Croatia

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GENERAL

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 prohibitory 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. Registration and recording system

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

There is a system for the registration of property rights and legal relationships arising from legal transactions connected to real estate. According to Croatian Land Register Act (Official Gazette 91/96, 114/01, 100/04, 107/07, 152/08, 55/13) (the Land Register Act), property rights (ownership, easements, constructional right, encumberance and pledge) are recorded in the land register. The acquirer of a property right is entitled to file the proposition to the land register.

Legal relationships, emerging from legal transactions connected to real estate (such as leasehold or security interest, as a creditor’s right emerging from legal transaction between creditor and debtor), can also be recorded in land register.

The legal effect of those records will differ as follows.

Real estate ownership is acquired by recording in the land register, so the person or legal entity will be considered a legal owner of real estate under the condition that it is a registered landowner. The purchase contract presents only the legal ground of real estate transfer, but the transfer will acquire legal validity by recording in the land register. On the other hand, the ownership of real estate acquired by a valid court decision does not require land register registration (in that case, registration will only constitute declaration of the acquired ownership).

Leasehold record represents only the declaration of the leasehold’s existence and provides publication of the leasehold.

Interests do not have to be recorded in the land register. They are usually recorded in case of a credit contract approved by banks, as part of a mortgage description.

Land register data is based on cadastral register data, so includes unregistered land. There is no special register where unregistered real estate is recorded.

3. Registration and recording

What are the legal requirements for registration or recording of conveyances, leases and real estate security interests?

Registration of the ownership

By recording conveyance, the buyer will have to follow procedure regulated by the Land Register Act.

The procedure is initiated by the buyer, who files a registration request with the land register. The request is usually submitted in written form, but the law also regulates the possibility of an oral request stated to the court record. The buyer is also obliged to file the needed documents and court fee:

- the conveyance contract (the legal ground);
- tabular statement (a statement provided by the seller confirming that the purchase price has been paid in full and authorising the buyer’s registration); and
- the fee determined by the Fee Act (Official Gazette 26/03, 125/11, 112/11), which cannot be minimised.

The buyer is also obliged to pay real estate tax regulated by the Real Estate Tax Act (Official Gazette 69/97, 153/02, 22/11) (the Real Estate Tax Act).

Registration of leasehold

According to the Civil Obligation Act (Official Gazette 35/05, 41/08, 63/08, 134/09, 94/13) (the Civil Obligation Act) and the Leasehold Act (Official Gazette 91/96) (the Leasehold Act), the lease is set up by lease contract conclusion. Registration is not required by law, but the owner of the real estate is entitled to submit the registration request to the land register, together with the lease contract and court fee.

Registration of real estate security interests

As already written in question 2, interests do not have to be recorded in the land register. They are usually part of recorded mortgage description, concluded by a credit contract with real estate security instrument registration.

A mortgage is recorded by filing the registration request to land register, together with credit contract and court fee.

4. Land records

What are the requirements for non-resident entities and individuals to own real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

From 1 February 2009 European Union citizens are considered equal to Croatian citizens. On the other hand, the citizens and legal entities who are not European Union citizens are entitled to conveyance in Croatia under condition of the Reciprocity Agreement as well as the consent of the Ministry of Justice.
The foregoing procedure can be circumvented by setting up a company in Croatia. The company will be entitled to acquire the property rights as any other domiciled legal entity.

The foreign entities are not obliged to fulfil any special qualification, serve any special reports to local authorities or obtain a special licence.

The foreign tenant does not have to fulfil the foregoing conditions; he or she is authorised on the leasehold's conclusion regulated by the Civil Obligation Act and the Leasehold Act.

The buyer should take into account the obligation to pay real estate tax with several exceptions when the tax does not have to be paid:
- if the real estate represents initial capital or an increase of share capital;
- if the real estate acquisition emerges as a result of a merger or de-merger of a company (according to the Companies Act (Official Gazette 125/11, 111/12, 68/13)).

When buying real estate from the seller liable to tax payment in accordance with value added tax the buyer is obliged to pay tax under the following conditions:
- real estate tax will be payable according to the land value, as well as communal land planning and
- value added tax will be payable according to the construction value of the building.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Repatration 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.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? 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; or
- 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

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.

7 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.

8 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? Are contractual choice of law provisions enforceable?

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).

9 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 (the 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.
10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, leasehold and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Croatian legislation provides different legal regulation regarding commercial and residential property.

Purchase and leasehold of commercial property are regulated by the Premises Lease and Purchase Act (Official Gazette 125/11) (the Premises Lease and Purchase Act).

Purchase of residential property is regulated by the Civil Obligation Act, while the leasehold is regulated by the Leaschold Act.

Subject to the enforcement procedure, both commercial and residential property is regulated by the Enforcement Act (Official Gazette 112/12).

11 Planning

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The planning process is determined through a detailed process of regional and urban planning, regulated by the Building and Urban Planning Act (Official Gazette 76/07, 38/09, 55/11, 90/11, 50/12, 53/12, 80/13).

Regional and urban planning efficiency is defined by regional and urban planning documents and executed by the government and parliament, on a state and regional level. Direct implementation of regional and urban planning is provided through Croatian regional and urban planning department at the state level, and the county department at the regional level.

Regional and urban planning documents determine aspects of organisation, usage and purpose and protection of the area. Basic regional and planning documents at the state level are the Urban and Regional Planning Strategy and Regional and Planning Program (created by the parliament) and a regional plan (created at county level).

12 Compulsory purchase

Does your jurisdiction have a legal regime for compulsory purchase of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

A system similar to the system of compulsory purchase in Croatia exists in a legal form of expropriation, regulated by the Expropriation Act (Official Gazette 9/94, 414/01, 79/06, 45/11, 34/12) (the Expropriation Act).

Real estate can be expropriated through an administrative procedure, initiated by an expropriation beneficiary. The beneficiary can be a physical person or a legal entity. The expropriation can be authorised under the following conditions:

- building or conducting construction work (such as in the infrastructure, energy, telecommunications, health, cultural or industrial sectors), when such work is required in a public interest; or
- when it is thought that the new purpose of expropriated real estate would provide a higher benefit.

Before taking any other legal steps, determination of public interest is required. The proposal is initiated by the expropriation beneficiary. The proposal is evaluated and a decision taken by the Croatian government, after obtaining the opinion of the municipal council or the city of Zagreb of the area where the construction work is to be carried out.

With determined public interest the beneficiary is authorised to submit the expropriation proposal to the Property Right Administrative County Department, who makes the first instance decision. The second instance decision is made by the Ministry of Justice.

There are two types of expropriation:

- complete expropriation (the expropriated real estate comes under the ownership of the beneficiary); and
- incomplete expropriation (the owner keeps the ownership, while the beneficiary acquires easement or lease).

The owner of the real estate is entitled to compensation. In the case of complete expropriation, the former owner is compensated by gaining other real estate of the same economic value in the same municipality. If the owner does not want to accept new real estate, or new real estate of similar value can not be found, the owner will be financially compensated.

In case of incomplete compensation, the owner will be financially compensated.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The defendant's property (including real estate) can be seized in a criminal procedure.

14 Investment vehicles

15 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 real estate is provided as an incorporation deposit or capital stock increase, including the procedure of joining and separation of the company, the company is not liable to real estate transfer tax or VAT (the Law on Real Property Transfer Tax, Official Gazette No. 69/97, 26/00, 127/00, 153/02, 22/11).

16 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.

17 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 Companies Act, a limited liability company is incorporated by its articles of incorporation. They are concluded before a notary public (Companies Act, Official Gazette No. 111/93, 34/99, 121/99, 52/03, 118/03, 107/07, 146/08, 137/09).

A limited liability company has to pay corporate tax.

In real estate matters, a company has to pay real estate transfer tax, except an acquisition as mentioned in question 14.

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.
ACQUISITIONS AND LEASES

17 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The real estate ownership is regulated by the Law of Ownership and Other Property Laws (Official Gazette 91/96, 73/00, 114/01, 79/06, 146/08, 38/09, 153/09, 90/10, 143/12) (the Law of Ownership). The right of ownership provides absolute and unlimited real estate disposition (under condition that such disposition does not hurt another person's rights defined by law). Apart from 'one person or entity ownership', the ownership can appear in the form of co-ownership (the ownership is divided and defined between two or more persons or legal entities) as well as joint or common property (condominium - ownership without division).

The legal grounds for the acquisition of the right of ownership are alienation, judicial decision or legislative.

Real estate ownership is legally acquired by registration at the land registry.

As well as the right of ownership, the Law of Ownership regulates easements, construction rights, encumbrances and pledges as 'other property rights'. Unlike the right of ownership (which authorises the bearer to absolute and unlimited disposition of the real estate), the bearer of 'other property rights' is authorised only to limited disposition of real estate.

The Croatian legal system makes a distinction between two types of lease; lease (regulated through the Civil Obligation Act and the Premises Lease Act (Official Gazette 125/11) (the Leasehold Act)).

A lease tenant is entitled to a wider range of rights; regular usage and retaining the real estate benefits, while the hire tenant is only entitled to regular usage of real estate.

A premises lease is always regulated and contracted under the Premises Lease Act.

18 Pre-sale

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;
- terminates the negotiations without reasonable grounds.

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

19 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 tax 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.

20 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.

21 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 escrow 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.

22 Leases and real estate security instruments

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

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).
23 Delivery of security deposits
What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits are normal under the Croatian legal system. A security deposit is usually stipulated to be an amount of one to three rent installments. 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.

24 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? Discuss the priority among the various interests in the estate.

The typical method of title search is to obtain new land registry extracts from the land registry. Pursuant to the Law on Ownership, 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 or she is the legal owner of the real estate.

25 Structural and environmental reviews
Is it customary to arrange an engineering or 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.

26 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.

27 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.

28 Closing preparations
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 or she conducts a detailed review of the documents.

29 Closing formalities
Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The presence of both parties at the moment of closing the conveyance contract is not specifically required by law. The conveyance contract has to be concluded in written form and signed by both parties to the contract. The Land Register Act imposes an additional registration condition; the seller’s signature has to include notary public certification.

The Premises Lease Act requires the written form for a purchase contract as well as a lease contract. In situations where the state or municipality is closing the contract as the lessee, apart from the written form, the law also requires a notarial document.

A credit contract containing a real estate security instrument, concluded in form of notarial document represents an enforcement document. Conclusion of a notarial document requires the presence of all the parties to the contract at the notary public’s office. Presence of the government representative is not required.

30 Contract breach
What are the remedies for breach of a contract to sell real estate?

When a down payment is deposited and the buyer is the party in the breach, the seller is entitled to:
• demand settlement of the purchase agreement (if this is still possible);
• demand damages, in which case the seller can chose whether the down payment will be considered as damages or returned to the buyer; or
• keep the down payment.

When a down payment deposited and the seller is the party in the breach, the buyer is entitled to:
• demand settlement of the purchase agreement (if that is still possible);
• demand damages and the return of the down payment; or
• demand the return of double the amount of the down payment.

When the conveyance contract is partially honoured, the injured party is not entitled to keep the down payment. One is entitled to demand fulfilment of the contract and damges or demand damages on the grounds of breach of the contract (in both cases, down payment will be included in damages).

When down payment was not provided, the injured party is entitled to:
• demand fulfilment of contract (as described hereunder); or
• rescind the contract.

The injured party is always entitled to claim damages.

The seller is obliged to hand over the object of the contract in the correct condition. If this contractual term is breached, the seller is liable on the ground of warranty of quality.

Subject to a conveyance contract, it is more important to mention legal deficiency liability.

If a third person claims a property right over real estate, through which a property right buyer’s right of property is limited or derogated, the seller will be liable for such legal deficiency under the condition that the buyer was not notified about the third person’s right at the moment of the contract’s conclusion and did not provide his or her approval of such limitation.

In order to activate the legal protection mechanism, the buyer is obliged to notify the seller and demand the seller release the third person’s right in a reasonable period. If the seller fails to provide release, and the real estate is taken from the third person, the contract will be discharged. If the buyer’s property right is only limited by a third person’s right, the buyer is entitled to choose between revoking the contract or demanding a lower price.

The buyer is entitled to claim damages.

If the buyer starts legal proceedings against the third person, without giving notice to the seller, and the judge rules in the third person’s favour, the seller will still be liable. But if the seller can prove that the evidence he or she would provide could bring a judicial
decision in favour of the seller, the legal grounds for legal deficiency liability would not exist. Legal deficiency liability can be excluded by contract.

31. Breach of lease terms
What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

The lease terms, as well as the breach of contractual duties terms are regulated by the Leashold Act and the Civil Obligation Act.

Relating to a breach of contract by a tenant, the landlord is entitled to discharge the contract if:
- the tenant does not pay the rental and living costs;
- in the case of a concluded sublease without the landlord's permission;
- other real estate owners are disturbed by the tenant's behaviour; or
- the tenant does not use the real estate for residence purposes or gives permission to another person to use the real estate for residence, without the landlord's approval.

Even under those conditions, the landlord will not be entitled to revoke the contract if the tenant was not admonished for breach of the contract at least 30 days prior to cancellation.

If the tenant ignores the landlord's admonition the landlord is entitled to rescind the contract without prior warning.

Subject to rearranging the real estate, the landlord is entitled to rescind the contract if the real estate is rearranged without his or her permission.

If the tenant refuses to leave the real estate, the landlord can start a legal proceeding against him.

If the contract is concluded in the form of a notarial document and includes an enforcement clause, the landlord is entitled to start enforcement proceedings against the tenant.

The landlord is obliged to transfer possession to the tenant and maintain the real estate in a proper state. If the leased real estate appears to be improper for regular usage, the tenant is entitled to rescind the contract or demand a lower lease price. When rescinding the contract, tenant is entitled to claim damages.

If the tenant is unable to use the real estate because of the poor condition of the real estate or repairs the real estate under the condition that the damage was not caused by the tenant, the tenant can demand a reduction in rent or rescind the contract. Prior to this, the landlord must be given a possibility to address the faults.

The landlord is also liable for material defects liability – liability for real estate defects that present an obstacle for regular or agreed usage (with the exception of defects that the tenant was familiar with). In order to activate the legal protection mechanism, the tenant is obliged to notify the landlord immediately and demand repairs within the proper term. If the landlord fails to do so, the tenant can demand rent reduction or rescind the contract. In both cases, the tenant is entitled to claim damages.

As described in breach of conveyance terms, the tenant is entitled to sue on the grounds of legal deficiency liability.

FINANCING

32. Secured lending
Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The usual security instruments in the Croatian legal system are hypothecation (mortgage) and fiduciary.

The mortgage entitles the lender (mortgagor) to collect matured debt from the value of real estate, while the real estate ownership remains with the mortgagee until the real estate is sold. The mortgage is recorded in the land register as the real estate lien. If the loan is repayed on time, the lien will be removed from the land registry, on the debtor’s proposal.

On the other hand, fiduciary entitles the lender to register his ownership to lend register. If the loan is repayed on time (before due), the ownership will be registered back to debtor and the fiduciary will be removed from the land registry on the debtor’s proposal.

Both mechanisms are usual security instruments in bank credit agreements, because the value of real estate guarantees debt repayment.

33. Form of security
What is the method of creating and perfecting a security interest in real estate?

The liens are usually created in standard forms of agreement and registered with the land registry.

34. Valuation
Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals are required by lenders for their underwriting of loans. The appraisals are regularly required by the banks. The specific qualifications of the appraisers are also required.

35. 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, the bank’s) rules.

Lien documents are usually made as separate documents or as clauses in credit agreements.

36. Loan interest rates
How are interest rates on commercial and high-value property loans commonly set? 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).

37. Loan 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 a 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, 67/08).

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

Lenders are entitled to take legal action in order to collect the whole amount of matured debt (including matured interests, including enforcement proceeding costs). In other words, according to the Enforcement Act (Official Gazette 112/12), the lender is entitled to proceed with enforcement procedure against borrower and guarantor, on their whole property, subject to certain restrictions prescribed by the Enforcement Act.

39 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.

40 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 or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated 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.

41 Cash management and reserves

Is it typical to require cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

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

42 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.

43 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 or her assets are sufficient to cover the lender’s claims.

The lender will commonly require the debtor’s written guarantee that he or she 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 or she will not alienate his or her asset once the agreement is concluded.

44 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.

45 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency 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).

Both the 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 rent will be paid to the bankruptcy commissioner and will become part of the bankrupt’s estate.

**46 Secured assets**

What are the requirements for creation and perfection of a security interest in moveable property? 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.

**47 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 or insolvency 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.