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International Real Estate Investment in Finland

In Finland, international investors and investment funds can benefit from favourable conditions for investment in real estate. Following the creation of the structural framework for a more intensive engagement with foreign investors, the market has grown quickly due to good profit expectations. In 2004 international investments already accounted for more than 40% of the aggregate transaction value of institutional investments.

by
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1. Legal conditions for real estate investment in Finland

The legal conditions for foreign investment in Finnish real estate are favourable. Since 2000 there have been no legal restrictions on the ownership of real estate by foreigners. There is a reliable central land register. Properly prepared applications for registration are dealt with swiftly; registrations that have effect for the rank of a right are usually made within the same day.

However, the refinancing of real estate investments in the form of investment funds has traditionally been nonexistent on the Finnish market. The urgent need for such financial facilities has recently been recognised, at both economic and political levels, leading to the passing of a dedicated Real Estate Fund Act (*kiinteistörahastolaki*) in 1997. The framework created by this Act may, however, be quite justifiably regarded as unsuccessful, since to date not a single real estate fund has been founded pursuant to it. This form of investment has

proven to be unattractive primarily for tax reasons.

This gap cannot be filled by traditional investment funds. According to the Investment Fund Act (*sijoitusrahastolaki*), these may invest only in securities traded on the stock exchange, but not in real estates. As a consequence of this, Finnish investment funds focusing on real estate have to rely on the acquisition of shares in foreign real estate funds. This in turn creates an impetus for foreign real estate funds to invest in the Finnish market.

2. Direct ownership or real estate company: advantages and disadvantages

Any person or company can hold ownership rights over real estate, and these rights are registered with the central land register. A great deal of Finnish property is, however, held by specialised *real estate companies*. Usually there is one company per property, and that property represents the company's only relevant asset. Using real estate companies, the

property can be transferred by transferring the shares in the company without having to make any registrations with the land register.

This form of ownership offers significant advantages for investors as compared to direct ownership. The transfer of real estate shares does not involve any special formalities and is favourable with regard to taxation: a transfer tax of 4% of the purchase price is imposed on the transfer of estates, while the same tax is only 1.6% when transferring negotiable instruments such as shares.

Real estate shares are also a significantly more attractive security than the property itself. Real estate may be used as security only on the basis of a mortgage over the property in question. In Finland the mortgage does not grant any immediate rights of execution over the property to which it relates. Instead, a money judgment must be obtained by way of an ordinary civil law suit, which may lead to delays of months or even years. Conversely, shares in a real estate company can be pledged

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to the creditor without any special formal requirements, and the latter may realise the pledge by selling the shares in the open market following a notice period of one month.

Despite these advantages, it may be advisable or necessary for investors and creditors to acquire their rights (additionally) directly in the real estate itself. In particular, a mortgage registered with the land register offers better protection for the creditors in certain scenarios.

3. Tax effects of the real estate investment

Any rent receipts gained from the property are subject to taxation in Finland. The same applies to any profits made by selling the property. The tax rate for companies is presently 26%.

According to the tax treaties between Finland and most European countries, this tax can be deducted from the corresponding taxes due in the company's home country.

Letting and leasing of real estate is generally not subject to turnover tax in Finland, but the owner of the property in question may apply for turnover tax liability in order to be able to make use of the deduction of prior turnover tax. Whether this option is worthwhile depends on a number of factors, amongst them the lessee's taxation.

Since the beginning of 2006, property tax no longer exists in Finland.

4. Real estate investment and due diligence

It is in the interest of the investor and the bank granting credit that the real estate to be acquired fulfils the expectations placed in it. The purchasing party cannot rely exclusively on the vendor's contractual warranties and representations but must also achieve a fair degree of certainty by carrying out its own scrutiny and analysis. As in the field of corporate acquisitions, such analysis is called due diligence.

A well-performed due diligence exercise will not only clarify the legal risks and possibilities involved, but may also make a valuable contribution towards finding the appropriate legal structure for the investment. In this phase, it may become clear whether it is better to acquire the property directly, or to acquire the shares of a real estate company; or whether it is more advisable to bring the property under the control of a newly formed real estate company. Contracts that are recognised as risk factors can be excluded from the investment package.

Typically, the following issues fall within the scope of the due diligence exercise:

- Property relations and insurance with regard to the property
- Questions of company law in the case of a real estate company
- Ability of the vendor to fulfil all obligations under the contract of sale

- Pre-emption rights or similar limitations on the right to dispose of the property
- Validity and term of lease contracts relating to the estate
- Condition of the building, security, and insurance
- Cost structure of the property, particularly maintenance agreements and related costs
- Conformity of the object with public building law, permissions and licences
- Possible environmental risks
- Pending legal disputes affecting the property

Due diligence is regularly carried out on the purchaser's behalf as well as on behalf of the bank granting the loan in respect of the property. The information and documents supplied by the vendor serve as the basis of the scrutiny.

In many cases, the conditions are also subject to scrutiny by the vendor him or herself, when he or she will have to accept certain contractual warranties and representations with regard to the investment object. In order to avoid liability, the vendor must ensure that the validity of the warranties provided is carefully verified.

On the other hand, the same issue also gives the other parties reason to scrutinise the documents supplied by the vendor with great care. When presented with liability claims, the vendor may later possibly rely on the fact that the circumstances forming the basis for liability could already have been identified by the purchaser, from the documents



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received from the vendor, prior to entering into the contract.

5. The purchase: contract-drafting, applicable law

The real estate purchase is the core of the investment. To a greater extent than is applicable with other types of contracts the purchase of real estate is closely intertwined with the national legal system at the place the property in question is located. In order to be valid the property transfer must be made in accordance with the requirements of local property law. Consequently, it is futile to agree that any law other than Finnish law will apply when concluding a real estate purchase contract in relation to property located in Finland.

This does not necessarily mean that the contract must be drafted in Finnish. Contracts in the English language are increasingly common even where investment in real estate is concerned. Nevertheless, contracts should be tailored to the applicable Finnish law. The adaptation of English model contracts that have been drafted on the basis of Anglo-American law often results in failure to fulfil the desired contractual purposes.

If contracts are drafted in English, it is usually necessary to have them translated into Finnish for the purposes of registration with the land register.

In addition to the transfer of the real estate proper it is usually necessary to transfer a number of contracts with third parties from the vendor to the purchaser. This concerns, in the first place, rental

and lease contracts with long-term lessees; but the new owner will usually also want to make use of insurances, maintenance contracts and the like. These transfers must be prepared with care. Generally speaking, contracts with third parties may be transferred only with the consent of the relevant contract partner. If valid transfer of the contracts is not achieved in time, the transfer of the property may give a long-term lessee the right to terminate the rental contract.

Finally, when using Finnish real estate as security, it should be noted that in Finland charges on properties do not cover receivables from rental or lease contracts. In order for these to serve as security they have to be charged separately.