

## What Is Cross-Border Real Estate Practice?

### INTRODUCTION

Cross-border real estate transactions have become a major economic factor over the past two decades. As Professor Colin Lizieri points out:

“A striking feature of the commercial real estate market of the late 1990s and the first decade of the twentieth (sic.) century has been the rise of global real estate investment. From relatively modest levels, cross-border portfolio investment has become a significant part of the real estate investment market. JLL (Jones Lang LaSalle) . . . reported that in 2005, of the \$475 billion direct investment in commercial property, \$164 billion—35 percent—was cross-border, an increase from the 29 percent share of 2004. Nearly a third of those international transactions were interregional, with European investors and global investment funds in particular investing outside their home continent. The following year JLL (2007) reported that 63 percent of the €244 billion direct investment in European real estate was cross-border, with 52 percent of that international investment going into office buildings.”<sup>1</sup>

Cross-border real estate practice sounds more exciting than just “doing” real estate, but actually the essential question is, “What is it?” Simply put, it involves a party from one country buying or leasing property in another country. A lawyer in such a transaction could represent a buyer, tenant, seller, landlord, bank, real estate broker, developer, architect, engineer, title insurance company, government entity, or other stakeholder. The buyer could be an individual, investment fund, asset management company, or other entity. The property could be an existing building, or land for development. Transactions may involve an individual seeking a vacation home in another country, or a

multinational corporation interested in acquiring land to establish a factory or a distribution center in a new jurisdiction, or a real estate investment trust (REIT) seeking to acquire property in another country that has potentially higher yields. (REITs are discussed in more detail in Chapter 3.)

Cross-border real estate transactions can be fairly simple and straightforward, such as those involving one property where there are no legal restrictions preventing a foreign buyer from purchasing the property. The only differences may be the legal processes the foreign buyer is accustomed to, as well as language and cultural variations.

On the other hand, a cross-border real estate transaction may be extremely complicated, requiring the establishment of local companies or, for tax reasons, a company in a third jurisdiction, and multiple agreements among several parties in multiple jurisdictions. A foreign investor may enter into a joint venture with a local partner. The sales price may include share swaps or swaps of land plots.

The transaction may be executed as a share deal rather than an asset deal. The differences between an asset deal and a share deal are discussed in chapter 12. For example, in a large project in Gdansk, Poland, my firm completed several acquisitions of land for a Danish company as a share deal rather than an asset deal because an administrative land tax was imposed on all sales of land made within five years of the implementation of the local master plan. But, with the sale of the shares of the company owning the land, no administrative land tax was imposed.

Also, it could require additional agreements with further obligations than those in the purchase agreement. For example, in the Gdansk project, a new road and infrastructure had to be constructed before any occupancy permits for new development on the acquired land could be obtained. Thus, it was necessary to negotiate a public-private partnership agreement for the construction of the road with the city of Gdansk.

## **WHAT THIS BOOK COVERS**

This book is not a survey of the real estate laws of numerous jurisdictions around the world. The Cross-Border Real Estate Practice Committee of the ABA Section on International Law on its website ([www.americanbar.org/dch/committee.cfm?com=IC651002](http://www.americanbar.org/dch/committee.cfm?com=IC651002)) gives information about real estate practice in a number of different countries. *PLC Corporate Commercial Real Estate Handbook 2009/10, sixth edition*,<sup>2</sup> which includes a section on real estate practice in Denmark that I co-authored, and other publications also survey the real estate practice in several countries.

This book does not intend to educate the reader on the specific cultural differences of many countries or how to deal with a negotiator from a specific country. Again, there are country-specific guides available, such as *India: Cross-Cultural Business Behavior for Business People, Expatriates and Scholars*.<sup>3</sup> Also, there are others that cover dealing with negotiators from different countries, such as “Part 2: Country-by-Country Guide to International Business Negotiations” of *The ABA Guide to International Business Negotiations: A Comparison of Cross-Cultural Issues and Successful Approaches*, 3rd Edition,<sup>4</sup> and “Part Two: Forty Negotiator Profiles” in *Cross-Cultural Business Behavior: Negotiating, Selling, Sourcing and Managing Across Cultures*.<sup>5</sup>

This book covers the areas that anyone conducting cross-border real estate transactions or operating a cross-border real estate practice should know. It will discuss the preponderance of issues I consider most important. This book will also provide practical advice about selecting a property for investment, conducting due diligence, learning about and understanding cross-cultural differences, differences in language and challenges of translation, difference in legal procedures and practices, and negotiating cross-border transactions. Then, cross-border tax issues will be discussed, along with some of the different types of agreements that are negotiated and drafted for cross-border real estate transactions. Finally, this book will cover the closing of a transaction and registration of title to property.

In the discussion of the issues that follow, I proceed from the point of view of a proactive lawyer, because I believe that to best represent your client in a cross-border real estate transaction, it is necessary for a lawyer to be proactive. In a cross-border transaction you are guiding your client through unfamiliar waters to ensure they reach their destination safely. Unless you know what to look for, your client could crash and the transaction will sink.

Many of the examples used are taken from the point of view of representing a client that is in the process of, or has already acquired property. Most of the information and advice provided, however, is applicable to representing either side in a real estate transaction. While the book is primarily aimed at lawyers and law students, real estate investors, managers of real estate assets, real estate brokers, and other professionals in the industry should find much of value in the chapters.

One note about the spelling and grammar in the book: Many quotes presented in the book were written by authors from the U.K., Australia, or elsewhere, and some grammar and the spelling of some words are different than in U.S. English. I have left the original spelling and grammar in all quoted material.

## **OVERVIEW OF THE CHAPTERS**

Typically, lawyers do not select the specific real estate for investment. But, to properly advise clients, it helps if the lawyer knows what to consider in evaluating whether a piece of real estate is a good choice for investment. Chapter 2 will identify nine primary subjects to consider: location, compliance, cash flow, capital gain, flexibility, tenant mix, duration, price, and exit value.

Before making a cross-border investment, an investor should have a strategy for exiting the investment. Understanding this strategy is important when evaluating whether or not to invest in specific real estate. Chapter 3 will discuss the exit value and developing the exit strategy.

A foreign purchaser needs to determine if there are any restrictions on purchasing the property or buying the shares of a local company. Many countries have restrictions concerning foreign direct investment (FDI) or ownership of certain types of property, such as agriculture, land near military locations, or businesses that are considered vital to the national security. The World Bank Group's "Investing Across Borders" project has recently completed a survey in 87 economies around the world of "restrictions on direct foreign investment." Chapter 4 explores some of the findings of the "Investing Across Borders" project and the situation in a sampling of countries (Canada, India,

Mexico, Peru, and Poland). Finally, it discusses the use of joint ventures to circumvent some restrictions on FDI.

Most cross-border real estate transactions start with an initial understanding between the parties. Chapter 5 explains why such understandings are used and explores the various options available to initiate a cross-border transaction such as a memorandum of understanding, letter of intent, and head of terms.

Thorough due diligence is required before making a cross-border acquisition. A lawyer must explain to his or her client the need for legal, tax, environmental, technical, and commercial due diligence. It is important to understand that what is considered normal to investigate and report on during due diligence in one country may vary greatly in another. While conducting due diligence, start to formulate the representations and warranties you plan to request from the other party. One should try to keep the due diligence report as short as possible, and clearly identify and warn the client about the key issues that were discovered in the due diligence. These issues are explored in Chapter 6.

Cross-border transactions are complicated by the fact that one must be able to deal effectively with cross-cultural differences. The more a lawyer knows about the cross-border differences between the parties, the better he or she will be able to assist a client in negotiating the transaction. Chapter 7 will identify several sources to learn about the culture of a country where you will be conducting a transaction. Then it will discuss several types of cross-cultural differences. Unfortunately, too often the discussion of cross-cultural differences uses broad generalizations. One must not fall into the habit of stereotyping these differences.

It is wrong to say that any one large country has a single culture. For example, “India is a mosaic of cultures and languages with a population of 1.2 billion people, more than half of whom are under 25 years of age. . . . There are 14 official Indian languages and English—the unifying language in government and business.”<sup>6</sup> Thus, one must be aware of not only what country the other party is from, but where in a country they come from, their age, educational level, business experience, and religion to better understand their culture and cultural perspective.

One of the greatest obstacles in cross-border transactions is the need to deal with more than one language. Even when one language is used, parties from different cultural backgrounds still may have difficulty understanding one another. Chapter 8 discusses the need for clarity in communications and the challenges that arise with translations.

A lawyer handling a cross-border transaction, even if he is cooperating with a local counsel, must be aware of the differences in legal processes and practices between the two countries and be able to explain those differences to his client. Chapter 9 looks at some of the differences in legal process and practices, including differences in common law versus civil law, attorney-client privilege, registration of title, the use of title and gap insurance, and the use of escrow accounts at the closing.

Chapter 10 presents some general and specific advice on how to be effective in negotiations and be more persuasive with your statements at the negotiating table. In addition, it explores how cross-cultural differences affect negotiations and offers suggestions on how to deal responsively toward them. Also, be aware that in most negotiations your counterparts will be as sophisticated in negotiations as you are, regardless of their country of origin. Probably, they have researched cross-cultural differences and thus have adjusted

their style of negotiating to make them more competitive with their own negotiation methodology. Therefore, you must make great efforts to know the parties with whom you are negotiating and develop an effective strategy to secure the best outcome for your client.

In some countries, such as Russia and China, at the start of negotiations you may not know who the real decision maker for the opposite party is. The opposite party tries to use this as a tactical advantage in the negotiations. One way of identifying the real decision maker is to insist on receiving the registrations and articles of association of the company to determine who is authorized to sign on its behalf. While none of those persons may actually be the real decision maker, it should help lead you to that person.

Chapter 11 identifies some of the cross-border tax issues that one should be aware of in conducting cross-border real estate transactions. One must investigate the tax consequences of a transaction not only in the jurisdiction where the property is located, but also in the jurisdiction to which you want to send returns on investment.

Chapters 12–16 look at specific agreements that one may encounter in a cross-border transaction, acquisition agreements, construction agreements, lease agreements; hotel agreements, and public-private partnership agreements. They highlight some of the key issues involved and provide information about the essential contents of each agreement. In addition, Chapter 12 generally discusses the interpretation and drafting of all kinds of agreements. Also, dispute resolution provisions will be dealt with at the end of Chapter 12, although the use of mediation will be discussed in Chapter 10.

Finally, the conclusion of a cross-border acquisition—the closing and registration of title—is discussed in Chapter 17.

## **UNDERSTANDING PROPERTY AND FINANCIAL STATEMENTS**

A lawyer conducting cross-border real estate transactions is not required by law to have a good working knowledge of real estate, or an understanding of what makes a property good for investment, but it definitely helps. I believe it is crucial to properly represent clients in a real estate transaction. People purchasing real estate may or may not have such knowledge. It is beneficial if you can read and explain a floor plan, elevation, construction documents, and a site plan to clients.

One needs to know what makes a good building. Its location, quality of design, and construction are key elements. As mentioned, these are discussed in the next chapter.

In addition to understanding what makes a property a good investment, transactional lawyers should be able to read and understand financial statements and calculations of net operating income, yields, deferred tax, and net equity value. When reviewing such statements, be sure that all operating costs, including external maintenance and property management costs, are included when calculating yields. Also, in a share deal, all liabilities, including deferred taxes, should be deducted when calculating the net equity value of the property.

## **ETHICS**

In representing clients and conducting cross-border transactions, lawyers are bound by the code of ethics of the jurisdiction where they are admitted to practice law. The codes

of ethics and laws of many countries prohibit lawyers from practicing law in a jurisdiction in which they are not licensed. The licensing laws and the ethical codes of the jurisdiction where a lawyer is licensed to practice law may differ from the laws and code of ethics for lawyers in the jurisdiction where the property is located. Thus, the first question to be raised in a cross-border transaction is: Are you practicing law in a jurisdiction in which you are not admitted to practice?

Given the globalization of business, some of these legal and ethical restrictions may be outdated. If a lawyer admitted in one jurisdiction sends legal documents, or legal advice in the form of letters, faxes, or e-mails, across state or national borders, or attends a negotiation in a foreign jurisdiction, is he or she engaged in the improper practice of law in that foreign jurisdiction? Currently, the American Bar Association is debating this topic in a review of its Model Rules of Professional Conduct.

This issue particularly concerns me. I am an American attorney-at-law, admitted to practice in the state of New York and before the U.S. Court of Appeals for the Second Circuit. I am the head of Cross-Border Transactions for a Danish law firm but am not qualified to call myself an *advokat* in Denmark (the Danish equivalent of an attorney-at-law). Most of my work in this position has been conducting transactions in countries other than the United States or Denmark. To avoid the improper practice of law issue, I do not give legal advice on Danish law; other members of my firm do. Also, I do not give legal advice on the law of the jurisdictions where the property is located; we use local lawyers for that. Some may argue that this is a very thin distinction. My clients, however, have needed cross-border legal advice on how to structure and conduct the transaction that goes beyond the law of just the jurisdiction where the property is located. Country laws and codes of ethics must recognize the globalization of real estate investment and development practice and realize that there is a cross-border expertise that has been developed by some professionals that transcends state and national borders.

A second ethical problem that lawyers face as negotiators is: are they permitted to bluff or make false statements in negotiations that they feel will help the interest of their clients? Again, ethical codes, laws, and practices vary across the world. Friedman and Shapiro highlight this issue:

“Negotiators commonly hide their true level of dependency, and commonly exaggerate the value of their options in the event of no agreement, their willingness and ability to choose other options, and the likelihood that their constituents (whose supposed demands may even be fabricated) will disapprove of concessions under discussion. . . . The process of negotiating is at its core a process of shaping perceptions of reality. . . . Whether these behaviors are ethical is a great source of debate.”<sup>7</sup>

Wokutch and Carson discuss bluffing by writing:

“Common sense holds that lying and deception are *prima facie* wrong. One could also put this by saying that there is a presumption against lying and deception: that [they] require some special justification in order to be permissible. . . . It is also obvious in a negotiating setting there are financial rewards for successful lies and bluffs. If you can conceal your actual minimal acceptable position, you may

be able to achieve a more desirable settlement. By the same token, learning your negotiating opponent's true position will enable you to press toward his minimal acceptable position."<sup>8</sup>

Dees and Cramton discuss the ethics of deception:

"It is interesting to note that the moral toleration for deception about settlement issues is also reflected in the law governing negotiations (torts and contracts) and in the American Bar Association Model Rules of Professional Conduct (the only professional code of ethics that we have seen that explicitly addresses this issue). The law allows recourse against some forms of deception or concealment, but only with regard to 'material facts.' Settlement issues are not generally taken as material facts. As it is put in comments on Rule 4.1 of the ABA Model Rules, with regard to representing clients in a negotiation with third parties, 'Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statement of material fact. Estimates of price or value placed on the subject of the transaction and a party's intention as to an acceptable settlement of a claim are in this category.' . . . This special legal treatment for settlement preferences is also a bit of a puzzle. . . . [Especially, when it is stated in] *American Jurisprudence 2d ed.*:"

"There is abundant authority to the effect that if one party to a contract or transaction has superior knowledge, or knowledge that is not within the fair and reasonable reach of the other and which he [the other party] could not discover by the exercise of reasonable diligence, or means of knowledge which are not open to both parties alike, he [the first party] is under a legal obligation to speak, and his silence constitutes fraud, especially when the other party relies upon him to judge the expedience of the bargain or transaction. (*American Jurisprudence, 2d ed.*, "Fraud and Deceit," section 148)."<sup>9</sup>

Also, Dees and Cramton argue that the negotiator needs to build trust among the parties to minimize the ethical dilemma.

"If trust is absent and the transaction is large enough to justify the cost, trust may be built or reinforced through a variety of mechanisms. . . . The best hope for building trust about settlement-issue deception among strangers or adversaries seems to lie not in standard external control mechanisms, but in relationship building and development of notions of group identity. . . . [I]n many cases of settlement-issue deception, . . . trust building may not be viable . . . caveat emptor may be the best advice."<sup>10</sup>

## SUMMARY

Cross-border real estate practice during good market conditions is an exciting and rewarding practice allowing one to use his or her legal, creative, negotiating, and cross-cultural skills to help clients complete successful transactions. In bad market conditions it

is more challenging, requiring lawyers to develop more creative solutions to problems. To do so, a lawyer must be able to maintain an overall view of the situation, so that the solution to the most obvious problem does not create new problems.

This chapter has given an overview of what to expect in the rest of the book. It also briefly discussed understanding property and financial statements. Then it emphasized the critical importance for a lawyer conducting cross-border real estate transactions to maintain the highest ethical standards.

Many signs at the end of 2011 indicated that market conditions for cross-border real estate transactions might be improving. Hopefully, the material that follows will help lawyers to be better prepared to conduct the new cross-border real estate transactions that will begin to arise. The next chapter examines the key factors to investigate when selecting a property for investment.

#### Notes

1. Lizieri, Colin, *Towers of Capital: Office Markets & International Financial Services*, (Chichester, West Sussex: John Wiley & Sons Ltd., 2009), 165.
2. London: Legal & Commercial Publishing Ltd., 2009.
3. Gesteland, Richard R. & Mary C. Gesteland, *India—Cross-Cultural Business Behavior: For Business People, Expatriates and Scholars*, (Gylding, Denmark: Copenhagen Business School Press, 2010).
4. Silkenat, James R., Jeffery M. Aresty, and Jacqueline Kiosek (eds.), (Chicago: American Bar Association, 2009).
5. Gesteland, Richard R., *Cross-Cultural Business Behavior (Negotiating, Selling, Sourcing and Managing Across Cultures) 4th ed.*, (Gylding, Denmark: Copenhagen Business School Press, 2005).
6. Gesteland, Richard R & Mary C., 173.
7. Friedman, Raymond A. and Debra L. Shapiro, "Deception and Mutual Gains Bargaining: Are They Mutually Exclusive?" Chapter from Lewicki, Roy J., David M. Saunders and John W. Minton, *Negotiation: Readings, Exercises, and Cases, Third Edition*, (Boston: Irwin McGraw-Hill, 1999), 260–61.
8. Wokutch, Richard E. and Thomas L. Carson, "The Ethics and Profitability of Bluffing in Business," chapter from Lewicki, 228–29.
9. Dees, J. Gregory and Peter C. Cramton, "Shrewd Bargaining on the Moral Frontier: Toward a Theory of Morality in Practice," chapter from Lewicki, 237–38.
10. *Ibid.*, 252.