

Real Estate Law

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Ukrainian real estate law, in particular concerning the acquisition and leasing of residential and office premises in urban areas and the right of use to land underneath, is still in a process of development. The basic system for property transfers is relatively straightforward and still resembles that in other Commonwealth of Independent States (CIS) countries. However, due to conflicts between the old Soviet and the new Ukrainian laws, as well as to several technical problems in the current legislation, in some situations, it can be impossible to give an absolute clean title opinion as in the west. There are usually procedures and verifications that can be used to give assurances of title that may, as a practical matter, be satisfactory. It is anticipated that the new Land Code will solve most of the existing problems.¹

Most state-owned residential premises remain leased to the occupiers under leaseholds that are normally inherited by the leaseholder's heir. There have been considerable changes, however, during the past four years aimed at enabling Ukrainians to acquire their own dwellings by privatisation. In general, buildings and the apartments and offices in them may be owned privately by Ukrainians and foreigners. Recent legislation also permits some agricultural and other rural land to be purchased by Ukrainians. Urban land, however, remains largely owned by the state and can not yet be purchased.

¹ Ukrainian real estate law presently consists of the applicable Ukrainian Civil Code provisions, principally the 1963 Civil Code of Ukraine and the 1992 Land Code of Ukraine, as supplemented by recent legislation including the 7 February 1991 law 'On Property', as subsequently amended, and a number of Soviet era laws that can still apply.

Much of the land and buildings in Ukraine are still owned by the state. Consequently, the laws on the disposition of state property are especially relevant, such as the laws 'On Enterprises in Ukraine', 'On Leasing of State Property', 'On Privatisation of the State Dwelling Fund', and 'On Privatisation of Property of State Enterprises'. On top of this legislative framework, Ukraine imposed a new Constitution in 1996 which, in Articles 13 and 14, asserts the right of the state, as well as of citizens and legal entities, to ownership rights in real estate 'as may be provided by law'.

Foreign purchasers

As observed below, foreigners were initially prohibited from purchasing any real estate interests. Under the law 'On Property' (1991), purchases by foreigners of buildings, as well as of office and residential premises in them, are permitted. Foreigners can not purchase land.

These restrictions on land ownership are ordinarily not important, since the private owners of a building have a right on payment of what are presently nominal amounts to occupy the underlying land. This right is supposed to continue indefinitely. Currently, where the state owns the land underneath and there is no single private owner or association of owners, there is no charge for this land use.

Privatisation of dwellings

Ukrainian urban residents may currently 'privatise' the apartments they rent by purchasing them for a state-appraised value. This right arises from the 19 June 1992 law 'On Privatisation of the State Dwelling Fund'. Whether any payment is in fact due from the occupier depends on a valuation based on the location, type, condition and size of the premises and on the number of family members or other occupiers involved.

For example, in Kiev, a family of three may ordinarily privatise an apartment of 73 sq m or less for free. For a larger apartment, an additional payment would usually need to be made for the extra space based on a formula. Such an owner might continue to rent the premises rather than pay to privatise it. Once privatised, the owner may deal with the premises as he or she wishes, including selling, leasing, mortgaging or otherwise disposing of them.

Purchases of offices and apartments

To purchase office or residential premises, the first step for the buyer is to verify the seller's title by reviewing his or her title documents and checking these with the notary or exchange house (assuming one was used) responsible for the conveyance. Although not yet customary in Ukraine, the buyer's lawyers should prepare an overall sale agreement to which the standard short form 'purchase-sale agreement', described below, is attached as an exhibit for execution, and then for use in the title registration process.

The State authorities ordinarily will only register title based on the short form contract. However, for contract law protection, it is advisable to have agreements and indemnities documented in the overall sale agreement. The law of misrepresentation and fraud is not well developed in Ukraine, and there is only limited recourse against sellers under the standard short form contract.

Turning to the title documents that should initially be presented by the seller, ordinarily a notarised purchase-sale contract, a contract of purchase through an exchange house, or evidence of inheritance or gift, as well as a certificate from the Bureau of Technical Inventory (BTI), should state that the seller is the owner. (Although even if such evidence is not necessarily conclusive and further due diligence is usually necessary.)

If a notary was used, the contract for sale will state the number and bear the seal of the notary who handled the prior conveyance. The seller's BTI certificate should show that the title is registered there and cite the BTI registration number. In addition, the seller should provide a document stating that the property is not in violation of law or subject to any mortgage, arrest or other impediment. However, for the reasons indicated below, such a document will not necessarily provide conclusive proof.

On the buyer's side, an individual will need to show a passport. A corporate buyer will need to prove that it is a validly existing and registered entity, which is usually accomplished by providing a fully notarised and legalised copy of a certificate of incorporation and charter.

Once good title has been verified as much as possible and the price and other sale terms agreed, a contract of purchase-sale is ordinarily executed before a notary and the transaction is listed in the register of notarial acts. Ordinarily three original copies of the sale contract are prepared, with one copy for the buyer, one for the notarial records and one for the seller.

Certain purchases may alternatively take place at an exchange house, which reduces the state duty fees from 5 per cent to 0.1 per cent, but notarial registration may still be preferred by a buyer for various reasons and may, depending on the circumstances, produce a lower overall tax burden for the seller. There are many such exchange houses in Kiev at which individuals or certain groups may sell their privatised apartments. Some buyers insist upon state notarisation as an additional safeguard of title, as the state notaries can assist with the verification process and provide the best proof of execution of a document.

The buyer should then apply for the transfer of the property to be registered at the BTI and obtain a registration number. There are some loopholes to the notarisation and registration process described above. Once a BTI certificate and registration number exist to evidence the transfer of title, the documentation formalities are completed, although in fact title actually passes with the execution of the contract of purchase-sale.

Special considerations for the acquisition of buildings

Where a building is to be acquired, either by outright purchase or by purchasing all of the apartments, special considerations apply. For formerly state-owned buildings, the state retains ownership of the non-privatised

apartments and the common parts with title usually held by the executive committees of the local councils, which in turn delegates management to the local state dwelling management enterprise (known as 'Zhek'). The owners of all apartments must pay Zhek for its maintenance role, irrespective of whether any services are actually provided, at rates that vary depending on the number of occupants and whether the apartment is for business or residential use.

It is presently possible for the owners of all of the apartments and other premises in a building, following their complete acquisition by privatisation, to form an association of owners ('condominium') to take over the ownership of the common parts and responsibility for their maintenance. The condominium can then retain Zhek or independently contract for building maintenance.

Acquisition of shop premises

Shops are usually specially zoned and are subject to special privatisation rules. A single manager or a collective of the employees that run a shop may privatise the shop's business, but they must go through a special procedure to privatise the shop's premises as well. Unless the premises are privatised, then they are ordinarily leased by the state to the new private shop enterprise.

The existence of shop premises can make acquisition of a building considerably more complex, especially if the acquirer would like to redesignate the entire premises for office or residential use. If a shop's premises are privatised, then their owner becomes a co-owner of the common parts with the other apartment and office owners and is subject to maintenance payments to Zhek unless a condominium is formed.

Land underneath premises

As previously observed, on payment of the relevant land tax (presently a minimal sum), the owner of all of a building (including a condominium) has the right to use of the land underneath, in principle in perpetuity (if properly documented). (The same rules for land use generally apply for the beneficiary of a right of use to a state building.) These land use rights pass with the transfer of the building giving rise to them, and can only pass to the new owner. This right of transfer was confirmed by Article 30 of the Land Code of Ukraine. The new owner of property should register its, his or her right of use to the land. Although the transfer of the right of use to land passes automatically, it should be documented in the transfer documentation.

Where the state continues to own the land underneath, for example

where apartments are owned by different persons and the state is a co-owner, there is no charge for the land use under current law.

Rights of use to undeveloped land - greenfield developments

Rights of land use are the usual form of rights to land. As observed, these rights automatically follow from ownership of the building on a site. However, before a building is constructed, where land is, as usual, held by the state, a temporary right of use must be granted to allow construction.

Obtaining a right of use for construction requires numerous local approvals to be granted. Project approvals for construction of the proposed structure on the site will also be required. In principle, this temporary right lapses once construction is finished, and the right of use to the site below should then be established by a separate act by the local authority. Usually, temporary rights of use for construction cover much more land than is granted by permanent rights of use, since additional areas are typically necessary for construction.

A right of use to land, as well as to state-owned buildings, can be granted for long fixed periods or in perpetuity by the state. Such a right will usually also be made subject to conditions or purposes which, if violated, can result in forfeiture.

Land ownership and leasing

As observed, rights of use to land are the norm for Ukraine, but some land can be owned directly by Ukrainian citizens. Under the 1992 Land Code of Ukraine, Ukrainians may only own land in limited circumstances, such as rural homes, garages, farms and gardens. Foreign individuals are expressly prohibited under the 1991 law 'On Property' from owning land. This prohibition on land ownership has been generally interpreted to apply to foreign companies. Arguably the prohibition also applies to Ukrainian companies that are majority owned by foreign persons or entities.

Foreigners may, however, lease land from the state on the same basis as Ukrainians, and such leases may run for up to 50 years (less one day) and arguably may be prolonged. (Foreigners may also have rights of use to property, as discussed above, for longer periods or in perpetuity.) Land ownership is permissible under the Constitution as may be provided by law, and it is anticipated that future legislation will expand land ownership rights.

Documentation and due diligence for purchases

The traditional purchase-sale contract for the transfer of premises is typically contained on only one or two pages (with annexes). Usually such an agreement merely states the names of the parties, the address of the premises with a brief description of the floor plan, the price and the current registration number allocated by the BTI. It shows the signature of the parties, and the signature, seal and number of the notary, if one is used.

Increasingly elaborate agreements, more like those used in the west, are now being used for transactions of substance, especially for transactions where foreign buyers and their lawyers are involved and the Ukrainian seller has substantial assets. Agreements guaranteeing absolute and unconditional title, the physical condition of premises, the absence of knowledge of defects, etc may often be obtained by negotiation. These are recommended to supplement the generally untested and somewhat vague protections under the Land Code of Ukraine and other legislation. As observed, these additional contractual protections are usually contained in an overall sale agreement to which the standard short form purchase-sale agreement is attached as an exhibit for execution and use in the title registration process. The state notarial and other state authorities are usually reluctant to accept sale documents for execution and registration that are not in a traditional short form format.

One version of the purchase-sale contract that is registered must be in Ukrainian, but the contract can be made in two or more languages. Once a foreign purchaser obtains an agreement in principle to acquire a property, in addition to verifying the title legally, certain practical verifications should be made as to the chain of title from the state. In the meantime, in order to protect the purchaser's right to acquire the property on agreed terms, a long lease with a purchase option might be signed at the outset.

Such a lease-purchase option document could give the purchaser the right to hold in escrow the prior purchase-sale contract or other evidence of title, which could make a transfer to others more difficult, if for example a third party offers a higher price before completion. A seller will usually require a down payment before parting with its purchase-sale contract. While not required, it would be preferable to have this lease-option document executed before the notary (if one was used) who was responsible for the previous sale of the property, and who holds one of the original copies of the prior purchase-sale contract. In principle, however, as explained below, if the seller sells to a third party in violation of the lease-option terms, the lessee's rights are terminated except against its lessor (the seller) for breach of contract.

Leases

Leases on residential dwellings, offices and buildings may be validly granted, including to foreigners, as noted above. Under the Soviet system, lease terms of 15 years were typical, but longer periods are now being agreed. The maximum lease term is uncertain, but a lease should certainly be valid for at least up to 50 years (*less* one day) and can probably be renewed.

In general, lease provisions can cover whatever the landlord and tenant agree. Typically, leases define the rent, the term and the extent and quality of permitted refurbishments, and may provide for first refusal rights should the premises be offered to a third party purchaser. Leases should be in Ukrainian (but may also be in a second language) and may, but need not, be executed before a notary. If the lessor conveys title to another person, then the transfer is subject to the lessee's rights to the leased premises under the pre-existing lease.

Zoning

All Ukrainian real property, including premises and undeveloped land, are ordinarily subject to use zoning. Most urban offices and apartments in urban buildings will be zoned for residential or non-residential use. Changes in zoning can be difficult to obtain, and therefore the zoning status should always be confirmed prior to acquisition or renovation. Where a non-permitted use is anticipated, the necessary change in zoning should always be carried out before the property acquisition. There are, however, a number of exceptions that permit certain non-zoned uses.

Mortgages

Ukrainian legislation permits mortgages ('hypothecas'), but they may be of limited value. In order to create a mortgage, a mortgage document must be executed between the owner (mortgagor) and the creditor (mortgagee) before a notary. Once mortgaged, the owner can not sell the property, except with the creditor's consent, until the mortgage is released.

If there is a default permitting the mortgage to be enforced, then the creditor can take over the property and cause it to be sold at a judicially supervised public auction. Following the sale, the creditor may deduct the amount secured from the sale proceeds, and must then pay over any balance to the former owner. If there are no purchasers in the auction, then the creditor can acquire the property based on a fair appraisal of its market value which, in the absence of other purchasers, can be expected to be low.

One of the principal problems with mortgages presently is that it is difficult to verify whether the owner has previously mortgaged the property before another notary, as there are hundreds of notaries in many areas and no central index or registry of mortgages. In principle, a mortgage (or unregistered sale) executed before a notary prevails over any subsequent mortgage transaction.

Enforcement

If an owner-occupier sells, but improperly refuses to vacate, the purchaser can move to have the transaction set aside or to have the former owner evicted. If a tenant stays on after its, his or her lease expires, eviction is also possible.

Normally proceedings for property disputes must be brought before the ordinary state courts, but where only corporate entities or entrepreneurs (registered sole traders) are involved, rather than simple individuals, proceedings must be initiated in the state arbitration courts. Once an eviction order is obtained, the judicial clerks may authorise the local militia to carry out the eviction. The militia should enforce the order but, as they are not under the direct control of the courts, enforcement problems occasionally arise. It is therefore always preferable to take vacant possession on or before paying for the purchase of premises.

Special considerations for purchasing and leasing state property

The foregoing has concentrated on dealings in privately held property, but much real estate, both buildings and land, is held by the state. Any purchase of state-owned property or lease of all of the property of a state enterprise must be made through the State Property Fund (SPF), and ordinarily also with the approval of the relevant ministry.

It appears that leasing some, but less than all, of the property of a state enterprise may be negotiated directly with the enterprise in question, subject to approval of the relevant ministry but without SPF consent. Practice in this respect varies, however, and the relevant law is not clear. Such a lease appears to be subject to being voided on privatisation of the enterprise that grants it, if the SPF was not formally involved.

Fees and taxes

Where a notary is used for the sale of premises and other real property, state duty covering registration and notarial fees of about 5 per cent of the

stated transfer value must be paid, subject to reductions for certain transfers within families. As noted earlier, where an exchange house is used, the fees are only 0.1 per cent, but other taxes may subsequently apply to increase the vendor's overall tax burden. Use of a notary for transactions should therefore be evaluated on a case-by-case basis.

As observed, where a building is owned privately by a single owner or condominium, then land tax is payable. This is presently a nominal amount. However, new taxes are expected to be adopted and apply to real property in the near future.

Future legislation

A new Civil Code that will incorporate a revised Land Code is planned for 1998. This is presently being developed with reference to the laws of other civil law countries, in particular France and Germany. In addition, a new law 'On Property' is expected in 1998 but, based on the current draft of this law, it is unlikely to do more of substance than to abolish the old Soviet concept of communal property, leaving only private and state property, much as in the west.