TaylorWessing

Property Passport France

Contents

About the passport

Our passport is a practical guide for anyone considering an investment in real estate in France.

Its purpose is to give you:

- a first flavour of the local property market(s) and its legal framework
- some initial guidance on the rules of behaviour (the dos and don'ts) when entering and working in France.

Having said that you must be conscious of the fact that this guide does not provide you with the level of information and practical instruction enabling you to undertake a real estate transaction in France.

You will have to instruct your team of vested advisors for your investment project, and we would be proud to be part of it.

Taylor Wessing is trusted by clients around the world to deliver success through an outstanding partner-driven service.

Legal 500

Why invest in France?

When it comes to real estate investments, global investors differ in their thinking.

There are however some basic 'boxes to be ticked off' when choosing an investment destination:

- A stable political and economic environment.
- A stable and predictable legal framework.
- Available third-party financing.
- A sophisticated network of double taxation treatments and sophisticated 'investment vehicles'.
- A positive demographic forecast.
- A well-developed infrastructure system.
- Fast internet connectivity in the territory.

In all these respects, France is a prime choice for real estate investors, with a proven track record over the past two decades.

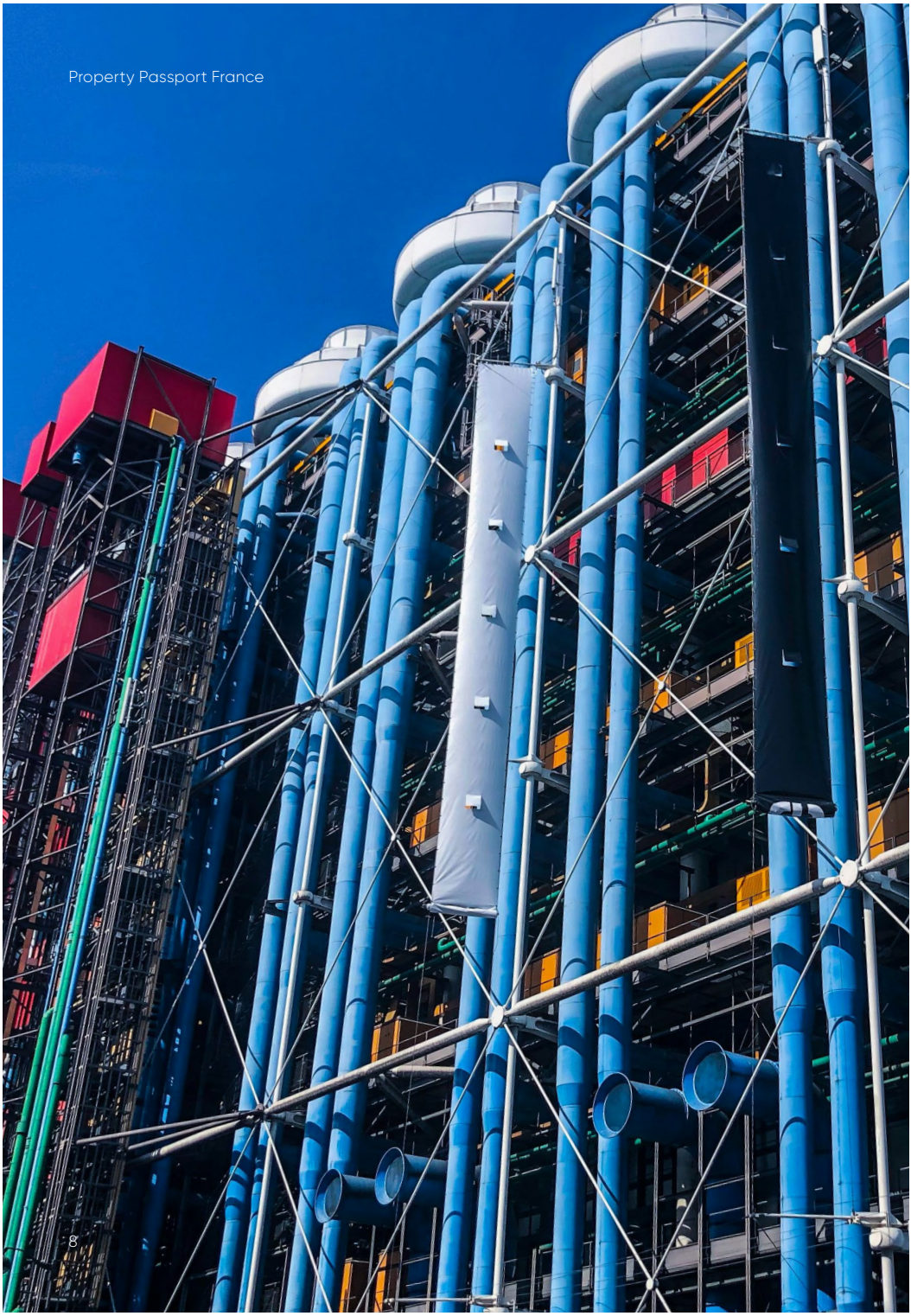
More than 50% of all real estate investments per year are undertaken by foreign investors coming from Asia, Canada, the UK, North America, and elsewhere in Europe.

The Parisian market continues to be particularly attractive because multinational companies have selected the city for their European headquarters due to its internationality and highly attractive 'lifestyle'.

Moreover, Franco-French companies do the same, considering it important to be close to the government and parliament for obvious reasons.

Companies from all industry sectors are also investing, which provides a 'sustainable' utilisation of office space and the demand for housing is growing.

The presentation of the attractiveness of France as an investment destination would be incomplete if we didn't mention several other trends observed since the beginning of the pandemic and its uncertainties, such as the dynamism of the regions or the acceleration of diversification strategies in favour of alternative and defensive assets.



Selecting the right asset

Foreign investors will vary in their investment strategy and will range from those wanting to hold the asset for a long term, to those working towards an early exit.

Considering this, selecting the right asset is of paramount importance. Investors will typically require advice on asset classes in which to invest, asset location, covenant strength of tenants and overall timing.

We work with international firms of surveyors and other bespoke houses to provide international investors with in-depth market analysis outlining future trends in the French market, helping them select the right asset at the right time.

We then help investors navigate the legal and tax implications of their investment to avoid any misunderstanding of the local legal landscape and prepare the ground for a swift and thoughtful implementation of the transaction and its financing.

We guide our clients through the whole purchase process so that they feel comfortable at each stage of the transaction.

Managing the asset

Real estate assets have a natural life cycle and they need to be nurtured throughout that cycle to maximise the return for investors. There are several aspects which are important to managing any building.

Attracting the right tenants

Whether you own or are looking to own a prime office building in the 8th Quarter of Paris, a hotel in the French Riviera, an out-of-town shopping centre or a portfolio of warehouses, the key questions will be – how do you secure your rental income, and can you trust your tenants to look after your building properly?

For most landlords, the key will be the covenant strength of the proposed tenants (and, if not sufficient), how that covenant strength can be boosted by rent deposits, parent company or bank guarantees which combined may cover a calendar year.

The market will dictate what package you need to grant to tenants (by way of a rent-free period or other incentives) while a prerequisite for an occupier has become the quality of the building in terms of energy consumption and CO^2 footprint documented by a certification (eg HQE/BREEM) and/or label (eg BBC/BEPOS) or the compliance with RT2020 or RT Existant.

The latter proof is very important for the tenant's choice as it'll allow them to improve their ESG reporting.

Allocating liability

The commercial lease is a contract for the rent of premises used for the operation of a business, industry, or craft.

The lease contract must include a precise and restrictive inventory and allocate the charges and expenses between the tenant and the lessor.

Maintenance and routine repairs are generally the responsibility of the tenant and major repairs are the responsibility of the lessor.

Expenses related to the ownership of the premises cannot be charged to the tenant, for example:

- Expenses relating to major repairs to the building, such as retaining and boundary walls, roofing and framing.
- Fees for carrying out major repairs to the building.
- Expenses relating to dilapidations or upgrades where major repairs are involved.
- Landlord's fees relating to the property management or management of the rent of the building.
- Taxes and fees related to the ownership of the premises.

Current maintenance and repair expenses, known as service charges (charges locatives), are related to the occupation of the premises, and therefore are the responsibility of the tenant:

- Current consumption expenses for water, gas and electricity.
- Routine maintenance and repairs such as painting, wallpaper, carpets, heating appliances, meters, sanitary facilities, external shutters.
- Condominium equipment expenses such as the share of lift costs or maintenance staff costs.
- Embellishment work that exceeds the cost of identical replacement.

The following taxes may be charged to the tenant:

- Property tax.
- Taxes and fees related to the use of the premises or building.
- Taxes, duties and fees related to a service from which the tenant benefits directly or indirectly.

The tenant's obligation to bear charges related to the ownership of the premises, which are normally the responsibility of the lessor, must be expressly provided for in the contract.

If they are not explicitly foreseen in a specific clause, they are not recoverable by the lessor.

Flexibility

The commercial lease is governed by a statutory regime. The main principle of the statutory regime governing commercial leases is 'security of tenure' (propriété commerciale).

This principle grants the tenant the right to either request renewal of the lease or to receive compensation corresponding to the loss sustained where the landlord should refuse to renew the lease. Such compensation is generally equal to the value of the tenant's business.

The term of the initial lease must therefore be for at least nine years, and this is a mandatory public policy provision. However, the parties may agree on a longer term.

A lease longer than 12 years is subject to a registration fee based on the total rent and service charges, within a limit of 20 years.

The tenant may terminate the lease either during the term of the lease or at the end thereof.

Triennial termination

The tenant can put an end to the lease on an expiry of each three-year period with six months' prior notice ('break-option' without cause).

This three-year termination right is a public policy provision; however, there are certain cases where the tenant may waive this right (eg at premises exclusively used as office space or leases initially entered into for more than nine years).

The tenant may express its intention to terminate the lease. It should be noted that the tenant thus waives the benefit of security of tenure and the right to the payment of an eviction indemnity.

The landlord has a triennial right to terminate the lease where certain major construction works are to be undertaken on the rented premises and otherwise only when the tenant breaches its contractual obligations.

The landlord can decide to serve notice to terminate the lease at the end of the contractual term. If the landlord decides not to renew the lease and the tenant satisfies the conditions for entitlement to renewal, the landlord must pay the tenant an eviction indemnity. The indemnity must correspond to the entire loss sustained by the tenant due to non-renewal of the lease.

In today's economic environment, flexibility has become increasingly important to tenants so that the statutory regime of the commercial lease does not fit their expectation.

There is a legal option to deviate from the statutory regime governing commercial leases status by entering a 'short-term' lease. This type of lease may only be entered into when the tenant enters the premises.

However, several successive short-term leases may be entered into, provided that the overall term of the leases does not exceed a term of three years.

The tenant must not remain in possession of the premises once the last short-term lease has expired, otherwise the tenant may be entitled to claim the benefit of the provisions governing commercial leases, which will automatically be granted.

Either of the parties may decide to conclude a 'service agreement' which is the case in shared office spaces (eg WeWork and alike) or in factory outlet centres.

Collecting your rents

As a foreign landlord, it is important to have trusted local surveyors to manage collection of rents and to run any service charge efficiently for you.

The commercial lease contract sets out the terms of the rent payment: the amount (variable or not), the date and the method of payment.

It regularly includes a 'resolutory clause', allowing the lessor to terminate the lease, if the tenant does not comply within its obligation to pay the rent and the service charges.

As soon as the first rent is unpaid and no amicable arrangement can be reached with your tenant, you should act.

Step 1: Notification of a payment order

The landlord should formally notify the tenant of a payment order through a bailiff, which is a prerequisite for enforcing the resolutory clause, (if applicable).

On pain of nullity, the summons to pay must precisely indicate to your tenant their fault (non-payment of the rent), the sums owed, the obligation to settle the debt within a fortnight and the fact that the contract will be terminated after one month's delay.

During these 30 days, your tenant can pay the rent and the resolutory clause falls away and the lease continues normally.

Step 2: Enforce the resolutory clause

If the rent remains unpaid, the landlord must file the motion to the interim relief judge (juge des référés) of the Tribunal judiciaire to terminate the commercial lease by the application of the resolutory clause.

The resolutory clause seems to be an effective protection in the event of unpaid rent, but in reality it is exceptional for a court to agree to terminate a commercial lease after just one month's delay.

Tenants in arrears usually ask the judge to suspend the application of the resolutory clause and to grant either a deferment of payment or payment by instalments.

This request is often granted to tenants who are in 'good faith' and who are experiencing a drop in turnover, for example.

The judge will likely propose a payment schedule that can be spread over a maximum of two years. In general, the payment plans set up do not exceed one year.

If the tenant does not respect the payment schedule and continues not to pay any of the rent under the commercial lease, the tenant is 'outlawed', becoming an 'occupier without right or title'.

Then you can once again refer the matter to the Tribunal in summary proceedings to have the termination of the lease recorded.

At this second hearing at the TGI, your tenant can once again ask for the deferred payment of rent. The judge may agree to a new payment schedule, with payment of the rental arrears, again of up to two years. The effects of the resolutory clause are then once again suspended.

If the judge refuses the second request for a payment schedule, he can issue an eviction order and order the tenant to pay the rental arrears, an occupation allowance for the time spent beyond the deadline, if applicable, as well as any baliff and legal fees.

Their client interaction skills are strong, they are attentive to our needs and good value for money. Their client service and desire to support is exceptional.

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Managing rent reviews

The initial rent is not subject to any statutory provision. The parties have full discretion in negotiating the rent and rent will normally reflect market conditions.

Contractual rent review

The parties may expressly agree to an indexation clause for the rent. The rent will then vary based on this index, which must be directly related to the purpose of the lease or the business of one of the parties, failing which the index will be null and void (in most cases either the Indice des Loyers Commerciaux (ILC) or Indice des Loyers des Activités Tertiaires (ILAT)).

Statutory rent review

a. Under Article L.145-39 of the French Commercial Code, 'should the lease include an indexation clause, a review may be requested whenever the rent calculated in accordance with this clause is increased or decreased by more than 25% compared to the price previously determined contractually or by Court Order.'

b. As a result, if the rent has increased by more than 25% due to the indexation clause, it may be challenged to be set at the rental value.

c. The three-year review enables the parties to request the rent be reviewed provided that at least three years have passed since the beginning of the renewed lease or since the last negotiated or judicial determination of the rent.

   The amount of the reviewed rent must reflect rental value. In the event of a three-year review, the reviewed rent is normally capped.

The rent may also be determined in part or in whole according to a percentage of the turnover generated by the tenant on the leased premises, or under an income clause or variable rent clause, which are very common in shopping centre leases. These clauses provide for:

- either a variable rent determined annually in accordance with a percentage of the tenant's turnover
- or, more often, a variable rent with a guaranteed minimum which will vary according to an annual indexation clause and a variable fraction calculated according to a percentage of the tenant's turnover (alternative income clause)
- a variable rent added to a base rent (additional income clause).

Managing the asset

We work closely with surveyors in managing property assets throughout the cycle of letting:

- granting of lease to licences for fit out/licences
- assigning/licences to sublet
- dealing with any breaches by the tenants during the life of the lease
- renewing the lease at the end of the term
- interim or final schedules of dilapidations
- service charges disputes and debt recovery.

We work together to ensure that the value of the asset is protected and enhanced.

They work to tight deadlines in an efficient and professional way.

Chambers and Partners

Financing the asset

An investor may wish to finance the acquisition and/or development of a property by raising debt, either at the time of acquisition or by way of a refinancing, following the acquisition of a property.

Such financings are typically structured as interest-bearing term loans, in some cases supported by mezzanine or alternative finance, granted by a credit institution licensed or passported in France.

However, senior financing may also be provided by debt funds that have been authorised in France to engage in lending activities or to purchase lending claims from credit institutions under a 'fronting bank structure' or a double layer cross-border finance structure.

Please note that real estate may also be financed by 'financial lease transactions' (crédit-bail immobilier) whereby the property is leased and the lessee benefits from a 'call option' at the expiry of the lease term.

Financial lease transactions can only be granted by (specialised) credit institutions.

Credit institutions or investors in real estate lend money on a secured basis.

They usually require from the shareholder(s) of the borrower:

- A pledge over the borrower's shares.

From the borrower:

- A mortgage over the financed property or the benefit of a special mortgage (including the assignment of the proceeds of the building insurance).
- A security over the rent and other (potential) receivables either in the form of a 'daily assignment' (if applicable) or a (civil law) assignment for security.
- A pledge over the bank accounts of the borrower.
- A guarantee.

More recently, in more distressed or complex transactions, French trusts (fiducies-suretes) have also been implemented. The settlor transfers the ownership of an existing or future real estate asset to a trustee on behalf of a beneficiary.

Those assets are protected against the potential insolvency proceedings connected to the settlor (here the debtor). The real estate trust is mainly established in form of a notarial deed as real estate properties or lands are transferred.

The lenders expectation is that the borrower would not have any other creditors, other than the investors, and that the investor's debt (shareholder loan) would be postponed to the lender's debt (via a subordination agreement) and that the senior lender has a priority over the investors.

Moreover, the property manager charged with the collection of rent must also accept a 'duty of care agreement' in which they engage to provide their services not only to the borrower but also to the lender.

Please note that French civil law provides for a security agent (agent de sûretés – special trustee). The parties appoint the security agent which is thereby entitled to constitute with the respective pledgor(s) all types of security interests foreseen in the facility agreement in its own name and for the account of the creditors.

As a special trustee, it is the holder of the securities and acts without additional mandate to defend the interests of the creditors. The 'parallel-debt structure' (applied in other jurisdictions) does not apply in France and was only in one court case explicitly acknowledged by the Cour de Cassation.

We chose Taylor Wessing for their unique capabilities to combine real estate and other legal expertise all out of a small and dedicated team in Paris and brought our transaction to success.

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Development finance

Under a facility which also provides for funding to be made available to finance the development of a property, the basic requirements of a lender are the same as for an acquisition financing, but a lender would also expect the following:

- An independent project monitor appointed by the lender to verify that the development will be completed on time and on budget, and to sign off on invoices to be paid by drawdown of the loan.
- Approval by the lender of the professional team appointed to complete the development, and collateral warranties to be provided to the lender from that professional team.
- Review and approval of any planning consents and pre-let agreements put in place and sign off on any rights of light issues that may arise pursuant to the development.
- If relevant, provision by the lender of an interest roll up facility to service interest on the loan during the development phase.
- The lender would also expect the borrower to sign up to several other development-specific covenants and undertakings.

Financial covenants

When determining whether a lender is willing to fund an asset, and how much it is willing to fund, the lender will consider the asset class, the tenant strength and geography of the asset, as well as the expected compliance by the special purpose vehicle (SPV) of several financial covenants:

- Loan-to-value (LTV): The LTV covenant is the ratio of the principal amount of the loan expressed as a percentage of the value of the property.
- Interest coverage ratio (ICR): The ICR is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt. The ratio is generally calculated by dividing EBIT by the cost of borrowed funds (interests) on a forward-looking perspective over 12 months.
- Debt service coverage ratio (DSCR): In the context of real estate finance, the DSCR is a measurement of a borrower's cash flow to pay current debt obligations. The net operating income (NOI) of the borrower will be divided by its total debt servicing. As a rule, a DSCR above 1.25 is considered 'strong', whereas ratios below 1.00 indicate that the company is unable to honour its debt payments.

The ESG discussion has led to the introduction of specific ESG covenants in loan agreements. From the inception of the loan agreement the lender may require that the building is certified eg HQE/BEEM) or has a label (eg BBC/BEPOS) and that the borrower as property owner engages to make the necessary investments to maintain such certification/label during the term of the loan.

The Lender may also request that the borrower spend some money on external environmental projects to obtain a reduction of the charged interest rate in the magnitude of five to 30 basis points.

Islamic finance

Real estate assets are predominantly sharia compliant assets and can therefore be a suitable form of security for structures where investors require finance to be provided on a sharia compliant basis.

This is a specialised area of real estate finance which is not commonly used in France, so we will call on our London team if the need arises which has market-leading expertise.

Refurbishing the asset

Whether you are looking to purchase a residential property or invest in a commercial property, the purchase of property can often result in extensive development, renovation, and refurbishment.

Construction works for a development and renovation, or refurbishment may involve the property owner, an architect (leading a team of design consultants), a project manager, a main builder and then several subcontractors, depending on the extent of the works required for the property and its proposed end use.

French law is specific in terms of different types of contracts which deal with the risk allocation and duties of the parties in various ways.

Design contract

Before any work is performed, the architect (in their role as project manager) is usually responsible for conducting preliminary studies relating to the project owner's proposed programme and to the land where the construction operation is planned, for drafting the technical specifications once the final design draft is established, and for choosing the materials to be used for the construction project.

The architect will also assist the project owner in preparing and submitting the planning permission application and awarding works contracts.

Under a contract of services (Contrat d'entreprise ou marché privé de travaux ou location d'ouvrage)

The service provider (contractor) covenants along with the project owner to plan, make, process, transform, start up or repair something or to achieve a particular result, in exchange for consideration.

The contractor may be entrusted with completing the construction works (including the supply of building materials) or it may simply make use of the materials supplied by the project owner.

Whether or not the contractor supplies building materials has legal and financial effects on the risk of loss or damage to materials prior to acceptance of the works.

Contracts for services can include construction or civil engineering.

Under a property development contract (Contrat de promotion immobilier (CPI))

The developer will enter into the covenant to carry out a construction project involving one or more buildings on the project owner's property for an agreed price.

The property developer will oversee negotiating and entering all contracts for services with contractors and of handling all or part of the legal, administrative and financial procedures involved in the project.

Property development contracts are not widely spread in practice due to the rather substantial obligations that these types of contracts entail for the developer.

Delegated project ownership agreements (Contrat de maîtrise d'ouvrage déléguée)

The project owner delegate is an ordinary agent acting for the client. The delegate's contractual liability is therefore limited since liability only applies where there is a documented breach.

Alfred Fink is a perfectly trilingual French/German/English lawyer with great expertise in structuring cross-border real estate acquisitions.

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Liability and insurance

In carrying out their works, builders incur the following types of professional liability.

Specific builders' liability

The ten-year warranty (décennale), the two-year warranty (biennale), and the one-year warranty covering final completion (garantie de parfait achèvement) derive from public policy provisions. They therefore cannot be limited or otherwise amended by contract. Any clause to the contrary would be deemed invalid.

The fact that builders owe specific warranties does not preclude any liability that applies under general (contractual) law.

Prior to acceptance, builders are subject to general provisions on contractual liability for all losses sustained by their clients. General liability also covers problems recorded as snagging items in the minutes of acceptance.

The project owner has the choice between relying on the warranty covering final completion (as explained above: specific builders' liability) or seeking to incur the liability of the contractor under general law.

The French Supreme Court has ruled that damage likely to be covered by the two-year or 10-year warranties should be remedied under these specific liability rules. Close attention must therefore be paid to the grounds that the project owner has cited in support of its action for damages.

Liability in tort towards third parties

For such action to succeed, the standard usual criteria must be satisfied: misconduct committed by the contractor (this may be in combination with misconduct of the project owner), loss or damage sustained by a third party and a causal relationship between the two.

Required insurance under French construction law

Before works even begin, the project owner is required to underwrite an insurance policy for construction work damage (assurance dommages-ouvrage) covering the building for the owner and subsequent owners of the building.

This is a type of property insurance intended to fund repair works that fall within the scope of the ten-year warranty, regardless of who is liable. This policy therefore provides advance financing for any works necessary to repair problems covered under the ten-year warranty.

Contractors in their capacity as builders must also underwrite liability insurance for the ten-year builders' warranty. The insurer for construction work damage provides advance financing for repairs that come under the ten-year warranty without any need for the project owner to establish liability.

That insurer may then bring a subrogated claim (exercising the project owner's rights) against any parties' responsibility for the problems in question and who are liable under the ten-year warranty.

The French insurance code (Code des assurances) sets out various criminal penalties for parties who fail to observe these two insurance requirements. These include a maximum prison sentence of six months, a fine of EUR 75,000.00 or a combination thereof.

Alfred Fink's input was highly appreciated as he mastered the case without a flaw and managed to get all parties to agree on relevant issues through his calm, knowledgeable and trustworthy manner.

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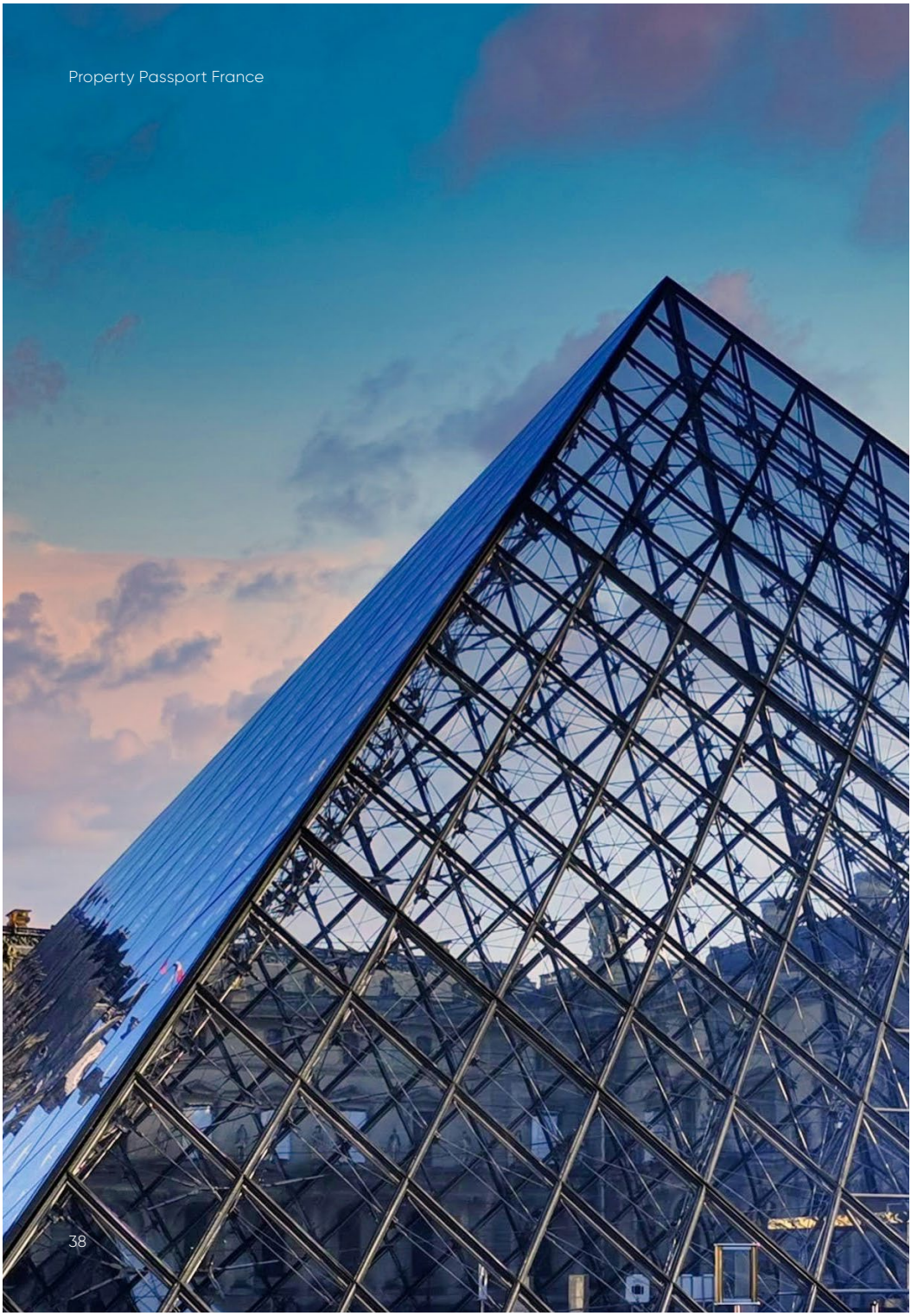

How to structure an acquisition

French law provides for several structures that can be used to invest in real estate assets. The choice of the appropriate legal structure depends on the investor's expectations regarding risk management and tax efficiency.

Below we cover the most common structures for real estate ownership excluding any specific investment vehicles (eg Organismes de placement collectif immobilier (OPCI), Société civile de placement immobilier (SCPI) and Société d'investissements immobiliers côtée (SIIC)). This is not an exhaustive list.

Partnerships

Société civile immobilière (SCI)

The main purpose of the real estate partnership is the management and rental of real estate. The SCI is subject to the legal provisions on the société civile since there are no specific rules to this partnership (objet civil).

There is no minimum share capital requirement.

These partnerships must be composed of at least two partners.

Each partner is liable for the company's debts in proportion to its stake in the share capital of the partnership.

The SCI is managed by one or more managers (gérants) which can be either individuals or legal entities.

Transfers of shares are subject to the other partners' unanimous approval, unless specified otherwise in the partnership agreement.

Société en nom collectif (SNC)

The unlimited partnership is a commercial and legal entity which comprises a minimum of at least two partners. All partners must be registered merchants.

There is no minimum share capital requirement set within an unlimited partnership. Partners are jointly and equally liable for all the debts and obligations of the partnership.

The partnership must however be managed by one or more managers (gérants) who conversely are not jointly liable for the partnership's debts (unless they are also partners).

Any transfer of shares will be subject to the unanimous approval of the other partners within the partnership.

Limited liability companies

Société anonyme (SA)

The joint-stock company is a commercial limited liability company which can offer its shares to the public in accordance with the regulation of the French Financial Markets Authority (AMF).

A minimum of EUR37,000.00 share capital is required for the incorporation of this type of company.

An unlisted SA must comprise at least two shareholders while a listed SA is composed of at least seven shareholders.

In terms of management, there are two options: the company can be headed by a board of directors or by two bodies: an executive board and a supervisory board.

There are no restrictions regarding the transfer of shares between shareholders, unless specified otherwise in the articles of association.

Société par actions simplifiée (SAS)

The simplified joint-stock company is a commercial limited liability company with no minimum share capital requirement. This company is a flexible structure: its corporate rules and governance are essentially determined in the articles of association.

The SAS must have one shareholder. The shareholder's liability is limited to the amount of share capital held.

The company is managed by a president who may either be an individual or a legal entity appointed in accordance with the articles of association. Other management structures may be freely determined in the articles of association.

It is possible, for example, to provide in the articles of association that the shares are not transferable for a maximum period of ten years, that shareholders may be excluded from the company and that transfers shall be subject to the prior approval of the other shareholders.

Public offerings of its shares are not possible, while it is under certain conditions able to issue bonds in the form of a private placement.

Société à responsabilité limitée (SARL)

The limited liability company is a commercial company with no minimum share capital requirement. The company must be composed of one shareholder and at most of 100 shareholders.

Shareholders' liability is limited to the amount of share capital held.

The SARL is managed by one or more managers (gérants) appointed by the shareholders. The manager(s), who must be an individual, is vested with the broadest powers to act on behalf of the company.

Regarding the transfer of shares between shareholders, there are no restrictions, unless prior shareholders' approval is required in the articles of association. In other cases, the transfer of shares is subject to prior shareholders' approval.

Public offerings of its shares are not possible, while it is under certain conditions able to issue bonds in form of a private placement.

Please note that companies must now identify and register their beneficial owner(s) at the Trade and Companies Registry.

The term 'beneficial owner' means one or several individuals who either directly or indirectly hold(s) more than 25% of the capital or voting rights of the company, or, exercise(s), by any other means, supervisory authority over the management, administration, or governing bodies of the company or over the general meeting of partners.

Failure to comply or the filing of inaccurate or incomplete information gives rise to a criminal liability (up to six months imprisonment and a fine of EUR7,500.00), as well as specific ancillary liabilities.

Tax efficiency will be core to your needs. We regularly advise on establishing appropriate French and/or foreign corporate structures, such as those described above.

Such arrangements are bespoke and will require detailed discussions before an appropriate structure can be selected and implemented.

With regards to the tax implications of such structures please see the section on the tax regime in France.

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Taylor Wessing advises several major French and international real estate operators on the negotiation of large office and commercial leases.

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The purchasing process

Negotiations may include: the discussion (Pourparlers) phase including written, verbal or electronic exchange, etc. and where applicable, the making of either a letter of intent or an offer.

The discussion phase occurs before any preliminary sale agreement or deed of sale is signed and, theoretically, during this phase, the parties are free to give or withhold their consent on to the proposed transaction.

Parties are under the obligation to negotiate in good faith and this obligation strengthens as the parties progress towards an agreement. Failure to comply with this obligation, ie by (i) entering into negotiations knowing that they have no chance of being successful or (ii) breaking them off suddenly and unilaterally, without reasonable grounds, may entitle the other party to claim damages for the loss incurred.

During discussions, it is common practice to implement a non-disclosure agreement (NDA), as the seller generally intends to ensure that any sensitive information that will be made available to potential purchasers during the acquisition process remains (strictly) confidential.

A letter of intent (LOI) or 'protocol' (heads of terms) commonly constitutes the step following either a call for tenders issued by the seller or direct negotiations between the seller and a potential buyer.

The document is generally drawn up in two original copies, signed by the potential buyer and countersigned by the seller. The legal value of an LOI will depend on its content.

Please do not confuse an LOI with an offer letter. An offer letter is an act of free will binding the author thereof to the terms of the offer. Once accepted, an offer letter is considered to be binding.

In the absence of an LOI or if the LOI does not set forth an exclusivity period, the parties may enter into an exclusivity agreement.

Due diligence (audit d'acquisition) is the review process whereby a potential purchaser analyses the target property. This covers:

- technical due diligence
- environmental due diligence (pollution, asbestos, etc.)
- valuation of the building
- tax and legal due diligence (property, planning, tenancy situation, etc.).

The seller generally discloses the respective due diligence documentation in either a physical or electronic data room.

Please note that the parties have a mutual obligation to disclose such facts and information to each other which may have an impact on the respective party's decision to enter the transaction.

The firm also assists corporate tenants and advises on financing matters.

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Asset deal – acquiring a (developed) property

Target asset

Ownership is a right in rem, ie a right attached to a thing – here: the target asset.

There are various rights of ownership and right in rem, for example:

- usufruct and bare title
- joint ownership (indivision)
- co-ownership (copropriété)
- land tenure (droit de superficie)
- flying freehold (division en volume)
- construction lease or long-term lease.

An asset deal usually consists of the acquisition of the undivided ownership (pleine propriété) of a building.

Possible rights encumbering or affecting the asset

An easement (servitude) is a burden imposed upon a property for the use and utility of a property belonging to another owner. Easements constitute rights in rem and are inseverable from the properties they are attached to.

Easements are either:

- contractual (usually published at the land registry or statutory/regulatory)
- permanent (eg pipes for water, sewage or rights of air, etc.) or temporary (eg rights of way, use of a well)
- apparent (eg a door, window, aqueduct) or non-apparent (eg ban on construction or ban on construction above a certain height).

A mortgage (hypothèque or spécial hypothèque) is a non-possessory security encumbering an asset, which entitles its beneficiary to a preferential right over other creditors in the event of the forced sale of the relevant asset, to pay-off the monies owed to them.

It also confers a 'droit de suite' (ie the right to follow the property into the hands of a third party purchaser to recover possession), entitling the secured creditor to take possession of the asset offered as security, even if it is possessed by a third party.

In the context of the sale of real estate, the French authorities will benefit from a right of pre-emption (only applicable within defined areas) that will enable them to purchase the property in lieu of the proposed purchaser.

A declaration of intent to dispose of the property must be filed with the municipality prior to any transfer of property subject to pre-emption, failing to do so will render the transfer agreement null and void.

The exercise of the pre-emption right is subject to a time limit of two months. If the right has not been exercised within this delay, the owner will be free to sell the asset at the price set in the declaration of intent to dispose of the property.

The lawyers in Taylor Wessing's real estate department understand the real estate market, its participants, and its stakeholders, and thus offer their clients advice that is well tailored to their needs.

Décideurs Leaders League

Preliminary agreements

A preliminary agreement is an important part of the conveyancing process in France and will contain all terms and conditions of the sale agreed by the parties.

There are essentially two types of preliminary agreement: the call option agreement or PUV (promesse unilatérale de vente) entailing a unilateral covenant to sell, and the sale and purchase agreement (promesse synallagmatique de vente) entailing a bilateral covenant to sell and purchase.

Both types of preliminary agreement may be subject to conditions precedent (eg a waiver of the local authorities of their pre-emption right, obtain a loan to finance the acquisition, securing planning permission).

A PUV is a contract whereby the seller or promisor irrevocably covenants to sell the property for a specific price, whereas the buyer or beneficiary has the option to purchase or not purchase the property during a given time.

In consideration for the option and the exclusivity granted, the parties may provide for the buyer to pay a deposit (indemnité d'immobilisation), which generally corresponds to 10% of the purchase price.

If the beneficiary exercises its option, the sale will be completed (with no retroactive effect), subject to any conditions precedent that may have been set forth, and the deposit will usually be deducted from the purchase price.

If the beneficiary drops out of the acquisition, the deposit will not be refundable. The deposit will be refunded to the buyer if any of the condition precedent set forth in its favour are not fulfilled.

A bilateral undertaking to sell (also known as compromis de vente) is a preliminary sales agreement. The owner agrees to sell to the buyer and the buyer in turn agrees to buy from the owner, subject to any conditions that are stipulated in the contract.

If the agreement does not provide whether the potential buyer may be substituted by a third party, no substitution shall be enforceable against the seller. If substitution is provided, such must take place before the conditions precedent have been fulfilled, for tax considerations.

Deed of sale

The deed of sale enables the transfer of title to a property from seller to buyer. It is notarised and, constituting the completion of the preliminary agreement, is entered into by the parties on the terms and conditions provided in such preliminary agreement.

The notary oversees registering the deed of sale in the land registry.

The deed will mention the rental situation of the building and the apportionment of rental payments to be made between seller and buyer.

If the property is sold within less than ten years from its completion, the purchaser shall benefit from the transfer of the two-year and 10-year warranty by the application of law.

The seller of a property is under the mandatory obligation to provide the purchaser with two warranties: the warranty covering dispossession and the warranty covering concealed defects.

Any modification of a right in rem over a building must be registered at the local land registry. Registration ensures that these rights are enforceable against third parties.

Share deal – acquiring a property company

Where a building is held by a company, the sale can be carried out through a share deal. Selling using a share deal is often due to legal, financial and tax reasons.

Key issues when purchasing a property company

The due diligence review to be conducted must cover the property, similar to the due diligence to be carried out for an asset deal, but also the structure of the company.

As a consequence, the scope of due diligence (and relevant warranties) could be more extensive for companies which had former activities other than merely holding a building.

The protection afforded by law in the case of a property transaction do not apply to a purchase of shares to the same extent. Therefore, contractual warranties should be inserted into the share purchase agreement as the acquisition of a property company is ruled by general contract law.

The structuring of a share deal may also consider trapped cash issues if the property is ultimately sold by the company.

The price for the shares is generally calculated according to a price formula to be agreed upon in the share purchase agreement.

The form of the company may also be taken into consideration as shareholders' liability differs depending on the corporate form.

Buying the property company could be less favourable than buying a building in cases of important latent capital gains, which will be taxed at the company level.

Property company acquisition process

Usually, the parties will enter into a preliminary agreement, such as a non-binding offer, to enter a discussion process, organise the data room, perform the due diligence review and discuss the contractual documentation.

Thereafter, the parties can agree on a binding offer or contract which is generally subject to conditions precedent (obtaining planning permission, conclusion of a lease or clearance of the urban pre-emption right of local council, clearance of antitrust issues – especially where significant revenue is derived from leasing or when acquiring a share of a bank facility, etc.).

The first step is to agree on the valuation of the buildings.

In principle, such a valuation is performed using the same methods as those which would be used if the building was to be purchased. The main factors are the building's actual or anticipated earnings, price/earnings ratio (taux de capitalisation) and the internal rate of return required.

For the calculation of the price of the shares, the parties often have an asset value approach which consists of a breakdown of the company's assets and liabilities.

The traditional formula is: value of the assets + current assets = debt.

However, in negotiating the calculation, the buyer should pay close attention to the definition of the different items (eg treatment of provisions). The value of the assets is often agreed on by the parties on an unalterable basis (ne varietur). By adopting this method of valuation, it is obvious that the greater the liabilities, the lower the value of the company. In this context, the valuation of the building is critical.

Moreover, the precise definition of terms is crucial because the accounts provided for by the vendor due diligence and reviewed by the buyer due diligence are provisional and final accounts which will be delivered after the acquisition date.

Buyer and seller will need to set a provisional price with a price adjustment mechanism.

When pursuing a share deal, a buyer will need to be aware that although its aim is to acquire the assets of the company (ie the real estate), the vehicle through which the sale is made is the property company.

As such, the representations and warranties should consider all necessary corporate aspects covering assets and liabilities other than the real estate.

Because a share deal consists in the acquisition of the property company, the applicable law is corporate law and several elements that would be mandatory in an asset deal are not so in a share deal. Using the representation and warranty mechanism, the buyer should seek to obtain the same level of protection he would have in an asset deal thanks to real estate law.

In any case, using the representation and warranty mechanism the buyer should seek protection from liabilities yet unknown at the date of acquisition, and in particular tax liabilities.

Some tax considerations

Registration duties in an acquisition

The registration duties of a property acquisition depend on whether the seller will dispose of a real estate asset (asset deal) or the shares of a property company (share deal).

Asset deal

In the acquisition of a property existing for more than five years, the following taxes and duties will apply:

- A registration duty of 5.09%, although most French 'départements' including Paris apply a rate of 5.81% (droit d'enregistrement) due to additional local taxes.
- An additional tax of 0.1% of the value of the property (contribution de sécurité immobilière).
- Notary fees of 0.799% (plus VAT) of the value of the property (please note that notaries may grant a rebate under certain conditions).

Moreover, an additional 0.6% tax will be levied on the sale of offices, commercial and storage premises located in 'Ile-de-France' (ie Paris area).

Hence, the purchaser of a real estate asset must expect an incidental acquisition cost of 7%-8%.

Purchasers qualifying as 'real estate dealers' can, however, benefit from a reduced registration duty of 0.715%. The term 'real estate dealer' means a company or individual subject to VAT who engages in the notarial deed of acquisition to 'rebuild' the target asset within a period of four years or to resell it within five years.

Value-added tax (VAT) on acquisition

If the target asset is a 'new' building (meaning completed less than five years before the sale) or if the seller is treating the real estate asset as a 'stock' in its business activity, the sale is subject to the standard VAT rate of 20%.

Share deal

The acquisition of shares in a property company will trigger a registration duty of 5% of the purchase price. A company qualifies tax-wise as a property company (société à prépondérance immobilière) if it is privately held and its assets mainly consist of French real estate assets and/or shares in one or more French property companies, eg a civil law partnership (société civile immobilière (SCI)).

Caveat: The lower tax rate in case of a share deal may look attractive to investors, however, the share deal implies that the purchaser acquires a company and only indirectly the property. Hence, it must undertake a thorough due diligence on the company and the property.

From a pure accounting perspective, the purchaser will have to continue the amortisation of the property on the historical value and is not entitled to record the 'agreed asset value' in the company's accounts at the purchase price for amortisation purposes. Hence, in the negotiations of a share deal, the parties may perhaps discuss the sharing of the 'latent taxes' to which the purchaser, in an ultimate disposal, will be exposed.

3% tax

Any legal entity, French or foreign, is subject to a 3% tax on the market value of its property and/or real estate rights it owns in France on 1 January of every year. The law provides for some general exemptions and for an exemption on request which is the most relevant in our practice.

In a nutshell, legal entities whose registered office is located:

- in France
- in a Member State of the European Union
- in a country or territory that has concluded an administrative assistance agreement with France to combat tax evasion and avoidance
- in a State that has concluded a treaty with France allowing them to benefit from the same treatment as entities whose registered office is in France

may benefit from an exemption from the 3% tax, when they (spontaneously) disclose the names of their shareholders each year by 15 May at the latest.

This exemption is granted in proportion to the number of shares, units or other rights held on 1 January by shareholders, partners, or other members whose identity and address have been declared; the declaration obligation applies only to shareholder holding more than 1% of shares.

The purpose of the tax is to find out whether a French citizen has (indirectly) invested in a French property and has not declared such participation in their French wealth tax declaration.

Taxation of capital gains

Sales of property by non-resident company

Subject to the terms of international tax treaties, capital gains from disposal of properties by taxpayers who are not domiciled in France are chargeable to a specific withholding tax.

The capital gain will be calculated as the difference between the (contractually agreed) fair market value and the net book value of the property in the seller's accounting books. A set of specific rules apply

to those companies which are residents outside the European Economic Area.

The withholding tax will be 25% (standard corporate income tax rate) with some additional charges.

The seller may, in principal, have to appoint a tax representative in France who will undertake to carry out the formalities and pay the withholding tax on behalf of the non-resident seller.

Sale of shares in a property company by a non-resident company

Most French tax treaties provide France with the right to tax capital gains arising from the disposal of shares in a French property company (société à preponderance immobilière).

The standard withholding tax is the corporate income tax rate of 25%. Please note that the disposal of shares in a stock-listed property company may benefit from a reduced withholding tax of 19%.

Sale of property by a resident company

Capital gains earned from the sale of a property by a company domiciled in France – equal to the difference between the purchase price of the property and its net book value after amortisation (or fiscal cost price) – are taxed at the standard corporate income tax rate of 25% plus the additional contributions.

Sale of property by a resident partnership

When the French legal entity is a civil law partnership, the chargeable gains from the sale are taxable to the partners in proportion to their share in the partnership capital and on their status (individual or legal entity):

- Non-resident individual partners: taxed at the rate of 19%; the capital gains are also chargeable to (i) a solidarity levy of 7.5% for non-French tax residents who are affiliated to a compulsory social security system, other than the French one, within an EEA country (EU, Iceland, Norway, Liechtenstein) or Switzerland or (ii) social contributions at the rate of 17.2% for non-French tax residents who are not affiliated to such a system.
- Non-resident corporate partners: the chargeable gains are taxed at 25%.

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Deeply embedded within our sectors, we work closely together with our clients to crack complex problems, enabling ideas and aspirations to thrive.

Together we challenge expectation and create extraordinary results.

By shaping the conversation in our sectors, we enable our clients to unlock growth, protect innovation and accelerate ambition.

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- Financial Institutions & Insurance
- Logistics & Transport
- Public Services & Education

2000+ people
1100+ lawyers
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29 offices
17 jurisdictions

Challenge expectation, together

With our team based across Europe, the Middle East, US and Asia, we work with clients wherever they want to do business. We blend the best of local commercial, industry and cultural knowledge with international experience to provide proactive, integrated solutions across the full range of service areas.

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We would be delighted to discuss your legal needs in confidence with you. Please contact us for further information.

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