

Leasehold Buyouts

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In 2007 the Moscow real estate market experienced another boom with a significant influx of capital accompanied by high returns. At the same time, most players still regard Moscow as one of the least transparent real estate markets in Russia, to say nothing of the rest of Europe. This is due not least to unclear land legislation and practices that often contradict federal legislation.

Recently the Moscow city government adopted several new pieces of land-related legislation aimed, *inter alia*, at creating clear-cut land use rules and eradicating the contradictions with federal legislation mentioned above. In particular, on January 5 the new Moscow city law "On Land Use" (hereafter the "Land Use Law"), introducing a number of important changes, came into force. On March 25 the city government adopted Resolution No. 203-PP, dedicated to the day-to-day operation of the Moscow Land Committee that outlines a number of procedures aimed at the implementation of the Land Use Law.

Below we would like to briefly review some of the innovations and developments introduced by the Land Use Law.

Right to obtain freehold to land

While the Land Use Law confirms that the city of Moscow treats leasehold as its first choice option, it nevertheless allows freehold to land to be obtained.



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It should be noted that freehold is only available for brownfield sites, while greenfield land continues to remain available on a leasehold basis only. This should not devalue the importance of the change, however, as the Land Use Law is the first piece of legislation in Moscow to spell out not only the principle, but also a relatively detailed procedure for obtaining freehold to land.

The Land Use Law provides that from January 5 until January 1, 2010 owners of buildings that were (i) acquired through privatization or (ii) redeveloped after privatization, or (iii) built anew on the sites of buildings that were initially acquired through privatization may acquire the freehold to the land plots on which they stand at 20 percent of the cadastral value of such land plots. Owners of buildings that do not fall into one of these categories above still may acquire the freehold to the land plot but for a higher price of 30 times the land tax payable on the land plot (the current level of land tax in Moscow being 1.5 percent of the cadastral value of the land plot). After January 1, 2010 the owners of buildings in all categories will be able to acquire the freehold to the land at full cadastral value.

As a side note it is important to mention that thanks to recent changes in federal legislation (Federal Law No. 212-FZ of 24 June 2007), the freehold to a site can be obtained even if the

owner of the building previously opted for long-term leasehold to the land.

Cadastral value of land as the basis for various payments

The Land Use Law reiterates that cadastral value of land serves as the basis for calculating land tax, land rent payments and payments for the acquisition of freehold and buy-out of leasehold rights.

It should be noted that the city government recently updated the cadastral value of all land in Moscow by adopting on December 4, 2007, Resolution No. 1046-PP "On the Approval of the Results of the Cadastral Appraisal of Land in the City of Moscow" (henceforth the "Cadastral Resolution"). Effective from January 1, the Cadastral Resolution increased the cadastral value of land twofold on average.

Redevelopment of land with change of permitted use

The cadastral value of land is closely linked to the location and the permitted use of the site. The Land Use Law states that demolition of existing buildings and construction of new premises on land plots, to which the freehold has been acquired as per the Land Use Law, is only possible if the use permitted for

the land is not going to be changed. In other words, if the privatized land plot was occupied by an office building at the moment when the freehold was acquired, the land plot can only be used for the operation of the existing office building or construction of new office premises. A change in the designated use of the site to allow the construction of, say, a shopping mall instead of offices, will only be permitted if the landowner first makes a payment of 80 percent of the cadastral value of the site to the city government's Department of Land Resources.

Change of certain types of permitted uses only on the basis of Moscow city law

As a matter of routine, change of permitted use of a land plot in Moscow is done on the basis of decisions taken by various representatives of executive authorities. In an attempt to provide greater protection for certain non-commercial uses as well as to support the operation of manufacturing facilities, the Land Use Law indicates the use permitted for land plots occupied by schools, kindergartens, scientific and manufacturing facilities can only be changed on the basis of laws adopted by the Moscow City Duma relating to each specific project.

Buy-out of leasehold rights to the land

City legislation sets down the general principle whereby any company that wants to lease land in Moscow first has to buy out the leasehold right from the city. Only when the buy-out is completed is the leaseholder entitled to undertake transactions involving the leasehold right (assign or mortgage the leasehold, lease the land, etc). Unless it has been purchased from the city, the leasehold is not tradable.

For a long period of time the city government took the view that this requirement applied both to greenfield and brownfield sites. Moscow city legislation stated that the owner of a

building was not obliged to buy out the lease to its 'footprint' but did have to buy out the leasehold of the land surrounding the building if he wished to undertake transactions with it.

The Land Use Law changed the above approach providing that owners of buildings do not have to make any payments related to the buy-out of the leasehold right.

Moscow City consents to transactions with leasehold rights

Previously all land users had to obtain preliminary consent from the city government for transactions with leasehold rights. It should be noted in passing that consent was usually refused if the leasehold rights had not been bought out first, although this practice contradicted federal legislation that stipulated that after October 30, 2001 (the date when the federal Land Code was adopted) a tenant who has entered into a long-term land lease contract (i.e.

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for a period of more than five years) does not require the consent of the landlord in order to undertake transactions involving the leasehold rights.

The Land Use Law indirectly recognizes the right of tenants holding such land lease contracts to transact with the leasehold rights in the absence of consent from the city government.

Upcoming changes

The Land Use Law and ensuing Moscow government resolutions are not the last documents to be adopted in the area of land use. The Moscow City Duma recently passed the Moscow City-Planning Code at its second reading and intends to work on the rules on land use and development with a view to having them approved by the end of 2009. The adoption of these laws will give Moscow a more robust legislative base for further development of the city. 