
THE REAL ESTATE LAW REVIEW

THIRD EDITION

EDITOR
DAVID WATERFIELD

LAW BUSINESS RESEARCH

THE REAL ESTATE LAW REVIEW

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THE REAL ESTATE LAW REVIEW

Third Edition

Editor
DAVID WATERFIELD

LAW BUSINESS RESEARCH LTD

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EDITOR'S PREFACE

Building on the success of the previous editions of *The Real Estate Law Review*, the third edition now extends to some 40 jurisdictions, and we are delighted to welcome new contributors from key countries around the world. *The Real Estate Law Review* seeks to enable practitioners and clients to meet the challenge of keeping abreast of the rapidly evolving global real estate market. Each chapter offers an up-to-date and accessible summary of the key legal and practical developments in the relevant jurisdiction, and a vital snapshot of the important market drivers, trends and opportunities. Together, the chapters provide an invaluable overview of international real estate.

It is no longer possible to look at domestic markets in isolation; real estate has become a global industry, and *The Real Estate Law Review* reflects that status. An awareness of the global real estate market and an understanding of the practices and requirements of overseas investors are vital if practitioners and their clients are to take advantage of investment trends and opportunities as they develop.

The Real Estate Law Review continues to provide an overview of the state of the international real estate market, including the types of investor, the sources of funding and those assets that are in demand. In general, the focus remains on prime properties in the world's leading global cities as investors continue to seek a safe haven for their capital. Although this remains the case with London, investors are starting to see opportunities in the wider UK market, and we are generally more optimistic than at this time last year. However, positive recent news, data and forecasts must still be considered in the light of continuing economic and political challenges, including the next US fiscal cliff, uncertainty in emerging markets and the stability of the eurozone.

Once again, I wish to express my gratitude to the distinguished practitioners from across the globe who have provided invaluable contributions to this edition. As ever, I would also like to thank Gideon Robertson and his team for their sterling efforts in compiling this third edition of *The Real Estate Law Review*.

David Waterfield
Slaughter and May
London
February 2014

Chapter 14

HUNGARY

Péter Berethalmi and Kata Molnár¹

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The general legal framework governing the types of real estate ownership is set out in the Act on Arable Land, the Act on Real Estate Registration and the Civil Code of Hungary. From 1 May 2014, the Act on Arable Land shall cease to exist, and the rules on arable land will be regulated by the Act on Trade of Agricultural and Forestry Lands. According to the rules, Hungarian private individuals and legal entities may acquire the ownership of real estate freely; however, a few restrictions and prohibitions exist.

Acquisition of ownership of non-arable land generates restrictions on non-resident legal entities and private individuals because in this case an authorisation is required. The rules for authorisation of EU nationals, and legal persons and entities without legal personality established in any Member State, are different from those for non-EU residents (see Section V, *infra*). For an investor, a more likely solution may be to set up a business or establish a branch office in Hungary, or to join a Hungarian business as a member or acquire participation (shares) therein.

The regulations on acquisition of ownership of arable land also differ depending on the acquirer. Hungarian private individuals may only acquire arable land up to a limit of 300 hectares in terms of size, or 6,000 gold crowns in terms of quality rating.² Hungarian legal entities and organisations that are not legal entities may not acquire ownership rights of arable land; however, the state of Hungary, local governments and public foundations are exempted from this prohibition. The acquisition is also disallowed in the case of

1 Péter Berethalmi is the managing partner and Kata Molnár is an associate at Nagy és Trócsányi Ügyvédi Iroda.

2 The gold crown system was introduced in Hungary in the second half of the 19th century and is still used to express the value of agricultural land.

non-resident legal entities and private individuals; if, however, an EU national wishing to settle in Hungary to engage independently in agricultural production has been residing legitimately in Hungary for at least three consecutive years and pursuing agricultural activities, the provisions pertaining to resident private individuals apply.

From 1 May 2014, the new Act on Trade of Agricultural and Forestry Lands will regulate land acquisition. According to the new Act, Hungarian private individuals and EU nationals that are not agriculturalists³ may only acquire land up to a limit of 1 hectare in terms of size. An agriculturalist may acquire land up to a limit of 300 hectares in terms of size, but acquisition of land is disallowed to non-resident private individuals, states other than the Hungarian state and legal entities. However churches, mortgage loan companies and local governments may acquire ownership of land.

There is a further prohibition that real estate owned exclusively by the state or real estate prescribed by law are not subject to trade; hence, the alienation of such real estate will be deemed as null and void.

ii System of registration

Any private individual or legal person contemplating acquiring real estate in Hungary should have an understanding of the system of land registration. The land registry is a large official database that records the most important data and information for all Hungarian real property, along with any relevant rights and facts of significance for legal purposes.

Land registry records are deemed authentic proof of registered rights such as ownership rights, usufruct, right of use, mortgage, right of execution and also the facts relating to the property. The registered rights and recorded facts – for the benefit of a *bona fide* acquirer – are considered true until proved otherwise. For the purposes of land registration, a person acquiring a right in real property by payment of a consideration and trusting the land registration will be deemed a *bona fide* party.

The registration system helps to guarantee the safety of real estate transactions, because any alteration, such as registration, modification and cancellation of certain data and information, must be registered in the real estate register, and this activity falls under the jurisdiction of the Land Title Office.

The land registry has a significant role in relation to any real estate transfer, as the change of owners must also be registered upon the transfer of ownership (beyond the contract for transfer or other legal titles). In this case, the ownership right is created upon being recorded in the real estate register. Hence, if the purchaser fails to register the change of owners, the acquisition will be effective only between the purchaser and the seller, but will be ineffective against third parties. Furthermore, it is possible that a person

3 Agriculturalist refers to a Hungarian private individual or EU national registered in Hungary who has an agricultural or forestry qualification or, lacking this, who pursues independently an agricultural or forestry activity in Hungary for at least three years under his or her own name and risk, or who is a member in an agricultural production organisation registered in Hungary in which it has 25 per cent ownership.

may acquire title outside the scope of land registry, but may not enforce it against *bona fide* third parties that rely on the land registry.

In addition, the register, and thus all relevant information about Hungarian real estate, is open to everyone, including foreign investors. The Land Registration Office issues land certificates regarding real property in Hungary and these can be obtained and reviewed without restriction by any person; however, the documents on which the registration is based can be reviewed only with the approval of the interested parties.

iii Choice of law

With regard to the transfer of Hungarian real properties, it is important to clarify which law is applicable. Generally, in the case of ownership and other property law, the law of the jurisdiction in which the asset is located is the governing law. Hence, as far as Hungarian real property is concerned, Hungarian law applies. Generally, the parties are not entitled to choose law different from that which is applicable at the location of the asset. There are, however, a few exceptions; in matters other than ownership and property law, the applicable law depends on the actual legal matter at hand.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2013, the market continued to be affected by the global recession, since it had not really started up again. The most noticeable features of the market included stagnation, low prices, unexploited properties, difficulties with financing, and a lack of demand and new developments. In 2013, the number of real estate investments continued to diminish; investments in Hungary in 2013 amounted to only €100 million, which is the same level as that in 2000. This shows the definite effects of the recession: prior to 2008, this figure was over €1,000 million. Apart from the recession, a lack of centrally located prime real estate and lack of correspondence between demand and supply may be contributory factors to the decision by foreign investors not to commit to the Hungarian market.

Generally, investors look for top-quality buildings that conform to the current trends. In the case of offices, the most important requirements are generally a good location, a high standard of architecture, design and innovation, and environmentally friendly technologies. In the retail market, certain trends may be significant in relation to commercial properties: a promising concept is the development of multifunctional or themed shopping centres, designed to be indispensable locations in people's lives, including their social lives. The increase in the size of these centres and their use of green or park areas has also helped to create an environment for market success.

III FOREIGN INVESTMENT

The Hungarian rules afford foreign investors complete protection and safety in relation to their investments. Non-resident private individuals and legal persons may also regularly pursue business activities in Hungary. Foreign nationals may establish business associations without restriction, and there are also several tax incentives, such as corporate

tax allowances (if the value of the investment is above a certain amount) and, in the case of real estate investment trusts (REITs), the lack of corporate tax liability.

Foreign nationals may generally invest under the same conditions and enjoy the same protection as Hungarian investors; there are, however, a few restrictions (see Section I, *supra*) on the acquisition of ownership of real estate located in Hungary.

In general, aside from the prohibition on the acquisition of arable land, there are no direct restrictions on foreign investment; however, non-resident private individuals and legal entities may acquire title of ownership to real estate only with authorisation from the competent administrative authority. EU nationals, legal persons and entities without legal personality established in any EU Member State may acquire title of ownership to real estate not qualified as arable land under the same conditions applicable to resident persons.

IV STRUCTURING THE INVESTMENT

In terms of real estate investment structuring, foreign investors have several options. They may choose direct investment, and within this, the direct purchase of a Hungarian real property. As mentioned previously, Hungarian law provides that investment by foreign nationals enjoys full protection and security, and generally there are no restrictions on foreign investment. A non-resident individual or legal entity may invest in Hungary directly, without establishing a business association, branch office or a commercial representation, but authorisation from the competent administrative authority is required in the case of real estate investment (especially the acquisition of Hungarian real estate).

It is possible, nonetheless, for investors to establish or buy project companies and also to acquire participations therein. These special purpose companies are established for a definite construction purpose, such as the completion of a new project or a new building. In contrast with direct investment, the owner of the completed project is the project company itself. The main business structures for project companies are limited liability companies and private limited companies. These are the most common business vehicles in Hungary, because they can be established quickly and have the further advantage of limited liability, which means that (with the exceptions set out in the Companies Act) members will not be liable for the liabilities of the company. Another advantage is the absence of restrictions, or special taxes in respect of foreign investment, on the ownership of a project company; however, investors have recently shown a preference for direct investment, to avoid the liabilities of the project companies issued in the past.

Foreign business entities may also establish branch offices and commercial representations. A branch office is an organisational unit of a foreign company, without legal personality, vested with financial autonomy and registered as an independent form of company in the Hungarian company registration records. Foreign companies are entitled to conduct entrepreneurial activities through a branch office or offices registered in Hungary. A commercial representative office of a foreign company is not involved in business activities in its own name, but is also registered as an independent business entity in the Hungarian register of companies. In addition, it engages – in its own name and on behalf of the foreign parent company – in the mediation, preparation and conclusion

of contracts, provision of information to clients and partners, and other client-related service activities.

Tax rules are applicable to all of the above-mentioned entities. Companies that pursue business activities for profit in Hungary must pay corporate tax. Taxpayers are subject to corporate tax liability on their income pursuant to the provisions of the Act on Corporate Tax. The tax liability of a resident taxpayer commences on the date when the memorandum of association is drawn up, signed and certified in due legal form. As regards a branch office, the tax liability of a non-resident enterprise commences on the day this branch is entered in the register of companies and terminates on the day it is removed.

A further option, one that offers tax advantages to foreign investors, is the foundation of a REIT, in the form of a public limited company (see Section VII, *infra*). While REITs currently enjoy exemption from corporate tax liability in Hungary, the mandatory 10 billion forint start-up capital does present an obstacle to the investor, and limited liability companies and companies limited by shares are more likely to be set up than REITs.

V REAL ESTATE OWNERSHIP

i Planning

Hungarian law provides obligatory rules and regulations regarding the establishment and development of any real properties. According to the Act on the Formation and Protection of the Built Environment, the rules of construction works and activities are regulated at both national and local level. Relevant national regulations regarding planning must be created by the state, and any type of construction work, such as building, expansion or a change of function, must be carried out in accordance with the national rules. Beyond this, local rules specific to the location of the real property also need to be fulfilled. All local requirements, rights and obligations are laid down in the local building code adopted by the local government.

A change in the function of an existing structure will only be allowed if it makes proper use of the area and is consistent with public policy. In addition, construction works may only be carried out, in general, upon conclusion of any relevant proceedings with the building authorities, such as those regarding building permits, demolition permits, occupancy permits or continuation permits.

ii Environment

Along with the above-mentioned general requirements, construction works must also be carried out in accordance with environmental obligations. Depending on the location of a structure, *inter alia*, special requirements regarding environmental protection and conservation of nature areas must be followed. As a general rule, the entity making use of the location is also liable for any harm caused or any imminent threat posed to the environment, and must contribute to any costs of prevention and remediation. Liability for environmental damage may fall jointly and severally upon the party registered as the owner or possessor (user) of the property; this party may be exempted from joint and

several liability if it is able to identify the actual user of the real property and to provide proof beyond any reasonable doubt that liability lies solely with the actual user.

In the event of failure to comply with the requirements, the environmental authority may limit, prohibit or suspend the activity causing harm to the environment, or a fine must be paid.

iii Tax

In Hungary, the purchaser must pay a duty on the transfer of real property to the tax authority. In a case of onerous transfer, the general rate of duty for the acquisition of real property is 4 per cent of the market value of each property acquired up to 1 billion forints, plus 2 per cent of the portion of the market value above 1 billion forints (not exceeding 200 million forints per property). The duty on transfer is due upon the conclusion of the sale and purchase agreement, before the transfer of the real property is completed and registered in the land registry.

On the acquisition of shares in a company with holdings in real estate properties located in Hungary, the beneficiary must pay duty if such holdings reach or exceed 75 per cent of the company's total capital (see Section VII, *infra*).

When the purchase of real property by foreign nationals involves authorisation, 50,000 forints must be paid for each property as a duty to obtain the necessary permit. Real estate-related proceedings such as those before the land registry or the building authority also generate duty.

iv Finance and security

The most common form of security granted over a real estate is a mortgage. In the event of a mortgage, the charged property remains in the possession of the obligor, who is entitled to use and utilise it. Real estate may be charged as security only in the form of a mortgage. A mortgage will only be considered valid if contracted in writing and recorded in the land registry. In practice, besides mortgages, a right of purchase (option) may also be a form of security. The owner of real estate may grant, by means of a unilateral statement, an option to another party entitling that party to buy the real estate. This option can be stipulated for a maximum of five years, and any option stipulated for an indefinite period automatically expires after six months. According to the new Civil Code, effective from March 2014, the above time limitation shall cease to exist, and the option can be stipulated for an indefinite period of time and does not expire after six months. Agreements on options to purchase must be concluded in writing, with the object and the purchase price specifically indicated.

VI LEASES OF BUSINESS PREMISES

The Flat Lease Act provides obligatory provisions for the lease of flats and commercial premises.

The Act regulates the occupational lease of premises (office rental) that qualify as non-residential premises. The conclusion of the office rental agreement must be made in writing between the lessor and the lessee. An agreement in breach of these conditions shall be deemed null and void. Both the lessor and the lessee may be foreign private

individuals, legal entities or other organisations that are not legal entities, without restriction.

The main obligations of the lessee are the proper use of the premises in accordance with the contract, and the payment of the office rent. The amount of rent will be determined in the contract by the parties, and there is no specific obligatory provision in relation to this. The lessor may inspect the lessee's proper use, and is entitled to claim for compensation if the lessee does not fulfil its obligations and causes any damage in the premises. In addition, if the lessee fails to pay the office rent according to the contract, the lessor may seize the assets of the lessee located in the premises up to the amount of the unpaid office rent. The most typical securities in the case of rent agreements, however, are the bank guarantee and the deposit.

The lease contract may be valid for an indefinite period, for a specified term or for an unspecified term until certain conditions are fulfilled. In the last two cases, the agreement is terminated upon the expiry of the agreement term or upon the occurrence of the conditions defined in the agreement. Lease agreements concluded for an indefinite period can be terminated by a party vacating the lease. Furthermore, the parties may always terminate the contract by mutual agreement. Typically, contracts are agreed for a five-year period and, after renegotiations, are subsequently extended.

In the Hungarian office lease market in 2013, stagnation continued in the cases of occupational premises, business premises and offices. A few new developments were completed in 2013 in the field of office premises (e.g., the completion of Bosch Center and the VáciGreens office park (see Section VIII, *infra*)). In east Hungary, occupation of offices diminished; however, occupation of offices increased in west Hungary. The property index, which summarises investor expectations, descended three points in the case of Budapest. In general, the market continues to stagnate.

Demand and the occupational rate also remained diminished in the case of industrial premises. The only new development in this area in 2013 was the completion of the Budapest Airport Business Park, which offers a further 10,800 square metre area of industrial premises for lessees and investors.

Despite optimistic expectations for 2013, a lot of premises remain unoccupied, the number of vacant properties has not reduced and rents are still at a low level in the cases of offices and apartments.

In 2014, rents will probably increase, the number of empty, unexploited premises should decrease and, of course, more developments are to be expected. The first build-to-suit developments were completed at the end of 2011, and it is anticipated that we will see more of these in the future, as they are well suited both to current trends and to demand.

VII DEVELOPMENTS IN PRACTICE

The last three years have seen several new developments in real estate law and practice in Hungary that may have implications for foreign investment.

i Duty and tax changes

Changes in duty on the transfer of real property, effective from 1 January 2013, may have an effect on investment in Hungary. The rules have changed regarding duty on the transfer of apartments. Until 2012, in a case of onerous transfer, the rate of duty for apartment purchases was 2 per cent of the market value up to 4 million forints and 4 per cent of the part above this threshold. From January 2013, the rate of duty for the acquisition of any apartment is 4 per cent of the market value of each apartment. This means that, for an apartment valued at up to 4 million forints, the buyer shall pay an extra 80 thousand forints upon acquisition. The duty on the transfer of apartments is, therefore, less favourable than it was in 2012; however, this does not amount to a significant increase in the buyer's obligations, and it is unlikely that this amendment will have a negative impact on investment.

ii Real estate investment trusts

The Act on Real Estate Investment Trusts, effective since 27 July 2011, is another recent development. This type of corporate entity is well known in many other European countries, but new to the Hungarian market. According to the Act, every REIT will be set up in the form of a public limited company with start-up capital of at least 10 billion forints, and will pursue defined activities in either Hungary or other countries. These activities are the purchase of real estate, the lease and operation of real estate, property management and real estate investment management. The state tax authority registers those public limited companies that function as REITs, and also may police the fulfilment of conditions laid down in the Act. These entities receive preferential tax and duty treatment. Basically, companies that pursue economic activities for profit on a regular basis and other similar gainful activities (business operations) must pay corporate tax. The Act notwithstanding, every company qualified as a REIT is exempt from corporate tax and local business tax: only the owners of the REIT must pay tax according to the profit and dividend. The main purpose of the REIT Act was to promote the activity of companies that invest in commercial premises and real estate with financial assets collected from small and other investors, and therefore encourage development in real estate. Despite the advantageous tax and duty situation, to date there is no company registered in Hungary as a REIT, and this may well remain the situation for the foreseeable future. The stagnant market produced by the recession and lack of capital affords little prospect of such a company being set up.

iii The Plaza Stop Decree

Another new measure, the Plaza Stop Decree, effective from 1 January 2012,⁴ declares a general moratorium on building commercial units exceeding an area of 300 square metres, unless permitted by the committee established by the Minister for Rural Development. While this three-year moratorium on commercial developments does affect hypermarkets in particular, the development of major shopping centres has already seen a slowdown as a consequence of a saturated market and decreasing personal consumption. The reasoning

4 Part of the amendment of the Act on the Formation and Protection of the Built Environment.

behind the decision to implement this measure was to alter the structure of commerce to give a more important role to domestic enterprises, and to promote and sponsor the retail trade; however, the restraint of commercial developments for three years clearly affects investment possibilities, and may deter serious foreign investors. Some opine that major development companies will stay away from Hungary in future and, in the worst-case scenario, those already present may even withdraw from the country because of the regulation.

The Decree has been in place for a year and primarily affects the development of grocery stores and hypermarkets. Thus far there have only been a few cases in which the committee established by the Minister for Rural Development has permitted the establishment of commercial units exceeding an area of 300 square metres.

VIII OUTLOOK AND CONCLUSIONS

At present, the Hungarian real estate investment market is still stagnating: there is no economic growth, demand is scarce and the banking system's whole engagement in the financing of property projects – in terms of capability, willingness and overall activity – still follows a negative trend. There are no favourably anticipated legislative measures or proposals pending, and the economic situation continues to generate insecurity. The market will probably continue to suffer from the same problems in 2014; however, there were a few new developments and trends in 2013.

There is still interest in commercial property developments. Despite the level of saturation in the Hungarian market, with few remaining areas worthy of being built up, plans for the construction of new shopping centres and sites in both the capital city and the country are under consideration. In 2013, two major developments were completed in this area. The Árkád 2 shopping centre in Budapest was handed over in March 2013, and seems as popular as Árkád itself; 95 per cent of its premises are occupied, which will probably increase to 100 per cent very soon. The other newly completed shopping center in Budapest is the first luxury centre, the 4,000 square metre II Bacio di Stile in the middle of Andrásy Street. However, KÖKI shopping centre, which was handed over in 2011, is now up for sale due to bankruptcy.

Expectations are positive for the apartment market: the rents and prices of apartments in Budapest are still low, which offers a great opportunity to investors. According to the surveys completed in 2013, lots of investors are buying apartments in Budapest due to the low prices and are leasing them. Compared with other European cities, Budapest has the most favourable prices.

In the office lease market, most transactions are renegotiations and contract extensions. Existing contracts notwithstanding, there have been some new deals, but stagnation is also expected in 2014. The one main development in this area in 2013 was the handing over of the A category VáciGreens office park, which has LEED Platinum certification and currently offers 18,000 square metres of office space. The occupational rate of its premises was 93 per cent within a few months of completion, and the park also won the Project of the Year award. In 2014, in the field of offices, demand will probably focus on such developments.

Appendix 1

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Péter Berethalmi is the managing partner of Nagy és Trócsányi. In addition to his position as managing partner, Dr Berethalmi is a partner in the firm dealing with mergers and acquisitions, property transactions and project finance matters. His clients include foreign multinational corporations and financial institutions. Dr Berethalmi joined the firm in 1996; he has been a partner since 2001 and became managing partner in 2005. He speaks Hungarian and English.

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