Croatia

Miroslav Plašćar and Iva Filipan
Žurić i Partneri d.o.o.

TRANSFER OF REAL ESTATE

1 Legal system
How would you explain your jurisdiction’s legal system to an investor?
The Croatian legal system is a civil law system. The courts rule in equity.
A party can obtain an injunction to prevent an action; a party is entitled to start the proceeding by prohibiting injunction (an order addressed to a particular person that either prohibits him or her from doing or continuing to do a certain act) or mandatory injunction (an order addressed to a certain person to carry out a certain act).
Under the Croatian legal system parol evidence is always admissible. However, some proceedings, for example, land registry proceedings, are mostly based on documentary evidence.
The Croatian legal system admits an oral form of contract, but for some types of contract (for example, a real estate purchase contract) the written form is mandatory.

2 Conveyance documentation
What are the legal requirements for documents recording conveyance?
The Law on Ownership and Other Property Rights requires a real estate sale contract to be in writing. The seller’s signature must be notarised to enable the buyer to register its title with the Land Registry. The judicial decision has to include a legal validity clause. The court fee for registration of title of ownership is payable by the buyer.
The fees are strictly regulated by the Law on Fees (Official Gazette No. 74/95, 57/96, 137/02, 136/03, 125/11).

3 Foreign investors
What other factors should a foreign investor take into account in considering an investment in your jurisdiction?
To purchase real estate in Croatia, non-residents, with the exception of EU residents, have to obtain the consent of the Ministry of Foreign Affairs. This is an administrative procedure, started by submitting a written application to the Ministry of Foreign Affairs.
A foreign investor should obtain a detailed review of tax legislation and the legislation regulating location, building and use permits.

4 Exchange control
If a non-resident invests in a property in your jurisdiction, are there exchange control issues? What about repatriation of capital?
Repatriation of foreign earnings is allowed, but not compulsory. According to the Foreign Exchange Act, the transfer of profits from one country to another is not restricted and may be effected after all tax and other statutory obligations in Croatia have been met. The general rule is that the amount that is left after corporate income tax has been paid can be repatriated. Moreover, the Investment Incentives Act was recently introduced. This Act prescribes all sorts of incentives to create a ‘fertile ground’ for foreign investment in Croatia. One of these incentives is related to corporate income tax. Depending on the amount of capital invested in Croatia, a company may gain a right to the lower tax rate. The higher the amount invested, the lower the tax rate becomes. Therefore, not only is the repatriation rule quite liberal, but also the provisions of the above act are in favour of the non-resident company.
In addition, it is important to underline the possibility of transferring any profit through the company’s foreign currency account that is held at one of the authorised local banks. This is possible if the company with profits to be transferred has its own foreign currency income from exports of goods or services.

5 Legal liability
What types of liability does an owner of real estate face? Is there a standard of strict liability and can there be liability to subsequent owners? What about tort liability?
Tax obligation liability
The buyer of real estate is liable to real estate tax payment and value added tax (VAT). Transfers of real estate are subject to VAT only when the object of the transaction is a newly constructed building, built after 1 January 1997.
Lease agreement liability
If the landlord sells or in any other manner transfers its right over business premises, the business lease is not terminated. The third party (the buyer) who acquires the business premises enters into the position of a former landlord, subject to the pre-existing lease, with all rights and obligations arising from it.
Tort liability
The buyer may be entitled to claim damages for actual damage suffered as a result of the other party’s negotiating without the real will to conclude a contract (Civil Obligation Act, Official Gazette No. 35/05, 41/08, 63/08, 134/09).
If the sale agreement is signed and it is later revealed that the seller was not entitled to sell the real estate for one of the following reasons, the buyer can claim that the transaction is invalid, resulting in the return of all gains acquired. These reasons are:
• the seller was not the registered owner of the property;
• the seller was not empowered by the owner to conclude the agreement;
• the agreement was the result of a wilful misrepresentation by the seller.
The seller also retains liability for misdemeanours and criminal acts.
Pursuant to the Civil Obligation Act the owner of a dangerous object will be responsible for any damage caused to another person.
Also, the owner will be responsible for any damage caused to another person if he owns the object which causes an increased level of peril in the surroundings (Civil Obligation Act, Law No. 35/05, 41/08, 63/08, 134/09). Regarding that issue, the owner of the real estate will be liable for damage caused to another person if the real estate presents this kind of peril, irrespective of intent.

Environmental issues are regulated by the Environmental Protection Act, Official Gazette No. 110/07. The act regulates the areas of noise, ionising and radioactive radiation protection, harmful effects of chemicals and lightning and waste disposal.

6 Protection against liability
How can owners protect themselves from liability and what types of insurance can they obtain?

Owners can take out all standard types of insurance policies.

7 Choice of law
How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction?

Pursuant to the Administrative Conflict Act, real estate contracts are strictly regulated by the law of the state where the real estate is situated (Administrative Conflict Act, Official Gazette No. 53/91, 88/01).

8 Jurisdiction
Which courts have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Pursuant to the Administrative Conflict Act Croatian municipal courts have exclusive jurisdiction over real estate disputes concerning real estate situated in Croatia for Croatian as well as foreign citizens (Administrative Conflict Act, Official Gazette No. 53/91, 88/01.).

- The parties in a proceeding are:
  - a plaintiff (a party whose right of ownership or possession is violated); and
  - a defendant (a party who is prosecuted over any violation).

The party has to be qualified to do business to enforce remedies.

9 Investment entities
What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

While investing in real estate, investors primarily use property companies, with the aim of mitigating tax liabilities, reducing personal liability.

The most common forms are the joint stock company and the limited liability company.

Pursuant to the Law on Real Property Transfer Tax, when the real estate is provided as incorporation deposit or capital stock increase, including procedure of joining and separation of the company, the company is not liable to real estate transfer tax or VAT (Law on Real Property Transfer Tax, Official Gazette No. 69/97, 26/00, 127/00, 133/02, 22/11).

10 Foreign investors
What form of entities do foreign investors customarily use in your jurisdiction?

The most common type of entity in Croatia is the limited liability company.

11 Organisational formalities
What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The most common type of entity is the limited liability company. Pursuant to the Company Act, a limited liability company is incorporated by its articles of incorporation. They are concluded before a notary public (Company Act, Official Gazette No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09).

A limited liability company has to pay corporation tax.

In real estate matters, a company has to pay real estate transfer tax, except an acquisition as mentioned in question 9.

Transfers of real estate are subject to VAT only when the object of the transaction is a newly constructed building, built after 1 January 1997.

12 Documentation
Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

There is no customary form of non-binding agreement. On the other hand, pre-contractual agreements are common. There is a pre-contractual liability for damages if either party:

- enters into a negotiation without intending to conclude the contract;
- negotiates in a manner contrary to the principles of conscientiousness and good faith; or
- terminates the negotiations without reasonable grounds.

It is not customary to take property off the market while the negotiations are ongoing.

13 Contract of sale
What are typical provisions in a contract of sale?

The Civil Obligation Act requires a real estate contract of sale to be in writing. The seller's signature has to be notarised.

The amount of a typical down-payment varies; alternatively, the price has to be paid all at once.

The payment is usually held in escrow or public notary deposit.

The seller confirms the fact of ownership with a land registry extract, which is available on the land registry websites, so the title search does not usually result in any special costs. However, official proof of ownership (with the official stamp) has to be issued at the Land Registry.

The most general representations and warranties are contracted in the form of a seller's statement that he is the owner of the real estate and that the real estate is not encumbered by a mortgage.

The buyer of real estate is liable to pay real estate tax. The obligation to pay arises at the moment of concluding the contract. The buyer must apply for taxation at the taxation office authorised for the territory where the real estate is situated, within 30 days of concluding the contract.
The buyer is obliged to pay a court fee to register ownership within 30 days from the date of delivery of administrative decision determining the tax obligation. The typical tax year is equivalent to the calendar year.

14 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Environmental clean-up clauses are not typical in Croatian property transfer contracts.

15 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Pursuant to the Law on Leases, the lease agreement will not be terminated if the third party buys or gains real estate on any other legal ground. This means that the buyer enters into the position of lessor, with all rights and duties to the lease contract (Law on Leases, Official Gazette No. 125/11).

The contractual lease provisions as well as any covenants made by seller are left to the will of the parties.

16 Leases and mortgages

Is a lease generally subordinate to a mortgage pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a mortgage upon foreclosure? Do lenders typically require subordination and non-disturbance agreements?

Lenders do not typically require subordination and non-disturbance agreements.

Pursuant to the Enforcement Act, lease contracts that are registered with the Land Registry before the registration of a mortgage will not be terminated in the case of enforcement proceeding over real estate. On the other hand, lease contracts which are not registered with the Land Registry will be terminated in any enforcement proceedings. In Croatia lease contracts are rarely registered with the Land Registry (Enforcement Act, Official Gazette No. 57/96, 22/99, 42/00, 173/03, 151/04, 88/05, 121/05, 67/08).

17 Delivery of security deposits

What steps are taken to ensure delivery of security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets?

Security deposits are normal under the Croatian legal system. A security deposit is usually stipulated to be an amount of one to three rent instalments. In addition to a security deposit clause, lease contracts often include an enforcement clause, by which the tenant entitles the landlord to conduct an enforcement proceeding against the tenant if the tenant refuses to leave the real estate or pay the rent or expenses due from the tenant.

Leases do have periodic rent resets.

18 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Does your jurisdiction provide statutory priority for recorded instruments?

The typical method of title search is obtaining new land registry extracts from the Land Registry. Pursuant to the Law on Ownership and Other Property Rights, ownership of real estate is acquired by registration of real estate with the Land Registry. In other words, if the seller is not registered as the owner of the real estate, the buyer cannot be certain that he is the legal owner of the real estate.

19 Structural and environmental reviews

Is it customary to arrange an engineering or an environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available? Is it customary to obtain a zoning report or legal opinion?

When required, an engineering and environmental review usually includes a review of legislation as well as a review of permits and certificates required by the legislation.

Environmental insurance is not common under the Croatian legal system.

20 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers do review leases. Lawyers point out all the relevant issues concerning the rights and obligations of the parties.

21 Other agreements

What other agreements does a lawyer customarily review?

Lawyers review the documents delivered by the clients, such as loan agreements, purchase contracts, debenture contracts, contracts of assignment, etc.

22 Closing of transaction

How does a lawyer customarily prepare for a closing?

The lawyer usually creates a chronological list of documents and actions. After creating the list, he conducts a detailed review of the documents.

FINANCING

23 Form of lien

What is the method of creating and perfecting liens?

The liens are usually created in standard forms of agreement and registered with the Land Registry.

24 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A loan secured by collateral will not create any special tax obligation for the lender. There is no general rule concerning a lender's obligation to qualify to do business in Croatia. It will depend on the creditor's (eg, banks) rules.

Lien documents are usually made as separate documents or as clauses in credit agreements.
25 Loan interest rates
How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is unreasonably high in your jurisdiction and what are the consequences if a loan exceeds the reasonable rate?

Banks stipulate variable interest rates, according to the banks' decision (mostly 7 to 11 per cent).

26 Default and enforcement
How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Remedies against a debtor are enforced through enforcement proceedings. The enforcement proceeding is initiated by writ of execution. The Enforcement Act regulates judicial and non-judicial proceedings. A judicial proceeding is conducted by the court and a non-judicial proceeding is conducted by a notary public (Enforcement Act, Official Gazette No. 57/96, 22/99, 42/00, 173/03, 151/04, 88/05, 121/05, 670/08).

A foreclosure enforcement is a judicial proceeding, conducted by the court. It can be initiated as soon as the debtor defaults.

27 Protection of collateral
What actions can a lender take to protect its collateral until it has possession of the property?

Collateral is established by registration with the Land Registry. The registration does not entitle the lender to acquire ownership of the real estate. It only entitles the lender to conduct a sale of the real estate in enforcement proceedings and recover his debt.

28 Recourse
May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged property or additional financing encumbering the mortgaged property or ownership interests in the borrower?

Most credit contracts include an enforcement clause by which the debtor entitles the lender to conduct enforcement proceedings over his entire assets. In this case, the lender is entitled to choose which part of the debtor's assets will be the subject of the enforcement proceedings.

In bankruptcy proceedings, all lenders (legal and physical persons) will be able to report their debts and try to recover their debts from all of the debtors' assets.

29 Cash management systems
Is it typical to require a cash management system and do lenders typically take reserves?

It is not typical to require a cash management system or to take reserves.

30 Credit enhancements
What other types of credit enhancements are common? What about forms of guarantee?

The most common credit enhancement is a guarantee agreement. A guarantee agreement is made in writing and it is usually notarised. If notarised, the guarantee agreement entitles the lender to start enforcement proceeding against the debtor, any of the guarantors or all of them at once. In other words, the lender is entitled to recover his debt from any of them. The person who recovers the debt is entitled to reimbursement from other debtors.

31 Loan covenants
What covenants are commonly required by the lender in loan documents? What is the difference depending on asset classes?

The lender will usually require the borrower's written guarantee that his assets are sufficient to cover the lender's claims. The lender will commonly require the debtor's written guarantee that he is the registered owner of encumbered assets (especially real estate) and that the assets are not encumbered by another mortgage. Quite often, the lender will require the borrower's written guarantee that he will not alienate his asset once the agreement is concluded.

32 Financial covenants
What are typical financial covenants required by lenders?

While obtaining bank loans, the debtor will usually bind himself to deliver his current account, statement of changes in financial position and annual financial report. Also, he will usually commit himself to inform the bank on opening an account in other banks.

33 Bankruptcy
Briefly describe the bankruptcy system in your jurisdiction.

The Law on Bankruptcy regulates involuntary and voluntary bankruptcy (Law of Bankruptcy, Official Gazette No. 44/96, 29/99, 129/00, 123/03, 82/06, 116/10, 25/12).

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**Žurić i Partneri d.o.o.**

<table>
<thead>
<tr>
<th>Miroslav Plašćar</th>
<th><a href="mailto:miroslav.plascar@zuric-i-partneri.hr">miroslav.plascar@zuric-i-partneri.hr</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Iva Filipan</td>
<td><a href="mailto:iva.filipan@zuric-i-partneri.hr">iva.filipan@zuric-i-partneri.hr</a></td>
</tr>
</tbody>
</table>

Ivana Lučića 2a
10000 Zagreb
Croatia

Tel: +385 1 5555 630
Fax: +385 1 4856 704
www.zuric-i-partneri.hr
Both debtor and creditor in bankruptcy are entitled to start bankruptcy proceedings by submitting a bankruptcy petition to the court (the Commercial Court).

A secured creditor will have to file his claim in bankruptcy as well as his security interest, submitting the claim in bankruptcy and security interest report to the bankruptcy commissioner.

If the secured interest is admitted by the bankruptcy commissioner, the secured creditor is entitled to demand settlement from secured assets.

Once the bankruptcy proceeding has started, the bankruptcy commissioner will undertake the obligation of management of the whole of the debtor’s assets. In relation to this, the rents will be paid to the bankruptcy commissioner and will become part of the bankrupt’s estate.

34 Secured assets
What are the requirements for creation and perfection of a security interest in non-real property assets? Is a ‘control’ agreement necessary to perfect a security interest and, if so, what is required?

Security interest in non-real property is created pursuant to the Enforcement Act regulations, by notification in the register of public notary insurances at the Financial Agency.

35 Single purpose entity (SPE)
Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy filing, has the concept been upheld?

In the Croatian legal system physical and legal persons acquire rights and obligations and there are no specific requirements for an SPE.