

# Commercial Real Estate

Second Edition

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# Spain

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## Leasing

### Practical points

#### *Framework*

Lease agreements in Spain are governed by the Spanish Lease Act. There are two main types of leases: residential leases and commercial leases. Commercial leases are used for letting commercial property such as offices, hotels and shopping centres. Parties may freely agree most of the terms and conditions of commercial leases, subject to certain mandatory provisions (e.g. the need to give a two-month deposit and which courts have jurisdiction over any dispute between the parties). Any matter not contemplated by the parties in the lease agreement is governed by the provisions of the Spanish Lease Act and the Spanish Civil Code.

#### *Securing the premises*

In order to secure the occupation of commercial premises in advance of them being constructed, parties usually enter into a lease agreement for future premises (*contrato de arrendamiento de cosa futura*), which is comparable to a turn-key agreement scheme, or sign a lease agreement according to which rent payments are conditional upon the construction of the property and certain milestones, such as for example the delivery of the final works certificate. In the case of existing premises occupied by a third party, pre-letting agreements are not uncommon, but potential tenants are more inclined to sign less detailed contractual arrangements (i.e. a letter of intent or heads of terms) until the property is vacated, and thereafter execute a proper commercial lease agreement.

#### *Taxes and fees payable*

The lease of commercial property is subject to and not exempt from Spanish VAT at a rate of 21%. However, tenants often find themselves paying the Real Estate Tax (RET) payable over the property, since it represents a major cost for the owner who usually tries to recover it from tenants as a service charge (see ‘Other occupational costs’, below). RET is a municipal tax levied annually on owners of Spanish real estate and is based on the cadastral value of the property calculated pursuant to the regulations of a government agency known as the cadastre (updated every 10 years and adjusted to the current market value). The RET rate for urban real estate depends on the relevant municipality regulations and ranges between 0.4% and 1.1% of the value set out in the cadastre.

#### *Codes of practice*

There are no industry codes or practices or guidelines that a tenant should know about which will help in negotiating the tenancy documentation. However, since the Spanish

real estate market is quite sophisticated, we advise potential tenants to try and replicate the terms and conditions they would be happy with in other jurisdictions. Note that most key players in the sector are familiar with complex lease agreements and understand the needs of potential anchor tenants.

### Key commercial terms

#### *Rent*

The amount of rent to be paid will very much depend on the tenant's bargaining power and is usually calculated on the basis of the surface area occupied by the tenant's premises. Parties usually agree a fixed annual rent based on the market value of the property, but for shopping centres you will usually find anchor tenants who have agreed a mixed scheme based on a turnover rent and a guaranteed minimum fixed rent.

#### *Rent adjustments*

The Spanish Lease Act does not regulate rent reviews. Parties generally agree annual reviews according to the Spanish Consumer Price Index (*Indice de Precios al Consumo*). Market rent reviews are usually stipulated as a condition to renew the lease and are even found in long-term leases (e.g. in a 15-year lease, the rent will be reviewed according to market rates in year seven). Turnover rent (or turnover rent combined with a minimum fixed rent) is also commonly used in the shopping centre/retail park sector.

#### *Other occupational costs*

It is common practice in Spain for landlords to recover the service charge they pay (e.g. general maintenance costs, security, cleaning, insurance, and local taxes) from tenants. The amount recovered will very much depend on the terms and conditions agreed between parties. The recoverability of Real Estate Tax is usually an important issue when negotiating leases, as it represents a major cost for the owner. Anchor tenants may benefit from caps on service charge contributions or even be able to agree a fixed monthly contribution. Triple-net leases are not uncommon in Spanish commercial lease practice and are usually required by investors in sale and lease-back transactions.

#### *Period of occupation*

The lease term can be freely agreed by the parties and the average term depends on the type of property being leased. For instance, for retail units in a shopping centre/retail park or small offices, a five-year term is usually agreed (with an option to renew), while a lease of a single-tenant office building or a large unit in a shopping centre/retail park will most likely be agreed for a longer term (10 to 15 years). Terms of over 15 years can be agreed in sale and lease-back transactions.

#### *Remaining in occupation*

There is no statutory right of renewal and parties may either expressly exclude or include the possibility of renewal in the lease agreement. It is market practice to foresee that any lease renewals be subject to a rent review according to market rates. If there is no express rent renewal provision and the tenant continues to lease the premises with the landlord's consent for 15 days after the lease has expired, the Spanish Civil Code allows the tenant to renew the lease.

#### *Right of first refusal*

Unless expressly excluded in the lease agreement, in the event of the sale of the leased premises, the Spanish Lease Act grants the tenant a right of first refusal within 30 days from the date on which the tenant receives notification from the landlord of the landlord's

intention to sell (*derecho de tanteo*). If a notification is not issued or premises are sold for less than the price set out in the notification, the tenant will be entitled to take over the contractual position of the buyer in the sales agreement (*derecho de retracto*).

#### *Disposing of the premises*

It is not common to find lease agreements that allow the tenant to dispose of premises at its discretion, or that allow for the possibility of returning the premises to the landlord. Parties usually agree a fixed mandatory term for the lease (and the possibility of renewals), which the tenant is bound by.

Unless otherwise agreed by the parties, under the Spanish Lease Act tenants may sublet or assign the leased premises to any third party without the landlord's consent. However, an assignment or sublease must be notified to the landlord, who is entitled to increase the rent by 10% (in the case of partial sub-lets) or by 20% (for total sub-lets or assignments).

In the event that ownership of the leased premises is transferred, the new owner will automatically step into the contractual position of the landlord and will therefore assume all its rights and obligations under the lease agreement – unless the application of the right of first refusal was not expressly excluded (see 'Right of first refusal', above).

#### *Alterations*

Unless the proposed fitting-out works may affect any structural elements of the leased premises, tenants are not required to obtain the landlord's approval. However, it is often contractually agreed that the tenant will be liable for obtaining all the relevant licences, permits and authorisations required to perform such works, keeping the landlord harmless from any sanctions imposed by the relevant authorities.

#### *Repair of the premises*

Even though the Spanish Lease Act contains specific provisions on maintenance and repair duties, in commercial practice such statutory provisions (based on the freedom of contract principle) are replaced with contractual provisions that are more landlord-friendly. Typically, the parties will agree that the tenant must repair any damage to the premises, that it should keep the premises in a good state of repair, and that the landlord will carry out works affecting the structure and façade of the premises. The tenant is not entitled to carry out any repairs that affect the structure of the premises, unless it has obtained written consent from the landlord.

#### *Deposit*

According to the Spanish Lease Act, it is mandatory for tenants to provide a deposit equal to 2 months' rent. The deposit must be made available at the time the lease agreement is signed and the landlord must deposit it with the competent body equivalent to the tenancy deposit scheme in England and Wales. The amount of the deposit cannot be reviewed (upwards or downwards) during the first 3 years of the lease. From the fourth year onwards, the amount of the deposit will be reviewed in accordance with the terms of the lease agreement.

#### *Registration*

Real estate leases should be formalised in a public deed executed by a notary public, as only a public deed can be recorded at the land registry. However, this is very uncommon in the Spanish market, since public deeds documenting real estate leases are subject to Stamp Duty at a rate of 0.25% to 1.5% over the total amount to be paid by the lessee during the full term of the lease agreement.

## Investment

### Practical points

#### *Exclusivity*

If an investor has not yet made up its mind as to whether to purchase a property, in order to make sure that the current owner does not sell it to a third party, the investor could submit a non-binding offer while requesting an exclusivity period.

#### *Restrictions on disposing of property*

The acquisition of an asset or a Spanish SPV by a foreign company is not subject to prior authorisation, but must be reported to the Ministry of Economy within 30 days as from the acquisition by filing the relevant standard form for statistical purposes only. However, companies that have registered offices or main places of business in a tax haven, or are interested in purchasing properties located near certain defence sites, must obtain prior clearance from the relevant authorities.

#### *Impacts on timing*

Every transaction is different and could be conditioned on several factors (e.g. the satisfaction of the conditions precedent set forth in the SPA, analysing all the information provided during the due diligence review, negotiating the R&W and specific indemnities). However, the most common factor that drives the timetable is obtaining external funding to pay the consideration agreed for the property (see ‘Financing, Lender due diligence’, below).

#### *Key milestones in acquisition process*

Generally speaking, the sale of property in Spain involves four stages. First, the parties usually sign a private agreement which sets out all the elements of the sale, or at the very least the essential ones. In more complex deals, this agreement may be preceded by a non-binding letter of intent and contain other provisions (e.g. conditions precedent, R&W, choice of jurisdiction or choice of law clauses). When executing the private agreement, the buyer often provides a deposit as security for the due and timely completion of the deal. Second, the parties appear before a notary public and execute a public deed of sale of the property which, after the relevant taxes have been paid (the third step), is registered by the buyer at the corresponding land registry (the fourth step). Upon the registration of the deed, the purchaser will have acquired valid, legal and almost indisputable title to the property.

#### *Requirement for transfer of monies*

Monies are usually transferred from an investor to the seller once the parties have appeared before the notary public and have executed the public deed of sale of the property (unless part of the price has already been paid as a security deposit) by means of a bank cheque, or a bank transfer via the Bank of Spain. There are no specific requirements for the transfer of monies in Spain, other than compliance with the Spanish Anti-Money Laundering Act which implements the relevant Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

#### *Execution procedure*

According to the Spanish Civil Code, the parties are free to choose the type of contract they wish to use. The will of the parties to be bound by the agreement determines the existence of a valid and enforceable agreement (even if it is not documented), and not any specific requirements on form.

In practice, the transfer of real estate is always carried out through a transfer deed executed before a notary public, as only a public deed can be recorded at the land registry (see ‘Development, Land ownership and assembly’, below). Except for mortgages or surface rights, which are only effective and enforceable once they are registered, the registration of a transfer deed or charges is not mandatory. However, buyers are strongly advised to register the title to their property, as recording grants protection to good-faith third-party purchasers who acquire title from a registered owner in exchange for consideration.

#### *Other procedural requirements*

Further to ‘Execution procedure’ above, in the event that the acquisition of the Spanish property has been registered in a foreign jurisdiction and the purchaser wishes to register its title, the following requirements must be met:

- The purchaser’s title must include the following: (i) identification of the contracting parties; (ii) a detailed description of the real estate to be transferred; and (iii) the consideration (price), with a detailed description of how the funds are to be paid (and where they come from and where they will be transferred to).
- The contracting parties must apply for a tax identification number (*número de identificación fiscal*, N.I.F.) issued in Spain. This condition is imposed by the Spanish authorities to allow the parties to pay the applicable taxes and other government charges related to the transfer of the real estate.
- The title must be drafted either in Spanish or in another language followed by a Spanish translation. In these cases, it is customary to draw-up the document in a double-column format and the translation into Spanish must be certified by a sworn translator.
- The title must be legalised according to the procedure in force in the country in which the contract was executed. It is therefore very important to set out whether or not the country is a party to the Hague Convention.

#### *Taxes and fees payable<sup>2</sup>*

The costs and expenses related to transfer and registration are the following:

- The taxation on the transfer of property generally depends on the type of property transferred (e.g. residential premises, commercial assets, or land). The transfer may be subject to VAT at the general rate (21%) or at reduced rates (10% or 4%) or to Transfer Tax at 3% to 11% (depending on the autonomous region where the property is located) over the market value of the property. Whereas no Stamp Duty will be payable in the event that the transfer is subject to Transfer Tax, transfers subject to VAT are generally subject to Stamp Duty at 0.25% to 2.5% (depending on the autonomous region where the property is located) over the real market value of the property.
- The transfer of land, new property and second-hand non-residential property is generally subject to VAT plus Stamp Duty and the transfer of second-hand residential property would be normally subject to Transfer Tax.
- Notary fees, which are calculated as a percentage of the amount of the deal (except for transactions in excess of €6m, the fees for which can be negotiated and agreed upon beforehand).
- Registry fees, although calculated on the basis of the transaction, are capped at €2,200 per registered plot and are not negotiable.

#### Key commercial terms

##### *Deposit*

As mentioned above in ‘Key milestones in acquisition process’, it is not uncommon for parties to agree that the purchaser must make a security deposit to confirm its interest in the

property. A typical agreement used in Spain for this purpose is the promissory purchase agreement with a deposit (*contrato de arras*). Security deposits usually range between 5% and 10% of the purchase price.

### *Timing*

The process of transferring title to real estate may take from a few days to several weeks or months, depending on the negotiations. For complex real estate assets (for example, shopping centres), the due diligence and the negotiations may delay the completion of the transfer by 4 to 6 weeks. As stated, financing could also play a role in delaying the transaction.

### *Employees*

Careful attention should be paid to the acquisition of assets such as hotels, which have employees or permanent staff linked to them. Under Spanish law, upon the acquisition of a business undertaking (and even if the employees were hired by a third party), the employment and social security authorities may consider that a transfer of undertakings has taken place. If this were to occur, the investor would have to subrogate the lessee's or the operators' labour obligations towards the hotel's employees (severance payments, retirement pensions, etc.).

### *Warranties for construction of building*

Under Spanish law all persons involved in the construction of a building could be liable for the material damage resulting from construction defects due to their lack of professional capacity or negligence for the applicable statutory periods (e.g. 10 years in the case of construction defects that affect the foundations, bearing supports, beams, supporting walls and other structural elements). In addition, the developer (*promotor*) of the works could be held jointly and severally liable for any construction defects without prejudice to its capacity of being able to recover the expenses from the constructor in charge of the works.

Under Spanish law, if an investor acquires a project under development there is a considerable risk that such investor would be subject to the relevant construction, planning and tax contingencies applicable to developers under Spanish law. Note that the Supreme Court considers developers to be the individuals or companies in charge of the construction of buildings for their own use or for use by third parties, whether they own the land or hold any other title to build on it.

## **Development**

### Practical points

#### *Land ownership and assembly*

A developer who wishes to find out who owns different parcels of land may seek this information at the land registry or cadastre.

Land registry offices are government agencies that register the title to land or property as well as interests over them (i.e. possession rights and mortgages). Spanish land registries provide information on the legal status of real estate properties. They hold information not only on ownership but also on encumbrances and liens (e.g. mortgages and attachments), *in rem* rights (e.g. usufructs, easements and concessions), certain other rights (such as certain option rights and leases) and any other circumstances (e.g. conditions precedent or subsequent, reservations of title and limitations to the right to dispose) or their owners (e.g. limitations of capacity, bankruptcy or suspension of payments and inheritances).



The cadastre is a register that records the descriptions of rural and urban land as well as land that has special characteristics. Although its main purpose is not to register title to land, all property owners must notify the cadastre of any disposal or alteration of land. The information held at the cadastre is used for calculating a number of local taxes applicable to land (namely, the RET – for further information, see ‘Leasing, Taxes and fees payable’, above).

Owners cannot be required to sell their land to developers. However, if the property is located in an area that is expected to be expropriated by the local compensation board (which is the most common way of carrying out private urban developments), the compensation board could force the council to expropriate the land of dissenting landowners.

#### *Land transfer*

Typically, developers buy the land with their own funds, and banks only provide finance once a certain level of pre-sales are achieved. Other possible construction schemes are turn-key agreements, or forward funding and/or forward purchase structures.

#### *Taxes and fees payable*

Transfers of agricultural or rural land are subject to but exempt from VAT, and therefore are subject to non-recoverable Transfer Tax at the applicable rate set out in the region where the assets are located (which could range between 3% and 11%). However, the VAT exemption can be waived by the taxpayers under certain conditions, in which case 21% VAT (which is usually recoverable for companies) will be payable upon the acquisition of the rural land in lieu of Transfer Tax. Where the acquisition is subject to VAT, Stamp Duty (at a rate of 0.25% to 2.5%) would also apply.

Transfers of urban land are subject to 21% VAT and Stamp Duty (at a rate of 0.25% to 1.5%).

The construction of a building is usually subject to Stamp Duty, which applies on the real value or cost of the works. Additionally, the tax on buildings, installations and works should be generally levied provided that the work or construction activity requires council permits. The tax base is the cost of the works, and the rate depends on each council. This cost should include the acquisition cost of the installations even though they could have been manufactured or produced away from the construction site.

#### Key commercial terms

##### *Price*

The price of land is calculated according to the guidelines in the Spanish Land Act, which sets out the factors that should be taken into account in calculating the value of land. The ultimate goal of the guidelines is to combat speculative practices and to set up an efficient and transparent land market. The Spanish Land Act will apply to expropriation procedures to be carried out by the public authorities, and has been welcomed by infrastructure companies who now see that the uncertainty surrounding the expropriation costs they have had to assume will now cease to exist. It will not, however, apply to transactions carried out by banks with respect to the portfolio of land they are building as a result of debt-to-asset deals agreed with developers, or foreclosure of mortgages where the value is calculated pursuant to Order ECO 805/2003 of the Ministry of Economy.

##### *Payment structure*

As mentioned, the investor’s payment of the agreed consideration will depend on the terms and conditions agreed with the seller. When a price deferral or any other future payments have been agreed, there are several ways pursuant to which landowners could secure such

payment, such as for example requesting a parent company guarantee, or setting forth a condition subsequent in the sale and purchase agreement (entitling the landowner to terminate the agreement if the payment is not completed).

### *Deal structures*

Forward funding or forward purchase structures used to be very frequent before the Spanish real estate bubble burst. However, for the past few years investors have focused on distressed transactions (assets and loans), instead of on the development of new constructions – or even the completion of unfinished constructions. However, it seems that the residential market is now awakening from a deep sleep and cranes are again reshaping the skyline of Spain's main gateway cities.

### *Taxes and fees payable*

Please see 'Investment, Taxes and fees payable', and 'Investment, Transfer of other tax or financial benefits', above.

## **Financing**

### Practical points

#### *Level of loan*

The maximum amount that lenders are willing to advance against commercial property usually ranges between 65% and 70% of the asset value of the property.

#### *Security*

Spanish law establishes a wide range of security packages similar to those known and used in most other European jurisdictions, but the most typical securities in the context of commercial property financing are mortgages and pledges over shares, bank accounts and credit rights. Promissory mortgages are also not unheard of in the Spanish market, albeit not that common.

Mortgages are security interests, enforceable against third parties, which enjoy significant privileges and can be granted over any type of real estate. The mortgagee may enforce the collateral to the exclusion of most other creditors by following relatively simple and expeditious foreclosure proceedings. A mortgage can secure all types of payment obligations, including, in particular, principal, interest, default interest and fees in respect of loans and credit facilities. If a borrower becomes insolvent, the lender cannot foreclose on the mortgage until one year after the date on which the insolvency was declared or the date on which a composition agreement with the creditors was approved.

The mortgage deed must expressly mention the maximum amount of the underlying obligations that is secured by the mortgage (typically 130% to 140% of the loan principal). In this regard, it is important to carry out a cost-benefit analysis, given that Stamp Duty must be paid on the basis of the maximum secured amount. Currently, Stamp Duty applicable to public deeds of mortgage may generally range between 0.5% and 2% of the secured amount.

A mortgage must be formalised in a public deed and recorded with the relevant land registry in order for it to be valid and enforceable, and these steps trigger the obligation to pay notarial and registry fees.

#### *Lender due diligence*

If an investor has already conducted a due diligence review in the context of the potential acquisition of a property, the lender will normally ask for a copy of the due diligence reports prepared by the investor's advisors (e.g. most frequently, the valuation report

prepared by a certified RICS consultant, and the legal due diligence report prepared by the legal advisors which, depending on the type of property to be acquired, usually covers, real estate, corporate, procedural and finance matters). Generally, investors do not involve the lender in the transaction until the due diligence review has been completed. In these scenarios, lenders will request the investor's advisors to prepare reliance letters so they can also rely upon the due diligence reports.

### *Formalities*

The principle of freedom of form applies also to financing transactions. Spanish law stipulates that a loan (irrespective of the security related thereto) should be documented in writing but does not require a specific type of document (private agreement, deed, etc.).

However, in order to secure certain procedural advantages in the event of enforcement, loan agreements are usually executed in the form of a deed witnessed by a notary public (*escritura* or *poliza*). Standard practice is to execute the loan and the mortgage in a single document, which is usually then granted in the form of a notarial public deed (or executed in private and afterwards converted into a public document before a notary public).

In any case, mortgages must be executed by means of a notarial deed in order for the lenders to be able to register them with the corresponding land registry, as opposed to pledges, which can be executed by means of a notarial policy – *póliza*). This is relevant due to the fact that only deeds and not notarial policies are subject to Stamp Duty.

### *Enforcement*

Spain is one of the jurisdictions in which lenders have full recourse to all assets of the defaulting borrower (not just the mortgaged property). In addition, the lender may not directly appropriate the mortgaged property from the borrower, but must instead initiate foreclosure proceedings monitored by a court (or, in some cases, a notary) in order to assure that the property is sold at market price. The foreclosure proceedings will be initiated by filing a claim with the relevant court and typically take between 15 to 18 months to fully conclude. Provided certain requirements are met, the mortgagee may request and be granted with the administration and/or possession of the mortgaged property. After giving the borrower the opportunity to repay the outstanding amount of the loan, the proceedings will end with a court-organised public auction.

As a general rule, to initiate a foreclosure proceedings the debtor must have incurred a material breach of its payment obligations under the loan agreement. It is unclear as to whether a material breach of other obligations (such as a financial or other covenant) under the loan agreement allows the borrower to seek the acceleration of the debt and trigger foreclosure proceedings. Spanish courts have very limited legal criteria as to what a material breach would be in such case, and it is therefore left to the court's discretion on a case-by-case basis. Moreover, the breach of the covenant would have to be declared by the court before the actual foreclosure, through ordinary court proceedings (which would substantially delay the entire foreclosure process). In such case, the foreclosure of the mortgage will in principle only be possible if such a provision has been included in the mortgage loan as an event of default and is also registered at the land registry.

### Key commercial terms

#### *Length of loan*

The term of the loan will very much depend on what the parties have agreed but it also depends on the purpose of the loan. For example, for the acquisition of shopping centres or office buildings, the term of the loan is usually 10 years depending on the expected returns

of the asset, whereas in the case of the refinancing or restructuring of distressed debtors this term is usually between 3 to 4 years depending on the forecasts in the business plan.

#### *Interest rate and payment dates*

Normally the nominal interest rate is the sum of the applicable reference interest rate (EURIBOR, and less frequently, LIBOR) plus the agreed margin, which usually ranges between 1.75% and 4%. The margin can be fixed but is more likely to be a variable figure linked to a certain financial covenant (typically, net debt Service to EBITDA).

Generally, the interest is calculated in successive interest periods of 3 or 6 months of duration.

#### *Repayment*

The usual circumstances which entitle a lender to demand repayment of a loan are the same as those that could be found in other jurisdictions or in an LMA agreement, (e.g. in the event of breaches of financial covenants, R&Ws, CoC provisions, etc.). Usually, any finance agreement contains a specific clause setting forth the events of default and the acceleration regime of the loan.

However, since Spanish courts may not consider the defaults to be material breaches (see ‘Investment, Transfer of other tax or financial benefits’), the corresponding court may not allow the lender to seek enforcement through foreclosure proceedings. The lender will instead have to seek a court decision enforcing its right to foreclose through ordinary proceedings (which take longer and do not necessarily give lenders direct recourse to the asset).

\* \* \*

### **Endnotes**

1. The information in this publication is provided for general information purposes only and may not be relied upon for any specific transaction. We do not accept any responsibility for any inaccuracy, omission or statement that might prove to be misleading. Readers are advised to seek professional advice before investing or doing business in Spain.
2. The authors recognise the valuable input of Luis Suárez de Centi from the tax department of Uría Menéndez.

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In 2009, Diego was one of the winners of the Iberian Lawyer 40 Under Forty Awards, which recognise the achievements of the new generation of top lawyers in Spain and Portugal.

He is also regarded as a *Leading Lawyer* by the main international legal directories such as Chambers & Partners, PLC and International Who's Who of Lawyers. He is also noted and praised by clients for his pragmatic and can-do approach.

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- Merger Control
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