortgage note. The debtor remains personally liable for the secured debt in both cases. A simple mortgage registration is created by a security agreement in the form of a notarized deed and an entry of the mortgage into the land register. While the secured creditor can request an extract from the land register, such extract only serves as evidence of the security interest (but not the claim) and does not constitute a negotiable instrument. For the same reason claims secured by a simple mortgage registration need to be transferred by way of a written assignment. Conversely, mortgage notes are negotiable and transferable instruments (in bearer or registered form) which serve as independent and abstract evidence of the owner's debt. Mortgage notes serve as security, either in the form of a pledge (*Faustpfand*) by way of delivering the mortgage note to the secured lender or in the form of a transfer for security purposes (*Sicherungsübereignung*), which leads to an outright transfer of the mortgage notes to the secured lender with the obligation to retransfer such mortgage notes after full satisfaction of the secured obligations. Since an outright transfer to the secured lender or the security agent has certain advantages for the latter in the case of the bankruptcy of the security provider, or in syndicated lending transactions, and in particular in lending transactions involving multiple lenders or cross-border facilities, an outright transfer of mortgage notes rather than a pledge of the mortgage notes, is the preferred option in such situations. If the mortgage note has been issued in registered form, the granting of a pledge or an outright transfer require a valid endorsement by the holder in favour of the secured lender or the security agent.

Certain rights are similar to rights *in rem* if they are annotated in the land register: option rights to buy or repurchase real property, the right of first refusal, and the right to rent or lease the property.

Transfer of ownership

While the creation, transfer, lapse and registration in the land register of different forms of ownership and other rights *in rem* in real estate (including certain statutory preemptive rights connected to such rights *in rem*) are set forth in the Swiss Civil Code, the sale of real estate and the creation of contractual call or put options and contractual pre-emption rights are governed by the Swiss Code of Obligation. A sale of real estate and the grant of call or put

Author biographies



Alexander Vogel
meyerlustenberger

Alexander Vogel is a partner and he heads meyerlustenberger's M&A/corporate group. He regularly advises companies and financial institutions on cross-border mergers and acquisitions, public takeovers, banking and finance, corporate governance and real estate transactions. Alexander Vogel graduated from the University of St Gallen and obtained a Master of Laws from Northwestern University School of Law. He is a member of the Swiss and New York Bar and is a notary public (civil law).



Wolfgang Muller
meyerlustenberger

Wolfgang Muller is a partner in meyerlustenberger's capital markets/corporate group. He specializes in capital markets, in particular equity capital markets, and M&A and real estate transactions. Wolfgang Muller graduated from the University of Zurich and obtained his MBA at the Australian School of Business, the University of New South Wales, Sydney and the University of Michigan Business School in Ann Arbor, USA. He is a member of the Swiss Bar and the International Bar Association.

options or pre-emption rights (to the extent fixing a specific exercise price) require a public deed drawn up by a notary public. The transfer of title, except in the case of a merger, demerger or transfer of assets and liabilities under the Swiss Merger Act, only becomes effective with the registration of the new owner in the land register. The registration fees for a transfer are (with particular exceptions such as transfers that are part of a restructuring, ie, merger, demerger, etc) based on the market value of the real estate to be transferred. Further, in most cantons, the transfer of real estate is subject to real estate transfer taxes and to real estate gain tax or corporate tax.

Restrictions for non-Swiss investors

The acquisition of Swiss real estate by non-residents (hereafter referred to as persons abroad or foreigners) is restricted according to the Swiss Federal Act on Acquisition of Real Estate by Persons Abroad (Lex Koller). Persons abroad include foreigners domiciled abroad and foreigners domiciled in Switzerland except EU/EFTA nationals and except persons having a permanent residence permit (C permit). Legal entities are considered to be persons abroad if they are domiciled abroad or if persons abroad hold a dominant position (more than one third of the capital or the voting rights) within such legal entity or where the entity has received financing from persons abroad exceeding certain maximum thresholds. The Lex Koller requires persons abroad to obtain a

permit from the cantonal and federal authorities to acquire Swiss real estate unless such real estate serves as permanent business establishment for the exercise of an economic activity. Economic activities in the sense of the Lex Koller include industrial production, trading or service activities. Further, real estate pertaining to a permanent business establishment may, as an exception, include residential property if for example: such residential property is necessary for the business, such as a caretaker's flat; or a separation from the business is impossible or unreasonable, or such residential property is mandatory pursuant to housing unit quotas under planning or zoning regulations. The building, sale or rental of housing does not qualify as an economic activity in the sense of the Lex Koller.

Moreover, persons abroad may purchase real estate with land reserves without a permit as long as such land reserves, as a rule, do not exceed one-third of the property surface. Land for development purposes may be acquired by persons abroad, provided construction works on buildings to be used for economic activities begin within approximately one year. Also, a person abroad may acquire residential property by way of a merger with, or acquisition of, a company whose main business purpose is not the acquisition, holding and sale of residential property and provided the value of the residential property amounts to less than 30% of the company's assets.

Besides the direct purchase of real estate, the Lex Koller also covers transactions which give persons abroad actual control over real estate, for example through the acquisition of rights *in rem* (in particular leaseholds) or the granting of financing.

Since April 1 2005, shares of companies holding residential property may be purchased without a permit by persons abroad if such shares are listed on a Swiss stock exchange.

Revision of the real estate and land registry law

In June 2000, the Swiss Federal Government started preparations for a partial overhaul of Switzerland's real estate law. It is the farthest reaching revision since 1912 when the Swiss Civil Code entered into force. Eventually, in December 2009, the Federal parliament approved the final version of this partial revision. The revised provisions, and the implementing provisions in the land registry ordinance that are still being revised, are expected to enter into force on January 1 2012. The partial revision will introduce some important changes.

Paperless mortgage notes

The most important change is the introduction of the paperless mortgage note (e-registered mortgage note). To date mortgage notes have been issued as physical securities (paper mortgage notes). The safekeeping, transfer and transport of mortgage notes can lead to significant costs, in particular when mortgage notes are not properly transferred (e.g. missing or incomplete endorsements) or lost, when endorsements of former transferors have to be amended or a time-consuming invalidation process must be started.

With the amendment of the relevant provisions, a mortgage note can in the future either be issued as a paperless e-registered mortgage note or in its traditional form as a paper mortgage note. Old paper mortgage notes can be converted into paperless mortgage notes on the written request of the property owner and the beneficiary of the mortgage note.

The paperless mortgage note is established with its entry in the land register. It is either registered in the name of the creditor or the property owner (the latter also referred to as an owner's mortgage note). Transfer takes place by entering the new creditor in the land register on the basis of a written declaration by the former creditor. Compared to the current law, this requires a filing with the land register, but also increases legal certainty and transparency regarding the

secured creditor. Under the current law, the name of the secured creditor is entered on the mortgage note and in the creditors' register only when the mortgage note is issued, while the endorsement in subsequent transfers (if necessary at all) can be in blank, and registration of the transferee in the creditors' register is possible at the request of the transferee but not mandatory; thus such entry may not be accurate anymore. The pledging of a paperless mortgage note (or the granting of a usufruct) by the secured creditor also needs to be entered in the land register. As a result, in future only the land register will serve as the basis for the issue, contents, transfer and pledging of a paperless mortgage note.

Statutory liens

Under the current law, statutory liens to secure claims under cantonal public or private law (for example property tax, property gains tax, deed transfer tax and registration fees) originate directly by law and do not have to be entered in the land register in order to be valid. In future, however, statutory liens for more than CHF1,000 (\$963) must be entered in the land register. If such liens are not registered within four months of the due date of the underlying claim, and at the latest within two years from the accrual of the claim, they can no longer be invoked against a bona fide third party.

Restrictions under public law

Currently the cantons are free to issue rules on whether, and to what extent, restrictions under public law must be entered in the land register. Federal law does not, however, force them to do so. Consequently, while the land register in most cases contains reliable information on the rights and encumbrances on a property existing under private law, it does not list restrictions under public law that might affect a particular property. The partial revision therefore aims to make the cantons (as well as the communes and the Confederation) note specific restrictions on title in the land register. This will only apply, however, to restrictions imposed by an administrative decree after the entry into force of the partial revision, and it will also only apply to permanent restrictions on use or disposal and to property-related obligations of the property owner. As a result, and also because restrictions under public law that concern an area comprising several properties will not be entered in the land register, the land register under the new law will still not reflect all restrictions under public law. In this context, we refer to the

ordinance on the register regarding restrictions on title under public law. This register shall comprise restrictions on title under public law that apply to an area comprising several properties. The register of restrictions on title under public law is currently being established by some cantons and should be introduced by all cantons by 2019.

Contractor's liens

The deadline for registering a contractor's lien will be extended from three months to four months from the time the work on the property has been finalized.

In addition, the claim to a lien on tenant fittings, which has already been recognized in practice in the past, has been explicitly provided for in the new provisions and expanded to cover similar cases. Under the new law, a contractor's lien can also be registered on work ordered by a tenant, a lessee or another person who is entitled to use the property, provided that the property owner has approved the work. Therefore, in the future, prudent contractors are well advised to request proof of the property owner's approval.

Servitudes and easements

Under the new law, a contract on the granting of easements, such as a right of way, must be drawn up as a public deed in order to be valid, instead of just being recorded in writing as until now. This new formal requirement also applies to the certain other servitudes and easements, in particular the creation of a leasehold or mortgage for the benefit of the owner himself.

Final remark

The upcoming changes will generally lead to increased legal certainty and the legal provisions will better meet the needs of the players involved. It will, for example, also be possible to agree on a majority vote (instead of unanimity) for amendments of facilities usage and administrative rules for co-owned properties and condominium ownership. The procedure for updating and deleting land register entries will be subject to updated rules. The Lex Koller, however, is not affected by the current revision and will remain – despite certain efforts to abolish it in its entirety or at least partially – in force for the time being. Nevertheless, it is possible that certain attempts to further ease the provisions of the Lex Koller may be successful in the nearer future. Two motions to that extent are currently pending in the Swiss parliament.

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meyerlustenberger Attorneys at Law
Zurich | Zug | Geneva
Forchstrasse 452 | P.O. Box 1432 | CH-8032 Zurich
P +41 44 396 91 91 | F +41 44 396 91 92
zurich@meyerlustenberger.ch | www.meyerlustenberger.ch

Contacts:
Dr. Alexander Vogel
Dr. Thomas Lustenberger
Dr. Wolfgang Müller
Dr. Armin Zucker