

# Client Update

## Top 10 Legal Developments in the Russian Real Estate and Construction Market in 2014

**MOSCOW**

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The international law firm Debevoise & Plimpton LLP presents a brief overview of what we believe to be the ten most significant developments in Russian legal regulation (including legislative initiatives) and court practice in the real estate, construction and infrastructure sectors in 2014.<sup>1</sup>

### LAWS AND REGULATIONS

#### Substantial Changes to Land Code

In 2014 substantial changes were made to the Land Code of the Russian Federation and certain legislative acts that have important consequences for how land plots are formed, how land is allocated for construction, and how land plots from public lands are leased.

In particular, the provisions of the Land Code relating to the procedure for allocation of public lands underwent significant modification. Generally speaking, the sale and lease of land plots is carried out by taking bids at auction.<sup>2</sup> An auction may be initiated by the public owner or private entity. The Land Code establishes an extensive list of exceptions whereby the sale or lease of land is carried out without bids being taken (e.g., for the implementation of large scale investment projects at federal or regional level, conclusion of an agreement for

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<sup>1</sup> Please note that this overview does not attempt to describe all major developments in the law and court practice that took place in 2014.

A similar Review was prepared by Debevoise & Plimpton LLP in 2013:  
<http://www.debevoise.com/insights/publications/2014/03/top-10-legal-developments-in-russian-real-estate/?translationGuid=9d7486a3-0575-44dc-a3f7-441f2b9c9da0>

<sup>2</sup> Prior to the changes there were two separate procedures for the allocation of land plots from public lands for construction purposes: with or without preliminary approval for facility location.

an integrated community development, conclusion of a concession agreement, etc.).

An important innovation for lessees of public lands is the provision whereby the lessee of a land plot that is publicly owned does not have a right of first refusal to renew the lease for a new term without a tender being announced. The rental amount is a material term in concluding a lease agreement, and if this term is not specified the lease agreement will be deemed not concluded. The Land Code sets forth the maximum limits for the lease of land plots based on the purpose for which the land is intended to be used (e.g., for construction and reconstruction of buildings and structures land plots are provided under a 3 to 10-year lease; land plots are provided under a lease of up to 49 years to owners of buildings and structures or premises within such buildings or structures situated on the leased land plot).

The changes also dealt with the hitherto problematic issue of the status of construction in progress items where the lease agreement for public lands is terminated. Thus, unless the law provides otherwise, a construction in progress item may be removed from the ownership of the titleholder by court decision and sold by public tender. The proceeds from the sale of such item are paid to the former titleholder minus the cost of holding the public tender.

Of the other amendments the following are notable for their practical importance:

- the concept of land plot has been clarified;
- new rules have been established for how land plots are formed;
- the procedure for creating an easement has been changed;
- certain types of rights in rem to land plots, such as use in perpetuity (“постоянное (бессрочное) пользование”) and right of occupancy for life with the right to bequeath (“пожизненно наследуемое владение”), have been abolished;
- the law now sets forth the possibility of swapping publicly owned land plots for land plots held in private ownership, etc.

For the most part the changes take effect from March 1, 2015.

(See Federal Law No. 171-FZ on Amendments to the Land Code of the Russian Federation and Certain Legislative Acts of the Russian Federation dated June 23, 2014.)

## Cadastral Value of Land Plots and Capital Construction Facilities in Moscow and the Moscow Region Determined

The results of the cadastral assessment of land plots and capital construction facilities in Moscow and the Moscow Region were adopted. Thus, from January 1, 2014, the cadastral value of land plots rose substantially, which led to an increase in the tax burden in respect of land tax. For example, within the Moscow city limits the increase averaged 11%, while in the satellite towns that had been added to Moscow ("New Moscow") the cadastral value of land plots increased by up to 2.5 times. This has resulted in an increase in disputes challenging the cadastral value of real estate.

As of January 1, 2014 property tax on certain real estate (such as office buildings and business centers, shopping malls and the premises within them, office premises, etc.) recorded in balance sheets as the fixed assets of an organization must be calculated on the basis of the cadastral value of such property.

The results of the determination of the cadastral value of capital construction facilities, including commercial buildings, residential buildings, residential apartment buildings, and residential and commercial premises, were adopted in Moscow.

(See., e.g., Decree of the Moscow City Government No. 751-III on Adoption of the Results of the State Cadastral Assessment of Moscow Lands dated November 26, 2013; Decree of the Moscow City Government No. 752-III on Adoption of the Results of the Determination of the Cadastral Value of Capital Construction Facilities in Moscow dated November 26, 2013; Instruction of Minmosobslimuschestva No. 1499 on Adoption of the Results of the State Cadastral Assessment of Immovable Property Situated within the Moscow Region dated November 28, 2013.)

## Clarification of Rules for Apartment Accommodation Construction in Moscow

In Moscow, the rules for apartment accommodation construction were clarified. Prior to the introduction of these changes there had been a widespread practice of building apartment accommodation as part of multifunctional office business centers, as separate immovable property, etc.

Since the changes apartment accommodation may only be situated in hotels and other accommodation-type property (apartment hotels, suite hotels, hostels) for the purposes of providing temporary accommodation.

Thus, it will no longer be possible to build apartment accommodation as separate capital construction facilities intended for accommodation, or as part of office business centers.

We note that the Decree of the Moscow City Government applies to the construction of new facilities and does not affect current projects for which the relevant permissive documentation and site design documentation has been issued. Should new apartment accommodation construction be attempted that is not part of a hotel, there is a risk of not being able to obtain the proper permissive documentation and site design documentation (including the land plot development plan ("ГПЗУ")), and for property constructed without such documentation there is a risk of being held accountable for unauthorized construction.

(See Decree of the Moscow City Government No. 660-III dated November 11, 2014 on Amendments to Decree of the Moscow City Government No. 228-III dated May 25, 2011.)

### **Substantial Amendments to the Law on Concession Agreements**

The amendments to the Federal Law on Concession Agreements are aimed at simplifying the procedure for the conclusion and performance of concession agreements and facilitating the creation of more PPP projects.

An important innovation was the broadening of the scope of application of the concession provider's payment, which may now be established in respect of all of the facilities of a concession agreement, and not just road transport infrastructure facilities.

The list of facilities of a concession agreement remains exhaustive; however, it now includes an elaboration of road curbside features and stops; the names of household waste processing and treatment facilities and public and community facilities have also undergone modification.

The amendments also allow for the extension of the term of a concession agreement for five years if approved by the highest executive branch or municipal authorities.

Other innovations include changes as to who can be a party to a concession agreement (joint tenders may be conducted by various public authorities), a broadening of the rights of creditors (an agreement may be concluded between a concession provider, a concession holder, and a creditor in respect of all facilities

of a concession agreement), addition of new material terms of a concession agreement (e.g., the gross revenue received by the concession holder upon the performance of the concession agreement is now a material term), modification of the grounds for amendment or termination of a concession agreement, etc.

Most of these amendments enter into force from February 1, 2015.

(See *Federal Law No. 265-FZ on Amendments to the Federal Law on Concession Agreements and Certain Legislative Acts of the Russian Federation dated July 21, 2014.*)

### **Other Changes in Legislation**

Amendments related to state registration of rights based on notarized documents came into force from February 1, 2014. In particular, registration of rights takes five business days from the filing of the documents, and the state registration authorities are not required to verify the legality of the notarized transactions.

(See *Federal Law No. 379-FZ on Amendments to Certain Legislative Acts of the Russian Federation dated December 21, 2013.*)

The Ministry for Economic Development has approved the classifier of types of permitted use of land plots containing more precise language for the types of permitted use.

(See *Order of the Russian Ministry for Economic Development No. 540 on Approval of the Classifier of Types of Permitted Use of Land Plots dated September 1, 2014.*)

In Moscow, the government approved a decree governing the construction of transport and social infrastructure facilities in implementing construction/reconstruction projects. If such infrastructure is not provided for by the city budget, then such infrastructure is to be built by the developer at his own expense. The newly constructed infrastructure facilities are transferred to the ownership of the city of Moscow without the city making any payment therefor.

The creation of transport and social infrastructure facilities had become widespread practice when implementing construction projects, including the implementation of so-called investment contracts with a public authority. Under such contracts the investor was required to build and transfer the transport and social infrastructure facilities to the public authority. Court practice shows that

there have been attempts to classify the transfer of such facilities as a deed of gift in favor of the public authority.<sup>3</sup> The Decree adopted by the Moscow city government brings matters relating to the construction and transfer of transport and social infrastructure facilities to a public authority when implementing construction/reconstruction projects within the regulatory framework.

(See *Decree of the Moscow City Government No. 671-III on the Construction of Transport and Social Infrastructure Facilities when Implementing Projects for the Construction / Reconstruction of Capital Construction Facilities in Moscow dated November 18, 2014.*)

In the Moscow region, provisions were added to the Town Planning Code increasing the number of cases where it is not required to obtain a permit for construction. In part, these amendments relate to the construction of power supply facilities with a voltage up to 20 kilovolts, inclusive, the construction and/or reconstruction of cable communications facilities and telecommunications cable lines, etc.

(See *Law No. 124/2014-O3 of Moscow Region on the Establishment of Cases where a Building Permit Is Not Required in the Moscow Region dated October 10, 2014.*)

## DRAFT BILLS

### Fundamental Change to the Framework of the Land Code

On December 9, 2014, the State Duma adopted in the first reading a bundle of amendments to the Land Code that would abolish the division of lands into categories and transition to territorial zoning from January 1, 2018. The rules for use of a territory within any particular territory would provide for one or more types of permitted use of land plots.

Discussions to this effect were underway within the expert community for a fairly long time, but it was only in 2013-2014 that work on the respective draft law recommenced with renewed vigor.

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<sup>3</sup> VAS Ruling No. 12444/12 dated November 19, 2012 in Case No. A32-24023/2011 noted that monetary funds paid to a public authority for the development of social, engineering, and transport infrastructure under an investment contract were a gift in the form of a donation. However, in the Ruling of the Presidium in the same case VAS took a different position, indicating that the transfer of monetary funds to a public authority for infrastructure development did not contravene applicable law (see VAS Presidium Ruling No. № 12444/12 dated February 5, 2013).

*(See Bill No. 465407-6 on Amendments to the Land Code of the Russian Federation and Certain Legislative Acts of the Russian Federation Pertaining to the Transitioning from Dividing Lands into Categories to Territorial Zoning.)*

At the same time, the State Duma is working on a bill on the seizure of land plots for construction purposes that alters the grounds and the terms on which land plots can be seized, the procedure for seizure, the period of validity of a seizure order, and the involvement of governmental and municipal authorities in any seizure, etc.

The bill is being considered in the second reading, and on December 8, 2014 it was decided to postpone consideration of this bill.

*(See Bill No. 304493-5 on Amendments to the Land Code of the Russian Federation and Certain Legislative Acts of the Russian Federation.)*

### **Amendments to the Civil Code**

As part of the ongoing reform of the Civil Code, on December 21, 2013, amendments to the Civil Code were adopted in respect of pledge, and these took effect from July 1, 2014. An important innovation was the abolition of “double” state registration of mortgages: as a contract and as an encumbrance. Mortgages are now only subject to state registration in the Unified State Register of Immovable Property Rights and Transactions Therewith as an encumbrance.

Other important innovations in the way pledge is now treated include the following: the acquisition of pledged property in good faith by a buyer serves as grounds for termination of the pledge; there is now provision for the conclusion of a pledge management agreement; a senior pledgee is no longer entitled to prohibit a secondary pledge; etc.

*(See Federal Law No. 367-FZ on Amendments to Part One of the Civil Code of the Russian Federation and on Deeming Certain Legislative Acts /Provisions of Legislative Acts of the Russian Federation Inoperative, dated December 21, 2013.)*

It is expected that in 2015 work will resume on the bundle of amendments to the Civil Code relating to rights in rem. One of the most actively discussed innovations of the bill was the introduction to Russian legislation of such a limited right in rem as building leasehold.

The bill also provides for the introduction of certain norms related to possession, including the concept, objects, methods of acquiring possession, and unified

rules for protection of possession; in addition to building leasehold, it is proposed that limited rights in rem be expanded to include the right of perpetual possession of land, usufruct, the right to acquire another person's immovable property, the right of limited possession of a land plot, etc.

*(See Bill No. 47538-6 on Amendments to Parts One, Two, Three and Four of the Civil Code of the Russian Federation, as well as to Certain Legislative Acts of the Russian Federation.)*

### **Fundamental Changes to the System for Registration of Immovable Property**

On October 22, 2014, the State Duma adopted in the first reading a bill that fundamentally changes the current system of state registration and cadastral registration of immovable property.

Among other things, the bill introduces a unified recording and registration procedure for immovable property, the Unified State Register of Immovable Property (USRIP), in purely electronic form and reduced waiting periods for cadastral registration and state registration of ownership rights.

*(See Bill No. 597863-6 on State Registration of Immovable Property.)*

### **Reduced Registration Period for Immovable Property and Cancellation of the Requirement for Notarization of Spousal Consent to Disposition of Immovable Property**

A bill has been tabled to the State Duma that reduces the waiting period for state registration of immovable property, and abolishes the requirement for notarized spousal consent to the disposal of immovable property.

It envisages that state registration of rights to immovable property will be effected within 10 business days (instead of the current 18 calendar days).

The bill removes the need for notarization of spousal consent to a transaction for the disposal of immovable property. A spouse whose consent to such a transaction was not obtained may seek to have the transaction invalidated within one year from the date when he/she became aware or should have become aware of the consummation of such transaction.

*(See Federal Law No. 640086-FZ on Amendment of Certain Legislative Acts of the Russian Federation in Respect of the State Registration of Title and State Cadastral Record of Real Property dated July 23, 2013.)*

## Federal Law on Public-Private Partnership

The framework of this draft law has been discussed by the professional community for a number of years. In 2013, a draft bill was at last submitted to the State Duma, reviving its consideration. A substantial bundle of amendments was drawn up for the second reading that was widely discussed both within the business community and within government circles. In 2014, work on the bill continued as part of the second reading. In June 2014, it was decided to postpone consideration of this bill.

(See *Draft Bill No. 238827-6 of the Federal Law on Principles of Public-Private Partnership and Municipal-Private Partnership in the Russian Federation and Amendment of Certain Legislative Acts of the Russian Federation.*)

## COURT PRACTICE

### **Clarifications by VAS on Lease Agreements Concluded on March 2 and 3, 2013**

In its clarifications the Higher Arbitrash Court of the Russian Federation indicated that lease agreements for a term of not less than one year concluded on March 2 and 3, 2013, i.e., during the period when their state registration was not required in accordance with the Civil Code of the Russian Federation, are deemed valid and concluded in relation to the parties to these agreements, but the lessees under such agreements do not have a right of first refusal to renew the lease agreement for a new term (Art. 621.1 of the Civil Code), or the right to remain a lessee upon the sale of leased immovable property (Art. 617.1 of the Civil Code).

(See *Ruling of the VAS Plenary No. 98 dated December 25, 2013 on Supplementing Ruling of the Plenary of the Higher Arbitrash Court of the Russian Federation No. 73 dated 17.11.2011 on Certain Issues of the Practical Application of the Rules of the Civil Code of the Russian Federation on Lease Agreements.*)

### **Overview of Supreme Court Practice Related to Issues of Unauthorized Construction**

The Supreme Court of the Russian Federation has issued an overview of court practice on problems associated with unauthorized construction. On the whole, the Supreme Court upholds the legal positions of the Higher Arbitrash Court (VAS) on unauthorized construction, and also elaborates on the approaches developed in the joint Ruling of the Plenaries of the Supreme Court and Higher Arbitrash Court No. 10 / 22 dated April 29, 2010 on Certain Issues Arising in

## Court Practice when Hearing Disputes Related to Ownership Rights and Other Rights *in rem*.

The Supreme Court also notes that the lack of a building permit *per se* cannot serve as a ground for denial of a claim for the recognition of title to an unauthorized construction, ownership title cannot be granted to part of an unauthorized construction (e.g., annexes, additional premises), and a court may grant interim relief under a claim for the demolition of an unauthorized construction in the form of a prohibition on construction work by the contractor undertaking such building work.

(See *Overview of Court Practice on Matters Associated with Unauthorized Construction, adopted by the Presidium of the Supreme Court of the Russian Federation on March 19, 2014.*)

## **VAS Overview of Various Issues Related to Unconcluded Contracts**

In its overview of issues of unconcluded contracts, VAS reasserted its previous legal positions on the consequences of failure to effect state registration of lease agreements concluded for a term of not less than one year. Thus, the lessee under an unregistered agreement cannot insist on its lease rights if there is a change to the titleholder of the leased immovable property.

VAS also stated that a party to an unregistered agreement cannot cite the fact of the lack of registration as a ground for the agreement to be deemed unconcluded. Such actions will be treated as acting in bad faith.

(See *VAS Presidium Information Letter No. 165 dated February 25, 2014 "Overview of Court Practice on Disputes Related to Findings on Unconcluded Contracts.*)

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We would be happy to answer any questions you may have regarding the above matters.

**DEBEVOISE & PLIMPTON LLP SELECT REPRESENTATIONS IN REAL ESTATE AND CONSTRUCTION IN 2014**

- Transneft in its more than \$1 billion acquisition of the Evolution Tower office building in the Moscow International Business Center (Moscow-City) from City Palace LLC. Representation of Transneft included legal due diligence of the building and land plot, preparation and negotiation of a draft sale and purchase agreement for the future real estate, and legal support in signing and closing of the transaction.
- Mosinzhproekt in the development of options for implementation of the project for the construction of the South-West metro line from Novatorov Street station to Stolbovo station and commercial and residential real estate jointly with Chinese investors China International Fund Limited and China Railway Construction Corporation Limited. The work on the project included development of the contractual model for implementation of the project, options for financing of the project by the Chinese investors, and analysis of options for provision of the land plots for construction of the metro line and commercial and residential real estate.
- Sberbank of Russia in the design and building of the International Financial Center in Moscow.
- A leading European developer in the drawing up of a design build general contractor agreement for the construction of warehousing facilities in the Moscow region.
- A number of major companies in preparing and commenting of draft lease agreements for Class A office buildings in the center of Moscow.
- An investment company in the acquisition of a 50% interest in six low-rise office buildings and the establishment of a 50/50 joint venture.
- Costa Construction in its construction of a number of buildings, such as a residential building in Kozikhinskiy Pereulok in Moscow and an office and hotel complex in Rostov-on-Don, including the associated work handling complaints and claims and representation in court.

**REAL ESTATE AND INFRASTRUCTURE PROJECTS IN RUSSIA AND THE CIS**

Debevoise & Plimpton LLP has extensive experience in the provision of services for real estate, construction and infrastructure projects. Our real estate practice group advises both Russian and international companies on the following matters:

- Due diligence. Project structuring.

- Land use and development, including issues of the permitted use of land plots, land use and development rules, land plot development plans, lease and conveyancing of land plots, etc.
- Conduct of tenders, requests for proposals, and review of proposals submitted by all project participants.
- Drafting and negotiating agreements with design firms, general contractors, sub-contractors, direct contractors, and vendors.
- Legal advice during the project design and construction phases.
- Development of project finance structure (including project financing).
- Drafting and negotiating agreements with banks and other creditors (including security packages).
- Drafting and negotiating lease, contractor, and service agreements in connection with the operation of real estate facilities.
- Legal advice on settlement of claims and arbitration under the project.
- Restructuring real estate, design, and construction companies (including pre-IPO or as part of the sale of shares to members of the public or to a strategic investor).
- Legal representation of clients in connection with the acquisition of companies and assets.
- Advice on various matters involving real estate and infrastructure projects (including regulatory matters).