

SECURITY ISSUES *when acquiring* REAL PROPERTY IN SWEDEN

When acquiring real property the investors and the lenders in most cases require security in the property. This article will give an overview of matters regarding security under Swedish law from an international investor's point of view when acquiring or lending money to acquire Swedish real property.

In Sweden, as elsewhere, security can be granted in many ways. However, in our experience there are seven main ways of issuing or obtaining security in Sweden regarding real property or the companies owning the real properties. Investors as well as creditors should consider these when structuring a transaction including Swedish real property. The seven main ways to obtain security are;

- (i) Mortgages in the respective real property
- (ii) Pledge of shares of the company acquiring the real property
- (iii) Pledges of accounts that the company acquiring the real property holds and other security over cash flow
- (iv) Assignment of contracts that the company acquiring the real property has entered into
- (v) Assignment of receivables of the company acquiring the real property
- (vi) Assignment of any insurance payments in regard of the real properties.
- (vii) New trend - securitization

Below we will comment on each separate way to issue or obtain security but firstly we will give a brief introduction to a typical real property transaction in Sweden.

Typical transactions

Generally, a transaction involving real estate in Sweden is either made through a direct sale of the real estate or through a purchase of shares in real property holding companies. The latter often triggered by the incentive of saving stamp property.

"Normal" transactions

A recent trend is that foreign investors have become more interested in Swedish real property and the transactions made on the Swedish market nowadays often include the sale of large real properties or portfolios as well as real property holding companies to foreign entities. The purchasers often originate from the U.S.A., England or Germany.

Sale and leaseback's

In recent years there has been an ongoing trend that large Swedish companies sell their real property in order to allocate funds and concentrate on their core-business. The real properties sold are often of strategic importance to the seller and the transactions are therefore often formed as a sale and leaseback of the real properties. The lease often runs with a long term of approximately 15 to 20 years.

Valid transaction under law

Regardless whether the transaction is structured as a sale and leaseback or a normal acquisition the sale of real property in Sweden is governed by Chapter 4 of the Swedish Land Code (jordabalken). Chapter 4 of the Land Code

stipulates minimum requirements for a valid purchase of real property. Based on the provisions in Chapter 4 it is common in Sweden to draft two separate agreements regarding the transaction. The first agreement is a contract of sale specifying in details the terms and conditions of the sale. The second agreement is a purchase deed, which often is limited to one page fulfilling the minimum requirements of a sale of real property. The contract of sale is entered into at signing while the purchase deed is signed upon closing of the transaction. The purchase deed is then used to gain title over the real property with the Swedish Land Registry. It should be noted that it is not necessary to use two separate agreements but it is often preferred since the document used to gain title to the real property becomes public after the registration for title. As stated above the purchase deed can be limited to include the minimum requirements for a valid sale of real property. However, it is important to note that any conditions of the sale to the effect that the transaction shall be deemed null and void if not fulfilled must be repeated in the purchase deed in order to be valid. This is true even if the condition is clearly stated in the contract of sale. Also, by issuing a purchase deed it is presumed that the purchase price has been paid in full and therefore it is not advisable for a seller to sign such a document unless it is clear that it has received the money.

The Swedish Land Registry

All real properties in Sweden have a unique property designation by which it can be identified. The Swedish Land Registry is public and well organized in the form of a database. Hence, through obtaining a certificate from the Land Registry or by being online a certificate of title can be determined within minutes. Furthermore, mortgages as well as registered encumbrances in the real property is listed in the Land Registry. However, it is possible that unregistered encumbrances including leases and easements can be valid after the sale of the real property. Therefore the seller often guarantees that no encumbrances other than those listed by the seller or included in the extract from the Land Registry exists in the real property.

Environmental issues

A further legal issue, which is increasingly playing a part in these types of transactions, is the extent of the potential liability for environmental damage. Under the Swedish Environmental Code there are specific provisions on remedial of polluted areas. These provisions were important novelties when the Code came into force 1999. They are applicable to land and water, buildings and structures, which are polluted to such an extent as to entail a risk for damage or nuisance to human health or the environment. The overriding principle of the liability regime is the "polluter pays principle". In the event that the liable operator cannot be found or is not able to take necessary remedial measures, anyone who, after 31 December 1998, has acquired or acquires a polluted area with knowledge of a contamination within the area in question may be held liable for reasonable remedy measures. The same applies if the purchaser should have known about the contamination.

Seven main ways of issuing or obtaining security in Sweden

(i) Mortgages in real property

The most common way to obtain security in connection with a transaction involving real property is to obtain mortgages in the property. In Sweden the registered property owner applies for the real property to be mortgaged. The Land Registry issues mortgage deeds (in paper) or if preferred by the applicant registers the mortgage in a database carries out the registration of the mortgage. Financial institutions prefer to use the data based mortgage that is becoming increasingly popular. The Land Registry does not carry out an evaluation of the real property but a stamp duty is levied. The stamp duty is two percent of the amount in the mortgage deed.

Whether using existing mortgages or applying for new ones at the Land Registry, the true owner delivers (pledges)

the mortgage as collateral for a credit or another claim. It should be noted that, since a new owner must apply to register for title, the true owner of the real property may be different than the registered owner.

The mortgage gives a security right over the real property comprised by the mortgage for a claim up to an amount equal to 115 percent of the face amount of the mortgage deed, plus interest on such an amount from the date of enforcement at a rate corresponding to the official Discount Rate plus four percent.

(ii) Pledge of shares of the company acquiring the real property

Generally, a share certificate is the bearer of the rights pertaining to the share. The pledge of a share is perfected when the share certificate has been transferred into the pledgee's possession or, if the share certificate is held by a third party, when the holder is notified of the pledge.

Coupons may be issued together with the share certificate. The coupons entitle the holder to receive dividends paid and bonus shares issued. Therefore, it is important to ensure that all coupons are transferred to the pledgee's possession. Also, it is important to note that a pledge of a right to receive dividends only is perfected when that particular dividend has been declared.

Even though the share certificate has been pledged the right to vote for the share remains with the pledgor. The only exception is if the pledgee is given a power of attorney from the pledgor. However, a power of attorney to vote for the share is valid for a maximum of one year. Furthermore, although a revocation may be a breach of the pledge agreement, the grantor will always be entitled to withdraw the power of attorney.

Lastly, all shares in companies listed on the Stockholm Stock Exchange as well as other certain companies are administered by a Swedish organization named VPC. No share certificates are issued in respect of such shares and a pledge is perfected by way of registration.

(iii) Pledges of accounts that the company acquiring the real property holds and other security over cash flow

In order to create a security interest over the balances on a bank account, the bank must be notified of such security interest.

In order for the security interest to be perfected, the pledgor must not be able to dispose of the bank account.

However, it is possible to provide for in the security documentation that the pledgor may dispose of the bank account, provided that the consent of the pledgee is obtained in each case a disposal is made.

(iv) Assignment of contracts that the company acquiring the real property has entered into

Pledges over contractual rights are perfected through notification of the debtor. The notification can be made by the pledgee or the pledgor in order to be valid. Furthermore, in order for the pledge to be perfected it is necessary that the pledgor is deprived of control over the collateral, i.e. the contractual right to receive payments. Therefore the debtor should be instructed to a new account which the pledgor does not control. It should be noted that exceptions apply where it is possible that the pledge is perfected without notifying the customers of the pledgor.

(v) Assignment of receivables of the company acquiring the real property

Assignment of accounts receivables are in Sweden made in the same manner as the assignment of contracts

described above. If the receivables are evidenced by negotiable instruments, it is possible to perfect the pledge without notifying the debtor. This is made by transferring the negotiable instrument to the pledgee's possession or, if the instrument is held by a third party, by notification of that party.

(vi) Assignment of any insurance payments in regard of the real properties.

Especially when financing real property transactions it should be considered if the lender shall assign all rights under the insurance policy held for the real property. The assignment is made through notification of the insurance company and may be made by the assignor or the assignee. It is important to remember that the assignment must be made in such manner that it is impossible for the lender to have access to reimbursements paid under the insurance coverage. Most commonly this is achieved by having the payments made to an account that is not controlled by the assignor.

(vii) New trend - securitization

Another possible way of financing real property is by securitization of cash flow such as rents. Such setups are becoming increasingly popular in Sweden, especially since the real property securitization transactions recently made in Sweden have been very successful. Since the transaction costs are substantial only larger portfolios should be considered for this type of transactions.

Summary, conclusion

It's rather complicated to purchase real property in Sweden. The mandatory conditions for a valid sale must be observed in both the contract of sale and the purchase deed (if used). The extent of the potential risk liability for environmental damage must also be taken under consideration. When acquiring Swedish real property the stamp duty for commercial real property is set to three percent of the purchase price. The purchaser most commonly pays the stamp duty, but it is possible for the parties in a sale to agree otherwise.

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