

Real Estate 2021

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Real Estate 2021

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Lexology Getting The Deal Through is delighted to publish the fourteenth edition of *Real Estate*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Finland, Indonesia, Ireland, Spain, United Arab Emirates and Vietnam.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Patrick Williams and Devina Rana of Fried, Frank, Harris, Shriver & Jacobson LLP, for their continued assistance with this volume.



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Japan

Shinichiro Horaguchi, Yoshinobu Koyama and Yoshihisa Watanabe

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GENERAL

Legal system

1 | How would you explain your jurisdiction's legal system to an investor?

Japan is a civil law country with a unified court system. The courts can exercise some discretion to achieve an equitable outcome, but Japan does not have separate equity courts. A court may order specific actions in a multitude of circumstances and pre-emptive injunctions are available. Oral contracts are valid in the same way as written contracts; generally, the only difference is the relative difficulty in proving the existence and contents of an oral contract in court. Parol evidence is generally admissible. Real estate-related laws are generally nationally applicable.

Land records

2 | 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?

Japan has a nationwide real property registration system for matters such as the conveyance of ownership or other rights over real property, with registration being required for that conveyance to be perfected. Registration generally only has the power to perfect interests, and interests can be created without registration; the existence (or non-existence) of the registration of interests does not guarantee the existence (or non-existence) of interests.

Registration and recording

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

For most matters that can be registered, the parties involved (eg, the seller and the purchaser) should jointly apply for registration.

Registration tax is payable at the time of registration of the conveyance of ownership, and is generally 2 per cent of the value of the conveyed real property. (At the time of writing, it has been temporarily reduced to 1.5 per cent for land conveyances.) In addition, real property acquisition tax is payable, generally at a rate of 4 per cent for non-residential buildings and 3 per cent for land and residential buildings. As a matter of custom, registration tax and real property acquisition tax are typically borne by the purchaser.

Reduced tax rates are available for certain types of real estate transactions. For example, a single purpose entity (SPE) (a *tokutei mokuteki kaisha* or TMK) established under the Act on the Securitisation of Assets is entitled to reduced tax rates, provided certain criteria are satisfied. Further, to reduce transaction tax costs, it is common in commercial real estate transactions to place the real property in trust, and thereafter to

transfer the rights to that real property in the form of a trust beneficiary interest. The registration tax for transferring the subject's real property to the trustee is 0.4 per cent of the value of the conveyed real property (currently temporarily reduced to 0.3 per cent for transfers of land to the trustee); and once the subject's real property is so entrusted, the registration tax payable upon a change of the beneficiary is only ¥1,000. Subsequent changes in beneficiaries will be similarly recorded in the real estate registry and the registration tax payable each time per property is ¥1,000. In general, real property acquisition taxes are not assessed on transfers through the trust arrangement.

Foreign owners and tenants

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

Generally, there are no restrictions on foreign investors investing in, owning or leasing real property in Japan. Under the Foreign Exchange and Foreign Trade Law, there is a post facto reporting requirement that must be filed with the Ministry of Finance, through the Bank of Japan, for certain types of acquisitions of ownership rights or other rights in real property by non-residents.

Exchange control

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

Other than the post facto reporting requirement under the Foreign Exchange and Foreign Trade Law (and possible fund transfer restrictions aimed at money laundering prevention), generally, there are no material exchange control issues in connection with direct investment in Japanese real property by a non-resident.

Legal liability

6 | 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?

Generally, the owner or tenant of real property may face tort liability if it wilfully or negligently acts, or fails to act, causing a breach of its duty of care in connection with the property and, as a result thereof, damage is sustained by a third party. Generally, the lender is unlikely to face any tort liability in this kind of situation, the lender will not have much control over the management of the property.

A person in possession of a building, tree or other structure on the land will be liable for any harmful conditions of structures existing as a result of his or her negligence. If, however, a person in possession

establishes that he or she has taken due care in preventing such a condition from causing harm to others, the owner of the subject structures will be strictly liable instead.

In Japan, the existence of asbestos in older buildings has become a major environmental issue. The concept of strict liability may apply in the case of damage caused due to the existence of inadequately maintained asbestos.

Environmental contamination of land is another major environmental concern. A landowner may be liable for damage resulting from environmental contamination caused by it or the former owners of the land.

It is standard for a seller to provide a contract nonconformity liability to a purchaser in a contract of sale. In the case of a sale of real property from a professional seller (a licensed real estate broker) to a non-professional purchaser, the seller is statutorily required to provide a minimum of two years' contract nonconformity liability.

Protection against liability

7 | How can owners protect themselves from liability and what types of insurance can they obtain?

A real property owner may obtain general liability insurance to insure against general liability claims brought against it. Insurance covering environmental liabilities, however, is extremely rare and costly. The only realistic protection available to an owner for this would be legal recourse against the previous owner of the subject real property. Such legal recourse would, for example, be available to the extent covered by environmental warranties in the relevant contract of sale and, unless expressly waived, would also be covered by a statutory contract nonconformity liability. Recourse under tort law may also be available against any person responsible for an environmental problem.

Choice of law

8 | 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?

Choice of law in Japanese courts is governed by the Act on General Rules for Application of Laws, which provides that the contracting parties can choose the contract's governing law and, generally, such choice will be upheld by Japanese courts.

The law applicable to matters in relation to real property (such as the method of change of ownership and the perfection thereof) will be the law of the jurisdiction where the real property is located, which, in the case of real property located in Japan, will be Japanese law.

Generally, contractual choice-of-law provisions are enforceable in Japan.

Jurisdiction

9 | Which courts or other tribunals 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?

The ordinary Japanese courts, which have subject-matter jurisdiction over most civil matters, have authority to hear cases and render decisions regarding disputes with respect to real property located in Japan. The parties necessary to an action will depend on the subject matter of the particular dispute. Generally, the court will effect service within Japan by post. The appropriate method of out-of-jurisdiction service will

depend on the terms of the relevant treaty entered into between Japan and the country of the other party. There is essentially no requirement that a party be qualified to do business in Japan to enforce its rights and remedies in a Japanese court.

Commercial versus residential property

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

Generally, there is no difference between commercial and residential properties with regard to real estate ownership, tenancy and financing, or the enforcement of those real estate interests.

Planning and land use

11 | 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 City Planning Act generally provides for rules on the use of the land. This law categorises the land into various zones and requires permits for certain developments of the land in certain zones, and provides certain limitations on the use of the land and on the buildings that can be built in each zone. Further, the Building Standards Act generally provides detailed rules on the buildings that can be constructed.

Generally, local governments have authority over the planning and zoning for real estate development and set the rules allowing for deviation from the default rules. Buildings not in compliance with planning or zoning requirements are illegal and are subject to receiving orders from the local government, such as to rebuild, renovate, or remove the building, or suspend or limit the use of the building, in addition to potentially being required to pay fines.

There are more laws that regulate and control matters that relate to real estate. Advice from lawyers or real estate agents should be sought for additional details.

Government appropriation of real estate

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

The Expropriation of Land Act provides rules regarding the compulsory purchase of real estate by the government, municipal governments and other authorities. Generally, a person who is expropriated of its rights, including the owners and tenants of the real estate and lenders with certain security rights over the real estate, will receive compensation. The valuation of the interests and the allocation of the compensation are determined by the expropriation commission.

Forfeiture

13 | 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?

A court may order the forfeit of real estate that it is related to, or the subject of, illegal activities.

Bankruptcy and insolvency

14 | Briefly describe the bankruptcy and insolvency system in your jurisdiction.

There are several types of bankruptcy or insolvency proceedings in Japan. Bankruptcy and insolvency proceedings can be commenced either voluntarily or involuntarily. In the case of bankruptcy proceedings, generally a bankruptcy trustee will be appointed. Although there is no automatic stay upon the filing of an application for bankruptcy in Japan, upon such filing, the bankruptcy court will normally issue a preliminary court order staying execution against the assets of the bankrupt borrower. Thereafter, once a bankruptcy proceeding has officially commenced, a stay against such execution will come into effect. Upon a seller's bankruptcy or insolvency, the seller's fraudulent conveyance can be voided (even if it is implemented before the bankruptcy) under certain statutory conditions.

INVESTMENT VEHICLES

Investment entities

15 | 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?

Various legal entities are used in real property transactions in Japan. Incorporated entities, such as joint-stock companies (KJs), limited liability companies (GJs) and *tokutei mokuteki kaisha* (TMJs), which provide limited liability to their shareholders, are the most common. Foreign corporations are also recognised and can be used as investment entities by first registering a branch office in Japan.

To achieve pass-through tax treatment, a silent partnership (TK) is commonly used. A TK is a two-party contractual arrangement between an operator (TK operator) and an investor (TK investor), pursuant to which the profits and losses of the silent partnership business (TK business) receive pass-through tax treatment in accordance with the TK agreement.

In addition, a TMJ can constitute a tax pass-through entity (although only with respect to profits), if it satisfies certain criteria. Foreign investors generally prefer the TMJ arrangement, as it is believed that Japan's tax authorities are less likely to challenge the legitimacy of a TMJ's pass-through tax treatment.

In the case of the TK arrangement, there exists a possibility that the Japanese tax authorities may challenge the pass-through tax treatment by re-characterising the TK as an ordinary partnership arrangement, which would result in the foreign investor being deemed to have a permanent establishment in Japan, thereby resulting in more taxes being imposed on the foreign investor. A tax specialist should be consulted for details on the application of Japanese tax on these investment structures.

Shareholders of KJs, GJs and TMJs have limited liability. Furthermore, a TK investor will have limited liability with respect to the TK's business conducted by the TK operator.

Among these alternatives, the TK arrangement may have a slight disadvantage in light of the possibility of being re-characterised as an ordinary partnership arrangement, which would result in the loss of limited liability.

Foreign investors

16 | What forms of entity do foreign investors customarily use in your jurisdiction?

TK and TMJ investment structures are commonly used by foreign investors.

Organisational formalities

17 | What are the organisational formalities for creating and maintaining the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Roughly speaking, most forms of incorporated entities can be incorporated with nominal capital and relatively simple documentation (such as articles of incorporation), accompanied by registration in the corporate registry, and maintained without any further formalities. A foreign entity operating its business continuously in Japan is required to register at least one individual to act as its representative in Japan, and of its representatives, at least one must reside in Japan.

Corporate taxation of Japanese corporate entities and of branch offices of foreign companies is basically the same, except for the special tax pass-through arrangements mentioned above (those for TKs and TMJs).

ACQUISITIONS AND LEASES

Ownership and occupancy

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

Ownership (absolute interest similar to fee simple interest) is the primary right in real estate. The holder of the ownership right will have the right to dispose of and use the real estate. Land and buildings are construed as separate, different types of real estate, and ownership of the land and ownership of buildings constructed on that land can be dealt with independently.

Generally, there is no other type of ownership interest (such as leasehold rights given by the government for a limited time period) for real estate. Ownership interests can be transferred by contract and there is no requirement on the formality of the transfer instrument; theoretically, it can be transferred by oral agreement, although that is not typical for real estate transactions.

Co-ownership is the typical way to allow real estate to be owned by more than one person. The right of the co-owner extends to the entire real estate and not only to part of it.

To allow a parcel of land to be owned by more than one person without using co-ownership, the parcel of land can be subdivided into more than one lot and each person can become the owner of a particular lot of the land.

To allow a building to be owned by more than one person without using co-ownership, the owners can subdivide one building into condominium units (by satisfying certain conditions that each condominium unit will have certain independence from the others).

The typical way to provide a right to use the land or building is through a lease, which can be created by a contract. Generally, there is no requirement regarding the formality of the lease contract except for certain types of leases that provide for fixed terms. A master lease structure is commonly used.

Generally, other types of benefits to, and burdens on, real estate are created by contract with the owner of the real estate.

Pre-contract

19 | What are the typical pre-contractual steps?

With regard to the sale of real property of substantial value (typically, ¥100 million or more), it is common for the potential purchaser to submit a letter of intent to the seller before undertaking a comprehensive due diligence investigation, and it is not common for the seller and potential purchaser to engage in negotiations over the term sheet for the contract of sale. Whether such letter of intent is binding will depend on its provisions. A letter of intent that is intended to be non-binding should expressly state that it is non-binding to ensure that a court will interpret it as such.

Customarily, sellers used to be reluctant to explicitly agree to take the subject property off the market while negotiating a definitive contract of sale. However, recently it has become more common to give exclusivity and to take the property off the market before the execution of a binding agreement.

It is common to have real estate brokers involved in sale and purchase transactions with respect to real estate. Financing arrangements are generally handled by investment managers or directly by one of the lenders acting as an arranger. Real estate brokers are required to have a brokerage licence and are also required to have a certain number of employees, each of whom is a licensed broker. There is a cap on the commission for real estate brokers. Real estate brokers are required to provide to related parties certain documents such as those outlining and explaining important matters with respect to transactions.

Contract of sale

20 | What are typical provisions in a contract of sale?

A contract of sale typically includes a description of the real property to be sold, the sale price, date of closing, and a contract nonconformity liability.

A typical contract of sale for commercial real property additionally includes seller's representations and warranties, closing conditions and seller's covenants.

In real property sale and purchase transactions, it is not unusual to require a 10 per cent to 20 per cent deposit at the time the contract is entered into. Generally, no escrow arrangement is used. The deposit will be forfeited if the purchaser cancels the transaction without cause, and the deposit will be returned and an amount equal to the amount of the deposit will be paid by the seller to the purchaser if the transaction is cancelled by the seller without cause.

Under Japanese law, it is difficult to obtain irrefutable evidence of good title to property. Rights over real property must be registered with the real estate registry to be perfected; however, while the register can serve as strong evidence of the existence of such registered rights, it does not serve as conclusive evidence. Accordingly, a purchaser must rely on the representations and warranties of the seller as to the quality of title to the conveyed property. The cost of the search of the real estate registry is borne by the purchaser, unless otherwise agreed.

Environmental clean-up

21 | 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?

The owner of contaminated land may be ordered by the relevant government authority to take appropriate measures to avoid any harm being caused to the neighbourhood by such contamination. When purchasing commercial real property, it is common for the purchaser to commission

an environmental survey of the land, and generally the cost of this survey will be borne by the purchaser. If any contamination is found as a result of the survey, generally the seller will be responsible for the clean-up of such contamination.

Although it is common for commercial real property contracts of sale to contain representations regarding environmental matters, it is not common for future purchasers of the subject land to rely on representations made in past contracts of sale. In some cases, the purchaser is willing to rely on the results of the environmental survey and purchase the land on an as-is basis. In such cases, the seller will not be responsible for any contamination clean-up.

Clauses regarding long-term environmental liability and indemnity that survive the term of a contract are not common in Japan. Exceptions exist in the case of real estate securitisation contracts and other commercial deals, where comprehensive and detailed environmental representation and warranty provisions and contract nonconformity liability provisions that survive for a certain time after the closing may be commonly found. Japanese law does, however, provide for a post-closing statutory contract nonconformity liability, which, although not mandatory and waivable by agreement under certain circumstances, is generally understood to cover environmental problems discovered after the closing.

If any environmental defect is discovered on a target real estate before the execution of a real estate sales contract, a purchaser usually requires a seller's covenant to cure that environmental defect before or after the closing, noting completion thereof as one of the closing conditions, or by setting that covenant as a post-closing obligation of the seller. Alternatively, a purchaser may require a price discount for the real estate, taking into consideration the environmental risks resulting therefrom while accepting that environmental defect.

In the case of a breach of a contractual covenant by a party, the non-breaching party may assert a claim for damages, and also apply for compulsory enforcement of the breaching party's obligation to the court, such as delivery of possession of the subject property (or alternatively, terminate the contract of sale).

Lease covenants and representation

22 | 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?

Typical representations made by sellers of real property regarding existing leases relate to, among other things:

- the major terms of such leases (eg, the term of each lease and the rent, common area charges, and security deposits payable thereunder);
- the existence or non-existence of any default under such leases;
- the existence or non-existence of tenants experiencing financial difficulties;
- the existence or non-existence of tenants of an antisocial nature;
- the existence or non-existence of any disposal of rights under such leases (eg, the creation of pledge over the right to demand the return of the security deposit); and
- the existence or non-existence of any requests by a tenant to reduce its rent or any other disputes with the tenants.

For major leases, it is typical for the seller to covenant to not take any action in relation to such a lease between the contract date and the

closing date without the prior consent of the purchaser. However, for minor leases, such as lease agreements for residential condominiums, such a covenant from the seller is not usually provided, as it is typical to leave matters concerning the operation of the property to the seller until the closing date, as long as the property is operated in the ordinary course of business.

Generally, representations and covenants do not cover brokerage agreements.

Lease representations and covenants generally do not survive after the closing of the sale.

Estoppel certificates from tenants are not customarily required as a condition to the obligation of the buyer to close under a contract of sale.

Leases and real estate security instruments

23 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? Are ground (or head) leases treated differently from other commercial leases?

Generally, a lease agreement will not provide for its subordination with regard to security instruments. Priority between a lease and a security instrument is determined according to the chronological order of perfection of such right over the real property. Generally, the perfection of a right over real property is done by registration in the real estate registry.

In addition to registration, a lease for land can be perfected where the lessee owns the building that is located on the leased land and the ownership of the building is registered in the real estate registry.

Further, the lease of a building, or a part of a building, can be perfected by delivering possession of the leased premises to the lessee. Most leases are not registered and are instead perfected using the latter alternative methods of perfection. If a lease has priority over a security instrument, the lease will survive, and be unaffected by, the foreclosure of the security instrument. It is not typical for a lender to require subordination and non-disturbance agreements from a lessee. Generally, the business practices related to real estate leases and the statutes and legal framework to be applied to real estate leases are largely different from other commercial leases.

Delivery of security deposits

24 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?

When ownership of real property is transferred to a buyer, all rights and obligations of the lessor under a perfected lease that are held by the seller with respect to such real property (including the obligation to repay security deposits to the existing tenants) are in principle transferred to the buyer without the consent of the tenants. For a buyer to ensure delivery of all security deposits, it is common for the buyer to offset the amount of such tenants' security deposits against the purchase price. Generally, security deposits are paid in cash, not by letter of credit. Under most leases, security deposits are required to secure the tenant's performance of its obligations, such as its obligation to pay rent. It is common for residential leases to have a short term (one or two years) and to have rent reviews at the end of the term. Various rent review methods are used in the case of commercial leases.

Due diligence

25 What due diligence should be conducted before executing a contract? Is any due diligence customarily permitted or conducted after contract but before closing? 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. Is it customary to obtain government confirmation, a zoning report or legal opinion regarding legal use and occupancy?

For large-scale real estate transactions, it is common to have an engineering company review the legality of the structure, use, and occupancy of the relevant real estate, and, further, to have a law firm perform a legal due diligence investigation. Due diligence is generally completed prior to the execution of the contract.

As mentioned above, for a purchaser to perfect its ownership as against third parties, the transfer of ownership must be registered with the real estate registry. Although registration is not conclusive evidence of ownership, it is generally understood that the real estate registry serves as strong evidence of ownership. To perform a title search in Japan, one will typically order and examine a certified copy of the real estate registry. It is common to use the services of a real estate broker or a lawyer to assist in this. There is no practice to use title insurance, legal title opinion or indemnity funds.

Japan provides 'statutory priority' for recorded documents at the real estate registries (which are prepared for each of the real estate lots managed by governmental registration offices) in the sense that the real estate registry is based upon a 'race' registration system (ie, first in time, first in right priority), irrespective of the signing date of contracts between the parties. This priority system, which relies on the real estate registry, applies to the order of priorities of various other interests with regard to the real estate.

It is not customary to obtain government confirmation, a zoning report or a legal opinion regarding legal use and occupancy, which generally will be reviewed by an engineering company, as mentioned above.

Structural and environmental reviews

26 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?

It is common to arrange for an engineering and environmental review when acquiring high-value real property (typically, ¥1 billion or more), especially in the context of a securitisation transaction. An engineering review will typically cover such matters as legal compliance with national and local codes and regulations related to building, construction and fire prevention, structural integrity, asbestos, soil contamination and other environmental matters, as well as other physical conditions of the building.

When acquiring high-value real property, it is customary to obtain representations, warranties and indemnities in relation to legal compliance with applicable laws and regulations, engineering and environmental matters. It is extremely rare to purchase environmental insurance.

Review of leases

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

It is common practice to have lawyers review leases in securitisation transactions or in important commercial lease transactions.

The Act on Land and Building Leases is quite favourable to lessees. For example, under this Act, subject to certain exceptions, a lessor is not permitted to refuse a lessee's request for lease term renewal unless the lessor can demonstrate a justifiable reason for its refusal (under Japanese case law, the concept of 'justifiable reason' has been construed quite narrowly); and notwithstanding the express terms of its lease agreement, a lessee may, in principle, seek a court order reducing its lease rent (if it is unreasonably high), even in the middle of a current lease term. Disputes relating to commercial leases are not unusual. A lender will typically not object to a lease having priority over its mortgage; however, it is extremely unusual for a lender to permit a property management agreement or other management agreements to have priority over its mortgage.

Other agreements

28 | What other agreements does a lawyer customarily review?

In commercial property transactions, in addition to the real property contract of sale itself, it is customary for lawyers to review a variety of other transaction-related documents, including the following:

- a certified copy of the real estate registry;
- brokerage agreements;
- trust agreements (where the transaction will be accomplished by way of a transfer of real estate trust beneficiary interest);
- asset management agreements (where the purchaser is a special purpose vehicle requiring asset management services);
- silent partnership (TK) agreements (where equity investments to the purchaser are to be implemented through TK investments);
- property management agreements and other service agreements; and
- debt financing-related agreements, if applicable.

A judicial scrivener usually drafts documents necessary for registering the transfer of title upon closure of a sale.

Closing preparations

29 | How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers are involved in closing high-value commercial real property transactions (including acquisition, leasing and financing transactions). In the case of a hard asset conveyance, the principal closing deliverables will be the following:

- a purchase and sale agreement;
- trust agreements (where the transaction will be accomplished by way of a transfer of real estate trust beneficiary interest);
- asset management agreements (where the purchaser is a special purpose vehicle requiring asset management services);
- silent partnership (TK) agreements (where equity investments to the purchaser are to be implemented through TK investments);
- property management agreements and other service agreements;
- debt financing-related agreements, if applicable;
- a property risk report – a statutorily required report from the seller to the purchaser explaining the material risks in relation to the target property;
- those required for registering the transfer of real property ownership (eg, documented proof of the seller's ownership of the subject property, possibly in the form of an officially stamped application for registration when the seller obtained ownership to the subject property); and
- powers of attorney from both of the seller and the purchaser.

In the case of a transfer in the form of a real estate trust beneficiary interest, written consent from the trustee with a certified date stamp from a notary public will be the principal closing document.

In a typical lease transaction, a lease agreement and a property risk report are delivered. A typical real estate securitisation transaction could involve more than 100 closing documents (including lease documents, equity investor sponsor letters and borrower counsel's legal opinions).

Japanese parties usually use corporate seals to execute documents, with confirmation of due corporate authorisation being accomplished through confirmation that the proper corporate seal has been used.

As a debt finance advancement is usually necessary for sourcing a part of the real estate purchase price, and a lender or other debt finance provider always requires immediate perfection of its security interest over the purchased real estate upon advancement of its loan, the timing of the closing and funding must normally be simultaneous.

The contract and closing of acquisition sometimes occur on the same date, but it depends on the case. The typical period between the contract and closing is one month, due to debt financing arrangements, preparations for acquisition and debt financing closing documents, etc.

Closing formalities

30 | 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?

Typically, a closing meeting for the transfer is held at the office of the purchaser's lender that is offering debt financing for part of the real estate acquisition price. At the meeting, the relevant parties and their respective legal counsel and a judicial scrivener confirm the various acquisition and debt financing closing documents. The parties are typically the following:

- the seller;
- the seller's lender;
- the purchaser;
- the purchaser's lender; and
- a trust bank representative (in a real estate trust beneficiary interest transaction).

After the confirmation of the closing documents, the purchase payment is wired from the purchaser's bank account to the seller's bank account. Then, documents for registering the cancellation of the security interests of the seller's lender and for registering the real estate title transfer to the purchaser are released to the purchaser. Application documents for those registrations as well as application documents for the registration of the security interests of the purchaser's lender are immediately filed with the relevant governmental office managing the real estate registry. Registration taxes levied on those registrations must be paid at the time of the registration applications.

Contract breach

31 | What are the remedies for breach of a contract to sell or finance real estate?

In the case of a seller's breach of the contract, a purchaser is entitled to request a court order for specific action (ie, an order to deliver the real estate title to the purchaser and to register the title transfer to the purchaser). In this case, the purchaser is entitled to claim for damages and, instead of specific action, to terminate the contract.

In the case of a purchaser's breach of contract, the seller is entitled to claim payment of the purchase price or terminate the contract, claim for damages and, if there is a down payment, the seller may or may not

retain it depending on the terms and conditions with regard to the down payment in the sale and purchase agreement.

In the case of a borrower's material breach of the debt finance documents (including the borrower's misrepresentation or breach of any of its covenants under such documents), a lender is typically entitled to perform the following:

- accelerate the maturity date of the debt;
- demand payment of default interest; and
- exercise its foreclosure rights under the mortgage(s) over the underlying real estate.

In some instances, a contract provides a monetary penalty payable by the breaching party, irrespective of the actual damage incurred by the non-breaching party. Japanese courts generally respect those monetary penalty clauses.

Breach of lease terms

32 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? Are the remedies available to landlords different for commercial and residential leases?

Upon breach of the terms of the lease by the tenants or landlords, the non-breaching landlords or tenants are entitled to claim for damages against the breaching tenants or landlords. If the breach is material, the non-breaching party is even entitled to terminate the lease. However, Japanese case law requires that the tenant's material breach be substantial enough to destroy the trust between the landlord and the tenant for the landlord to terminate the lease for the tenant's material breach.

In other words, Japanese courts tend to interpret landlords' rights to terminate the lease restrictively (irrespective of the wording of the contract) and are reluctant to affirm termination of leases due to minor breaches by tenants. For example, Japanese courts tend to require two to three months' worth of rent to be unpaid for a landlord to be able to terminate the lease for the tenant's failure to pay rent. The remedies available to landlords are the same for commercial and residential leases.

FINANCING

Secured lending

33 Discuss the types of real estate security instruments available to lenders in your jurisdiction. Who are the typical providers of real estate financing in your country? Are there any restrictions on who may provide financing?

Typical security instruments available to lenders in Japan are mortgages and revolving mortgages over real estate (in the case of hard asset transactions), and pledges over real estate trust beneficiary interests (in the case of real estate trust beneficiary interest transactions). Under these security instruments the lenders are granted certain rights similar to those rights held by holders of liens or charges. Historically, a defeasible conveyance over real estate that has been affirmed under Japanese case law has also been widely used for real estate security instruments. However, due to the lack of detailed written rules regarding defeasible conveyances, there remains uncertainty in the foreclosure, etc. of defeasible conveyances. At present, the above-mentioned statutorily defined security instruments are more widely used. Commercial banks and other licensed moneylenders are the typical finance providers for real estate transactions. In the case of use of *tokutei mokuteki kaisha* (TMKs), there are certain limitations on finance providers; however, generally commercial banks are qualified to act as the finance providers to TMKs.

Leasehold financing

34 Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

In Japan, the rights of lessees to ground leases are generally well protected by the Act on Land and Building Leases; therefore, it is standard for financial institutions to grant debt financing to borrowers that are secured by mortgages over buildings located on leasehold land. Certainly, a ground lessee's transfer of its rights, interest and position in and under a ground lease typically requires consent from the landowner (ie, the lessor of the ground lease), and the landowner usually requires payment of a fee for such consent, or may even refuse to give such consent. This can be a hurdle for the financial institution to overcome when it seeks to exercise its foreclosure rights under the mortgage over the building with the ground lease.

However, in such a case, under this Act, the financial institution may petition a court for an order consenting to the transfer of the ground lessee's rights, interest and position in and under a ground lease, upon the foreclosure of such financial institution's mortgage over the building with the ground lease. The court will usually issue such an order, subject to the payment of a certain amount, as a consent fee, to the landowner. Thus, this landowner consent requirement is not an insurmountable hurdle to prevent debt financing secured by mortgages over buildings located on leasehold land.

As long as the ground lease is subject to this Act and has the minimum term as provided for in this statute, financing will generally be available. However, if the ground lease is a lease that falls under some exceptions to the protection under this statute (such as a lease for temporary use), financing will be unlikely available. There are no specific lease provisions required in a ground lease to make it financeable.

Form of security

35 What is the method of creating and perfecting a security interest in real estate?

Mortgages and revolving mortgages are the typical methods for creating security interests over real property. They are created by a contract and are perfected by registration in the relevant real estate registry. In the case where the transaction is accomplished by way of an acquisition of real estate trust beneficiary interests, a pledge is created by a contract over the real estate trust beneficiary interests, and this pledge is perfected by way of written consent of the trustee (with a certified date stamp by a notary public).

Valuation

36 Are third-party real estate appraisals required by lenders for their underwriting of loans? Are there government or industry standards for appraisals? Must appraisers have specific qualifications or required government or industry certifications? Who is required to order the appraisal?

Usually, lenders of real estate loans obtain third-party real estate appraisals to evaluate the underlying real estate. This is absolutely necessary in the case of real estate non-recourse loans (in Japan, real estate loans are generally recourse loans unless a specific non-recourse carve-out clause is provided in a loan document), where lenders will not have recourse to other assets of borrowers. There is a government standard for real estate appraisals, and real estate appraisers must be licensed to provide official real estate appraisals.

Legal requirements

37 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?

The mere making of a loan secured by collateral situated in Japan will not trigger any licensing requirements. However, a lender who makes loans as its business to residents of Japan is considered to be engaging in the business of moneylending and is thus subject to rules under the Money Lending Business Law and required to register thereunder as a professional moneylender.

A mortgage or revolving mortgage is usually granted by execution of an agreement between the lender and the borrower (who is the owner of the real property to be mortgaged). Initial registration of a mortgage or a revolving mortgage is subject to a substantial registration tax (basically 0.4 per cent of the amount of a secured loan in the case of a mortgage, or of the maximum amount of loan secured in the case of a revolving mortgage).

A mortgage is typically assignable without the consent of the mortgagor or any other mortgagees, and a revolving mortgage is typically assignable with the consent of the mortgagor, but without the need for consent from any other mortgagees. The registration tax rate for the transfer of a registered mortgage or revolving mortgage will usually be 0.2 per cent.

In the case of a pledge over a real estate trust beneficiary interest, no registration tax is applicable because it can be perfected with the trustee's consent without registration.

Separate from registration tax, stamp duties are applicable to loan and bond documents signed by a borrower. However, the amount of stamp duties is small in comparison with the amount of registration tax and should not affect the lender's choice of a debt financing structure.

Loan interest rates

38 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 legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Reference to the Tokyo Interbank Offered Rate (TIBOR) to determine a floating loan's interest rate is common. Interest rates established as a spread amount over TIBOR or central bank interest rate indexes are essentially enforceable in Japan. However, interest rates exceeding 15 per cent per year (where the principal amount of the loan is ¥1 million or more) are not enforceable. If a loan's interest rate exceeds 109.5 per cent (20 per cent in the case of a professional moneylender) per year, the lender will be subject to criminal sanction.

Loan default and enforcement

39 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?

Enforcement of a debtor's obligations under a loan agreement can be made through judicial proceedings. In the case of a mortgage or revolving mortgage, the loan collateral can be foreclosed through judicial proceedings.

The loan agreement will typically specify what constitutes a 'foreclosure event', with default of a material loan agreement obligation typically serving as an event of default, and then grounds for loan acceleration and foreclosure. Although there will be some amount of variation from case to case, typically it will take from several months to more than a year to complete a mortgage or revolving mortgage foreclosure.

A separate foreclosure action must be brought on each type of collateral. Japan does not have concepts similar to the 'one-action', 'one at a time' or 'security first' rules. Once a lender's claim has been satisfied through the foreclosure of its lien on collateral securing the debtor's obligations under the note, the lender is required to suspend all other actions to collect on the said note, enforce obligations under a guarantee, or otherwise.

Loan deficiency claims

40 Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

In Japan, real estate loans are generally recourse loans unless a specific non-recourse carve-out clause is provided in the loan documents.

Lenders are generally entitled to recover (until the claim becomes unenforceable because of the statute of limitations) any deficiency between the outstanding loan balance (and permitted additions) and the amount recovered in the foreclosure from the borrower or guarantor (if any), except in cases of non-recourse loans that explicitly provide a non-recourse carve-out clause. In the case of recourse loans, upon default, lenders are entitled either to foreclose the security instruments and recover the deficiency separately from the borrower or guarantor, or to recover the full amount of payment owed by the borrower or guarantor without foreclosure.

In the case of non-recourse loans, lenders are only entitled to foreclose the security instruments and are not entitled to recover deficiencies that are not recovered in the foreclosure.

Protection of collateral

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

Generally, the lender will not have possession of the property unless the security agreement provides for the contractual right of the lender to obtain possession and make a private sale. For the mortgagee to collect rent during a foreclosure, the mortgagee must obtain a judicial order to appoint a receiver and have the receiver collect rent and distribute the rent as dividends or obtain a judicial order for the attachment of rent and require that the tenants of the mortgaged property pay their rent over to the mortgagee.

Recourse

42 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?

Unless otherwise provided in the loan agreement, a lender will have recourse against all the assets of the borrower. Recourse loan

agreements are typical. There is basically no difference between recourse and non-recourse security arrangements in a bankruptcy filing. Typically, a lender's recourse, as against a guarantor, will not be limited to an action forcing the guarantor into bankruptcy, an action foreclosing on the mortgaged property, or an action compelling the guarantor to obtain additional financing to protect said guarantor's interest in the mortgaged property or ownership interest in the borrower.

Cash management and reserves

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

In the case of a non-recourse loan to a special purpose company, it is typical to require that a cash management system be established pursuant to which the borrower must establish and maintain reserves for various purposes (such as reserves for future interest payments, tax payments, insurance payments, return of tenant security deposits (tenant security deposits need to be returned to tenants upon termination of the leases), and repair and maintenance costs) and to require the borrower to open an account at a lender bank to manage all cash flow of the borrower. It is relatively rare to require cash management systems and reserves for other types of loans.

Credit enhancements

44 | What other types of credit enhancements are common? What about forms of guarantee?

It is relatively rare for a lender to obtain credit enhancements beyond mortgages and other security arrangements mentioned in the answers above. Letters of credit, holdbacks and guarantees are not common, especially in Japanese non-recourse real estate loan transactions. On occasion, the equity sponsor to a special purpose company receiving a non-recourse loan will provide a recourse carve-back guarantee letter (a 'sponsor letter') to the lender with regard to 'bad boy acts'. Such recourse carve-back guarantee letters are generally considered enforceable. Use of completion guarantees in development transactions is relatively rare except for a constructor's completion guarantee in a project finance deal.

Loan covenants

45 | What covenants are commonly required by the lender in loan documents?

In the case of a non-recourse loan, it is common to incorporate a set of covenants aimed at protecting the lender. Such covenants may include the borrower's obligation to maintain its bankruptcy remoteness status, to effect loan repayments through a predesignated cash-flow waterfall and to refrain from taking on additional debt or selling or otherwise disposing of the assets subject to the lender's collateral. Covenants in a recourse loan arrangement (typically corporate loans) are much more limited in scope and number. Covenants in loan documents are not generally different, depending on asset classes.

Financial covenants

46 | What are typical financial covenants required by lenders?

In the case of a non-recourse loan, it is common to incorporate a set of financial covenants, including loan-to-value ratio and debt service coverage ratio covenants. To effect such financial covenants, it is common to require that the borrower submit financial reports and update collateral appraisal reports periodically. The above-mentioned financial covenants are relatively rare in a recourse loan.

Secured movable (personal) property

47 | What are the requirements for creation and perfection of a security interest in movable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Typically, mortgages or revolving mortgages over real property (in the case of hard asset financing transactions) and pledges over real property trust beneficiary interests (in the case of trust beneficiary interest transactions) serve as the key security interests for lenders. In addition to these key security interests, sometimes security interests in movable (personal) property assets, such as pledges over furniture, fixtures and equipment and other movable assets that are necessary or useful for real property operation are also provided to the lender. Pledges over movables are perfected by the transfer of possession to the lender or registration. No 'control' agreement is required for perfection.

Single purpose entity (SPE)

48 | 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 case of a non-recourse loan, the lender will usually require that a borrower be an SPE. For this purpose, a limited liability company incorporated under the Companies Act, or a TMK, is typically used. Incorporation of these companies is neither difficult nor materially different from incorporation of the more standard forms of companies. However, in the case of a TMK, an asset liquidation plan must be submitted to the relevant local office of the Financial Services Agency.

To achieve remoteness from influence of a bankruptcy of equity sponsor and asset manager, the non-recourse lender will commonly require the appointment of an independent director as well as an independent shareholder for the SPE. Furthermore, it is quite common for the non-recourse lender to require the independent director and shareholder to submit a non-petition letter for the purpose of trying to preclude a bankruptcy filing; however, the enforceability of such a non-petition letter is arguable and has not been judicially tested in Japan.

UPDATE AND TRENDS

International and national regulation

49 | Are there any emerging trends, international regulatory schemes, national government or regulatory changes, or other hot topics in real estate regulation in your jurisdiction? (eg, transition to a new alternative benchmark rate upon cessation of LIBOR as benchmark rate?)

In response to increasing troubles related to the rental housing business, the Act on Proper Management of Leased Housing was promulgated on June 2020 and its main provisions are scheduled to take effect within one year from its promulgation. Under this act, a person engaged in the property management business of leased housing (ie, a leased housing property management operator) must obtain generally registration and comply with the rules under the act, including appointing one or more business managers for each of its business offices. Furthermore, under this act, a person who engages in the business of subleasing leased housing is not required to obtain registration, unlike the above-mentioned leased housing property management operator, but will be subject to various conduct rules, including the prohibition against misleading advertising and wrongful solicitation and

the requirement to explain the provisions of master lease agreements between lessors and sublease business operators who lease the target property for the purpose of subleasing to the lessors, subject to certain exceptions where no explanation is required.

The Japanese Civil Code was amended on 1 April 2020. The Japanese Civil Code was enacted in 1896 and has not been revised since then, except with respect to some minor points. This marks the first material amendment to the Civil Code in the past 120 years. Although most of the amendments are to reflect the rules established by court precedents prior to the amendment, some of the amendments are intended to add rules to the Civil Code, enabling the Code to function better in today's world.

Examples include the following:

- revisions to the statute of limitations: the pre-amendment Civil Code provided for different time limitations for claims depending on the nature of the claim, such as two years for legal fees and 10 years for ordinary monetary claims. The amended Civil Code, however, provides for more uniform statute of limitations periods; and
- revision of the statutory interest rate from a fixed rate to a floating rate: under the pre-amendment Civil Code, the default interest rate for claims that would accrue interest was 5 per cent per annum (despite the fact that the current interest rate in Japan is quite close to 0 per cent). The amended Civil Code decreases the rate to 3 per cent per annum, and introduces a floating rate mechanism to gradually bring the statutory interest rate in line with the market rate.

Coronavirus

50 | What emergency legislation, relief programmes and other initiatives specific to your practice area has been implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Compared to some other jurisdictions, the Japanese government has no strict power to lock down the entire country or specific cities. However, certain regulations authorise the government to implement some specific actions against the threats of covid-19 to public health.

Key highlights of the regulations in relation to the covid-19 pandemic that would affect the real estate practice are as follows:

- the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response grants the Prime Minister as the head of Novel Coronavirus Response Headquarters the power to declare a state of emergency, following which the governors of the relevant municipal governments have the power to, if necessary for establishing temporary medical facilities, use a particular piece of land or building held by civilians upon the owners' and occupiers' consent being granted (with some rare exceptions where no consent is required), as well as the authority to request, and issue an order to, restrict the use of some types of facilities (eg, schools, shopping centres and hotels) or the holding of events; and
- the Act on the Prevention of Infectious Diseases and Medical Care for Patients with Infectious Diseases authorises the governor of the relevant municipal government to, inter alia, issue an order to restrict the use of a particular piece of real property where necessary to prevent the occurrence or spread of certain infectious diseases (covid-19 was designated as an infectious disease in January 2020).

The Japanese government has not enforced a moratorium or emergency amendment to the existing rules applicable to real estate transactions in

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response to the covid-19 situation. Rather, to improve the market situation and boost the economy, the government has issued some guidance, initiated various benefit and subsidy programmes and implemented certain changes in the tax regulations. Some typical examples of these governmental initiatives are:

- the Ministry of Land, Infrastructure, Transport and Tourism issued a 'request', dated 31 March 2020, which was addressed to real estate-related organisations, calling for flexible measures, such as accepting deferrals of rent payments requested by tenants;
- the National Tax Agency clarified in its announcement that the amount of reduction in rent may qualify as deductible expenses for tax purposes if certain conditions are satisfied;
- certain small or mid-size companies are entitled to a reduction of, or exemption from, fixed asset tax and city planning tax for the 2021 tax year;
- a benefit programme supporting rent payments for those who have suffered significant decreases in revenues has been introduced; and
- the GO To Travel campaign, which is a government-supported travel discount programme aiming to stimulate hospitality, tourism and other local businesses by providing subsidies of up to a certain part of travel costs to local travellers, has been promoted.

The situation described in this section is subject to change, and clients are encouraged to check and obtain the most up-to-date information in respect of the legislation, relief programmes and other initiatives relevant to real estate.

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