



# Real Estate Investment in Denmark

THE LEGAL PERSPECTIVE







# Introduction

The Danish real estate market continues to be considered as an attractive place to invest due to many years of stable rental prices and a strong economy together with a unique mortgage credit system, which allows for favorable ways of financing real estate.

Transaction and development activity in Denmark has been steadily increasing since 2012, with 2017 as a record-setting year measured by the total number of transactions. Even though 2018 continued the streak with a historically large number of transactions, the total number of transactions came in slightly under the record-breaking year of 2017. Foreign investors still play a major role in the market for Danish real estate transactions, with approximately 50% of the deals in 2018 involving foreign investors.

The Danish real estate team at DLA Piper is one of the largest in Denmark, with offices in both Copenhagen and Aarhus, forming part of the only global law firm present in all Nordic countries as well as one of the largest real estate teams in the world. Real estate is a core practice of our firm, and as a result, we provide a full range of integrated services supporting foreign as well as Danish investors throughout the entire life cycle of their investments.

This document is intended to serve as a guide to the most relevant aspects of law for commercial investors investing in Danish real estate. As the guide does not claim to be exhaustive, our experienced Danish real estate team will be happy to assist you with any questions you may have.

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# 1. Ownership of real estate

## 1.1 Full ownership

Full legal ownership is the most complete and comprehensive right over real estate. Legal ownership of a property generally consists of title to the land, including all buildings and fixtures.

Ownership can be acquired by one or more persons, companies and/or other legal entities. Co-ownership is possible through a partnership or in undivided shares.

Legal title is registered in the digital Danish Land Registry. It is not a validity requirement when title is transferred; however, registration is necessary to obtain protection against conflicting rights.

## 1.2 Buildings on leased land

The property may also consist of a building on leased land, in which case the building will have a separate section in the Land Registry, and ownership of the land and the building will be separated. This property type is not very common.

In case of a building on leased land, a lease agreement for lease of the land will (or should) be entered into and registered as an easement in the Land Register of the cadastral plot. Such agreements cannot validly be entered into for a period

exceeding 30 years, meaning that neither of the parties can be bound for a period exceeding 30 years.

## 1.3 Owner-occupied units

Another special kind of ownership or property type is the ownership of owner-occupied units (*ejerlejlighed*), where a building has been divided into owner-occupied units, such as residential flats and premises for business purposes.

In this case, the owner will have legal title to the owner-occupied unit(s), and the so-called main property (*hovedejendom*), consisting of the surroundings such as the land, common areas, external of the building, etc., will be owned jointly by the owners of the units through their membership in the owners' association (*ejerforening*).

Each unit will have its own register in the Land Registry, and legal title will be registered separately for each unit.

## 1.4 Cooperative housing associations

With cooperative housing associations (*andelsboligforening*), the property is owned by the cooperative association, which is a separate legal entity with the sole purpose of owning the property.

Each member has a membership share of the association, which gives the member the right of use to a specific flat. The membership share in the association is not characterized as a certain type of ownership of real property, as the property is owned by the association.

## 1.5 Restrictions on ownership by foreigners

Foreign companies and citizens generally need permission from the Danish Ministry of Justice to purchase real estate in Denmark. However, companies domiciled within the EU or the EEA can acquire real estate without permission, provided that the property is acquired to establish a business or provide services in Denmark.

As the restriction applies to direct acquisitions only, it can be avoided by establishing a Danish subsidiary company and acquiring the property through this legal entity.



## 2. Acquisition of ownership

### 2.1 Formal requirements

An agreement for transfer of real estate is governed by the general principles of Danish contract law, and there are no formal requirements in order for such agreement to be legally binding.

In order to perfect the transfer of title, a conveyance must be registered in the Land Register, and such conveyance must include certain information, such as the purchase price, date of completion, etc. The registration of title is merely an act of protection and not a validity requirement.

### 2.2 Registration

By registering a title in the Land Register, the buyer is protected against (non-registered) existing rights and future conflicting rights. The Danish state is liable for faulty registrations and errors in the Land Register. As such, title insurance is not necessary in Denmark.

The fee for registration of a conveyance for commercial properties is DKK1,660 plus 0.6% of the purchase price or the official property valuation, whichever is higher. This registration fee is usually paid by the buyer.

In the case of a change in ownership for certain companies in certain circumstances as part of a merger, demerger, reorganization or transfer of assets, the registration fee for transfer of the title is reduced to the fixed fee of DKK1,660.

### 2.3 Asset deals

One way to acquire property is by direct investment as an asset deal. In order to perfect the title following such transfer, a conveyance must be registered, subject to a registration fee, cf. section 2.2 above. Further, the direct transfer of real estate is subject to taxation of the capital gains, cf. section 7.6 below. Mainly for these reasons, most property deals in Denmark are completed as share deals.

The purchase agreement for a direct transfer of real estate is usually based upon Danish market standards, which are set out in the agreement. The agreement usually includes certain information and details regarding the property, disclaimer of liability for defects (transfer “as is”), the purchase price, description of the completion process and certain standard regulation.

When a commercial investor acquires real estate in Denmark, a due diligence investigation of the property is usually carried out. The investigations will most commonly be carried out during the period between the signing of a letter of intent/head of terms and the signing of the purchase agreement, or after the signing of a purchase agreement subject to satisfactory completion of the buyer’s due diligence. In a structured sales process where the seller invites several potential buyers to submit a tender for a property or a portfolio, the seller will sometimes carry out

due diligence investigations and present the due diligence reports to potential buyers as part of the sales material.

The due diligence investigations in respect of an asset deal include general property matters such as title, easements and charges registered in the Land Register, planning and zoning, environmental information, permits, service contracts, insurance policies, property taxes, owners’ associations, together with a review of the lease agreements and lease matters relating to the property. In addition, technical due diligence will usually be completed to determine the physical state of the property and consequently the future needs and costs for maintenance. For development properties, the due diligence will extend to the basis for future developments, existing permits, construction contracts, etc. and thorough environmental investigations.

For asset deals, the purchase agreement usually include a limited catalogue of warranties and/or statement of facts, most of which are qualified by the seller’s knowledge. Unqualified warranties will generally be limited to fundamental matters such as title, encumbrances, pending disputes, etc. Aside from these fundamental matters (subject to negotiation), the property is transferred “as is,” and any warranties or statements of facts with respect to hidden defects, pollution, etc. will be qualified by the knowledge of the seller.

Completion of the transfer of real estate is generally completed in accordance with standard procedures where the buyer makes an escrow deposit or provides a bank guarantee for the full purchase price, after which a digital conveyance is signed and filed for registration with the Land Register. The purchase price will then be released to the seller once clear and final title has been registered, ultimately ensuring a “simultaneous” exchange. The buyer’s attorney is usually appointed as the attorney responsible for completion of the sale and ensuring that the purchase price is not released until final title has been registered.

## 2.4 Share deals

Mainly for tax reasons, most property deals are completed as indirect transfers by transfer of the shares of the legal entity owning the property. In Denmark, ownership of real estate is often structured through special purpose vehicles (SPV) in order to be able to sell the properties through a share deal. Such entities are most often structured as private or public limited liability companies (*anpartsselskab and aktieselskab*).

Through the indirect transfer of real estate via a share deal, taxation of capital gains is avoided, as capital gains from transfer of shares held by corporate entities are generally not subject to Danish taxation, cf. further in section 7.7 below. However, deferred taxes on capital gains on the property are as a main rule included as a liability when

the net equity of the company is calculated, ultimately reducing the purchase price. The handling of deferred taxes is part of the commercial negotiations when the property value is agreed on, and often it is agreed that deferred taxes are to be included with 50%, and thereby reducing the purchase price with 50% of the deferred taxes.

Further, by indirect transfer of a property through the transfer of shares, the registration fee for the transfer of title is also avoided.

The share purchase agreement is subject to negotiation between the parties, but the agreement is usually based on market standards with relevant amendments. Depending on the type of transaction, the agreement will usually include detailed regulation on calculation of the purchase price, warranties, agreed limitations of liability and the closing process.

In addition to the due diligence investigations completed for asset deals, cf. section 2.3 above, the investigations for share deals will extend to a review of the company in question, including corporate matters, liabilities, accounting and financial information, tax and VAT matters, employment, and other matters as is usual when a company is acquired.

For share deals, the share purchase agreement will also include further unqualified warranties with respect to corporate matters, accounting, taxes and VAT, liabilities and

employees. Most commonly, certain limitations will be agreed upon in respect of the seller’s liability for breach of warranties, e.g. de minimis amount, basket, cap and time limitation. Certain fundamental warranties such as ownership/ title, taxes and VAT will normally be exempt from the agreed limitations.

Closing of the transfer will be set out in the share purchase agreement and will be completed by the exchange of all closing deliveries and signing of a closing memorandum. It is specifically agreed in the share purchase agreement that the respective deliveries are deemed to have taken place simultaneously, and no action shall be considered as performed until all required actions have been performed (or waived by the other party).

## 2.5 Public auctions

Purchasing a property at a public auction is also an option, and is usually the result of an enforced sale due to bankruptcy or default in credit facilities. Buying a property at a public auction is associated with some risk compared to an ordinary purchase, because the property is sold “as is” and with full exclusion of liability. To compare with a transfer between commercial parties, an asset transfer in this case is also completed “as is” with the exclusion of liability as to the state and condition of the property, but the purchase agreement will include some warranties and statements of facts to which the seller is liable, cf. section 2.3.





## 3. Other rights to property

### 3.1 Easements

There are several ways in which a property may be encumbered under Danish law and will generally relate to either a limited right of use to the property such as a right of passage, or a right to demand a certain state or condition maintained such as limitations on building or plantation height, limitations in use of the property, or other obligations resting with the owner of the property at any time.

In any case, an easement must be linked to the property. A mere personal obligation on the current owner will not be regarded as an easement and cannot be registered in the Land Register.

In general, easements are created by means of a contractual agreement between the owner of the property and the holder of the right. In addition, it is possible to acquire a right by prescription. An easement may also be created by public authorities in accordance with the law such as building lines or preservation, which will be in the nature of planning regulation, or limited rights created by way of expropriation.

All easements must be registered in the Land Register in order to obtain protection against the owner's creditors and third parties. However, public easements created in accordance with the law do not require registration to be protected. Registration of an easement is subject to a registration fee of DKK1,660.

General rights of use of the whole or part of the property such as leases are protected against opposing rights of third parties and creditors without registration in the Land Register to the extent that the lease

agreement does not provide for more extensive rights compared to the lease law. It is possible for a tenant to register a lease agreement as easement in the Land Register to ensure protection of any extended right against third parties, cf. however section 6.13 below.

### 3.2 Mortgages and charges

In general, there are two types of mortgages; a regular mortgage (*pantebrev*) and an owner's mortgage (*ejerpantebrev*). Mortgages may be created by a physical mortgage or in the Land Register; however, in order to obtain legal protection against the owner's creditors and third parties, the mortgage must be registered in the Land Register, cf. below.

A regular mortgage secures a specific indebtedness and is used by mortgage credit institutes which use specific mortgage forms. The regular mortgages may also be used by banks or other credit providers.

An owner's mortgage is a mortgage where the owner of the property gives itself a mortgage security in the property for a specific amount. The owner's mortgage may then be used as security by sub-pledging (*underpantsætte*) the owner's mortgage as security for the underlying indebtedness between the owner of the property and the mortgagee. The indebtedness secured by the owner's mortgage depends on the underlying letter of pledge and may be for a specific indebtedness or for any amounts owed to the mortgagee.

Another type of charge is the registration of an easement as pledge, which will follow from the wording of the easement.

A common example is the registration of the articles of association of a landowner's association or an owner's association as both easement and pledge as security for the owner's fulfilment of its obligations towards the associations.

Mortgages and charges must be registered in the Land Register in order to obtain protection against the opposing rights of third parties and other creditors, cf. section 8.3 below. Registration of a mortgage or charge in the Land Register is subject to a registration fee of DKK1,660 plus 1.5% of the mortgage amount. However, the borrower may under certain circumstances be able to reuse registration fees paid on mortgages already registered on the property.

A stamp duty mortgage (*afgiftspantebrev*) may also be registered on the property. This is not an ordinary mortgage and is merely a way of saving a registration fee that has already been paid for later use in connection with repayment of an existing mortgage, i.e. if no new mortgage is registered in connection with a redemption or if the existing mortgage exceeds the new mortgage amount.

### 3.3 Options and pre-emption rights

A property owner can grant an option or a pre-emption right to purchase the property on certain terms. There is no specific regulation in respect of such agreements; however, in order to be protected against third parties and creditors, the right must be registered in the Land Register.

A mandatory tenants' pre-emption right (*tilbudspligt*) exists with respect to transfer of certain residential properties, cf. section 6.13.

## 4. Zoning and planning law permits

The Danish planning and zoning system consists of an overall state regulation of framework planning conditions, whereas local planning belongs to the Danish municipalities. Planning is regulated by the Danish Planning Act.

The municipalities set out overall local planning principles and requirements in structure plans (municipal plans), governing the municipality as a whole, and in local development plans (local plans), regulating smaller areas within the municipality in question. Both types of plans are subject to public enquiry and political approval. The local plans will often be prepared in dialogue with the developer or investor owning or willing to purchase the area in question.

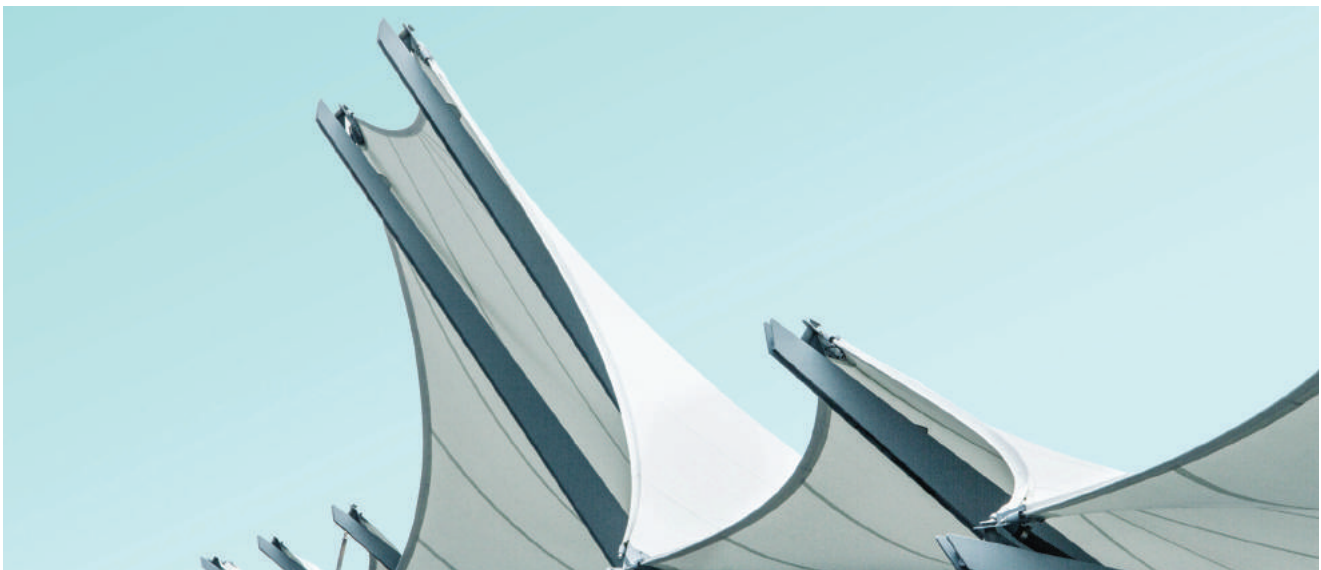
The possible use of an area and the content of a local plan for the area widely depend on the zone status of the area – whether the area is laid out as urban, rural or holiday-house zone. For example, the possibilities for erecting new buildings in rural areas are highly restricted.

Local plans are directly binding, not only on landowners but also on tenants, infrastructure owners and other parties who use properties within the area of the district plan. A local plan can regulate a wide range of issues, including appearance, design, development of the area, designated use of the area, etc. It is, however, important to note that even though almost anything can be regulated via the planning and zoning system, nothing can be regulated retroactively.

In addition to the regulation following from local planning, the requirements in the Danish Construction Act and the ancillary executive order The Building Regulations 2018 setting out the technical requirements for new buildings must be adhered to both green-field projects and major refurbishment projects.

A building permit must be obtained from the municipality before any construction work is commenced, and an occupation permit from the same source must be obtained before the building is taken into use. The process of obtaining a building permit may also include application for exemptions from the planning rules, i.e. a municipality plan or a local plan.

If a project is expected to affect other parties directly (e.g. neighbours, particularly if the project requires exemptions from either the Construction Act, the building regulations or local planning) it is likely that any such directly affected parties will be consulted in the approval process, giving them the opportunity to object to the project.



## 5. Environmental liability

In accordance with the “polluter pays” principle, a landowner cannot be held responsible for pre-existing soil contamination. Existing contamination will, however, often result in limitations and obligations with respect to future development and change of use of the property.

There is strict liability on soil contamination from 2001 and onwards to legal entities and liability to private persons if fault or negligence is determined.

Furthermore, there is an obligation on the polluter to investigate the dissemination and effects of soil contamination. If there are several polluters, joint liability can be constituted.

An injunction to a polluter to execute remediation of a soil contamination can be issued even though the contaminated area is (no longer) owned by the polluter. If so, the landowner must tolerate a remediation.

In Denmark, soil contaminations, if known or suspected, are registered on the Danish Environmental Portal. The register should be investigated prior to acquisition of land. However, it is important to note that if the property is not registered it does not necessarily mean that the property is free from contamination.





## 6. Leases

### 6.1 Types of leases

In general, there are three types of leases in Denmark: residential leases, commercial leases and other leases.

Residential leases are governed by the Danish Lease Act (*Lejeloven*) together with the Danish Housing Regulation Act (*Boligreguleringsloven*) applicable in regulated municipalities, which is the case for most municipalities. The legislation is comprehensive and complex, with most of the provisions mandatory. For example, the legislation provides mandatory formal requirements, specific rules on rent fixation, rent adjustment, fixed-term leases, maintenance, refurbishment and the landlord's right to terminate.

Commercial leases are governed by the Danish Commercial Lease Act (*Erhvervslejeloven*). The Act applies to lease of building premises for any other use than residential. The Commercial Lease Act provides for a high degree of freedom of contract, except for some mandatory rules, which cannot be derogated from, such as formal requirements for agreements on payments in addition to the rent, fixed-term leases, and the landlord's right to terminate.

Other types of leases such as lease of land and lease of unbounded area (e.g. open parking spaces) are not governed by the Commercial Lease Act, and will therefore, in general, be subject to freedom of contract.

### 6.2 Formal requirements

For commercial leases, there are no general formal requirements

for the lease agreement; however, the agreement must be in writing if required by one of the parties.

Further, specific requirements apply with respect to agreements on payments in addition to the rent, cf. section 6.5 below. For commercial lease agreements entered into prior to January 1, 2000, there are certain formal requirements regarding the use of authorized lease forms and highlighting of deviations.

For residential leases, almost all lease agreements are entered into by using the authorized lease forms, as this is required when a landlord makes use of form or standardized agreements. The lease form must be the form authorized and in effect at the time when the lease agreement is entered into.

If an incorrect lease form is used, all terms and conditions deviating from the legislation in favor of the landlord can be set aside.

In addition to the general formal requirements, residential lease law includes specific requirements regarding information to be included for certain agreements to be valid such as agreements on certain rent fixation principles.

### 6.3 Duration

Generally, commercial leases are entered into for an unlimited period with a minimum term during which the lease is non-terminable. A fixed-term lease agreement may be set aside if the fixed term is not justified by circumstances of the landlord. The agreed period of non-terminability varies and depends on the type of lease and the landlord's investments when preparing the premises for the tenant. The agreed period is usually twice as long for the landlord.

For residential leases, a fixed-term lease can also be set aside if the fixed term is not justified by circumstances of the landlord, which is rarely the case with professional landlords. It is generally possible to agree on a non-terminability period, in which the lease cannot be terminated by neither the landlord nor the tenant.

### 6.4 Rent

Determination of the rent for commercial leases is subject to contractual freedom. A limited rent rebate period is sometimes agreed upon. Further, certain commercial leases sometimes include agreements on rent determination based on the tenants' turnover with or without minimum rent.

For residential leases, the most common principles for rent fixation are: (i) cost-determined rent, which is the general rule in regulated municipalities, (ii) rent based on the "value of the leased," which in regulated municipalities applies to premises that have been thoroughly improved under certain circumstances, and (iii) unrestricted rent determination, which applies to properties taken into use after 1991 and certain other leases, where unrestricted rent determination has been agreed. Additional detailed regulation applies to other certain properties.

In general, the regulation on rent fixation and rent adjustment is complex and includes specific formal requirements to be fulfilled in order for such agreements to be valid.

## 6.5 Operating expenses

For commercial leases, it is commonly agreed that the tenant shall pay its share of the landlord's operating expenses in addition to the rent, such as taxes, maintenance of common areas, common utility costs, insurance premium, etc.

The Commercial Lease Act provides for strict formality requirements to be fulfilled in order for an agreement on payments in addition to the rent to be valid (the so-called specification requirement). The lease agreement must specify which expenses the tenant shall pay in addition to the rent, including both specification of the type of expense and the estimated amount of each expense. The same requirements apply with respect to agreements on payment of utility expenses in addition to the rent.

For residential leases, agreements for payment of costs in addition to the rent is limited to the specific costs provided for in the Danish Lease Act such as costs for water, heating, cooling, electricity, common antenna, etc. Any other operating costs cannot be charged in addition to the rent.

## 6.6 Rent adjustment

For commercial leases, the parties will most commonly agree upon a yearly rent adjustment based on the increase in the net price index, and often with an agreed minimum (and maximum) percentage adjustment regardless of the change in the net price index.

If the commercial tenant does not pay taxes and duties in addition to the rent as part of the operating costs, cf. section 6.5, the landlord

is entitled to increase the rent following an increase in the taxes and duties charged on the property or if new taxes or duties are imposed. On the other hand, if the taxes and duties are decreased, the landlord is obligated to adjust the rent accordingly, unless otherwise agreed.

In general, the landlord and the tenant for commercial leases are entitled to demand the rent adjusted to the "market rent" if the rent paid is significantly lower or higher than the market rent. The market rent is mainly assessed by a comparison with similar leases, taking into account the lease terms and the premises' location, use, size, quality, equipment and state of maintenance. According to present case law, a discrepancy of 10-15% is regarded as significant. The rent may be adjusted to market rent, at the earliest, four years after commencement of the lease. The market rent adjustment may be derogated from in full or in part, and it is often agreed that the parties are not entitled to market rent adjustment during the tenant's non-terminability period.

For residential leases, the rent adjustment depends on the rent fixation principle. For leases with cost-determined rent, the rent is set based on the necessary operating expenses of the property plus a fixed yield and with addition of any general or individual improvement works. If the necessary operating expenses increase, the landlord is entitled to increase the rent; however, it is limited to the value of the leased and certain other limitations. The same applies for thoroughly improved leases with rent based on the value of the leased.

For leases with unrestricted rent determination and leases with rent based on value of the leased, it is possible to agree upon a yearly rent adjustment based on the increase in the net price index. For leases with cost-determined rent it is also possible for the landlord to adjust the rent based on increase in the net price index (however, limited to the operating expenses exclusive of taxes and duties) for a two-year period. However, the cost-determined rent must be calculated at the end of the two-year period. For lease agreements entered into prior to July 1, 2015, it was also possible to agree on fixed adjustments by specific amounts at specific times, subject to certain formal requirements.

Finally, for residential leases, the landlord is entitled and obligated to increase and decrease the rent based on changes in taxes and duties, or if new taxes and duties are imposed relating to the premises. For leases with unrestricted rent determination, these rules may be derogated from.

## 6.7 Maintenance

Unless otherwise agreed, the landlord is responsible for the internal and external maintenance of the property. For commercial leases, the parties are free to agree on the responsibilities with respect to maintenance, and commercial lease agreements usually include detailed regulation with respect to the division, extent and definition of the maintenance obligations.

It is most commonly agreed that the internal maintenance is carried out by the tenant and the external

maintenance is carried out by the landlord. If the tenant is the sole tenant of the property, the full maintenance obligation will often be imposed on the tenant with a few exceptions. With respect to maintenance of common areas used by multiple occupiers/tenants, maintenance is carried out by the landlord; however, it is often agreed that the tenants shall pay a share of the common costs in addition to the rent, cf. section 6.5 regarding operating expenses.

For residential leases, the landlord is as a starting point responsible for the internal and external maintenance of the leased premises. It may be agreed that the internal maintenance is imposed on the tenant. It is however never possible to impose the external maintenance on the tenant, except for maintenance of garden belonging to the leased premises.

For all lease agreements commencing after July 1, 2015, the tenant's internal maintenance obligation cannot be extended beyond whitening, paperhanging and lacquering of floors. Should the parties agree to expand the tenant's internal maintenance obligation, such agreement may be set aside. Prior to July 1, 2015, it was possible to extend the tenant's internal maintenance obligation to cover e.g. windows, doors, etc.

For residential leases where the landlord has the internal maintenance obligations, the landlord must allocate specific fixed amounts for internal maintenance. For certain properties in regulated municipalities, the landlord must allocate and to some extent set aside fixed amounts for external maintenance.

## **6.8 Renovation at end of lease**

As a general rule for both commercial and residential leases, the leased premises must be handed over upon vacation in the same state as at commencement, except for normal wear and tear not covered by the tenant's maintenance obligations.

For commercial leases, it is most commonly agreed that the premises shall be handed over newly refurbished with detailed regulation in the lease agreement on the extent of such obligation.

For residential leases, the general rule can only be deviated from in favor of the tenant. For leases with commencement prior to July 1, 2015, it was possible to agree on an obligation for the tenant to hand over the leased premises newly refurbished, regardless of the state at commencement. Further, for leases with commencement on and after July 1, 2015, the landlord cannot claim for refurbishment unless a moving-in report was prepared at the commencement of the lease.

## **6.9 Assignments/transfers**

For commercial leases, the tenant is generally entitled to assign the lease to another tenant within the same line of business, unless the landlord has material reasons to oppose such assignment, e.g. in relation to the assignee's financial position or knowledge of the business. Lease agreements often limit the tenant's right of assignment combined with change of control clauses deeming a transfer of majority shares as an (unlawful) assignment.

For residential leases, there is no right to assign the lease unless agreed; however, a tenant is entitled to swap leases with another residential tenant under certain circumstances. In these cases, the landlord is entitled to thoroughly improve the leased premises and set the rent in accordance with the value of the leased.

## **6.10 Subleases**

For commercial leases, a tenant is not entitled to sublease the leased premises without the prior consent of the landlord, unless otherwise agreed.

For residential leases, the tenant is entitled to sublease up to half of the dwelling rooms. Further, the tenant is entitled to sublease the premises for a period up to two years in certain circumstances where the tenant's absence is temporary due to illness, business or study travels, etc.

## **6.11 Security**

For commercial leases, the security to be provided by the tenant is subject to the agreement between the parties. It will most often be agreed that the tenant must provide a cash deposit, a bank guarantee, or a combination of the two, for an amount corresponding to between 3-12 months' rent.

For residential leases, deposit and prepaid rent may be agreed upon for an amount of up to three months' rent respectively. Such amounts may be adjusted following adjustment in the rent.

## **6.12 Termination**

Subject to an agreed non-terminability period and with the expectation of fixed-term leases, a tenant is entitled to terminate the



lease for any reason at the agreed notice period. If a tenant decides to terminate a lease within an agreed non-terminability period; the tenant is liable for rent, etc. during the remaining period; however, the landlord has a general duty to mitigate the loss and re-let the premises.

Besides termination for breach, the landlord's right to terminate is limited to the specific instances in the Commercial Lease Act and the Danish Lease Act, respectively. The most relevant instance is where vacation of the premises is necessary due to demolition or conversion of the property, in which case the landlord must offer the tenant to lease premises of the same nature upon completion.

For business protected commercial leases, which are leases where the location of the specific premises is of essential importance to the tenant's

business, the landlord must pay damages to the tenant for the loss suffered by the tenant as a consequence of the termination and loss of goodwill.

### 6.13 Sale of leased property

Sale of leased property does not affect the leases, as the new owner will step into the lease agreement as landlord on the same terms as the previous owner. As described in section 3.1 above, leases are protected against third parties in good faith without registration in the Land Register to the extent that the lease agreement does not provide for more extensive rights compared to the lease law. However, the purchaser of a property will generally in all instances review the lease agreements as part of the due diligence investigation, and in that way become aware of any such extensive rights.

For certain properties with residential leases, a mandatory pre-emption right exists, according to which a landlord is obligated to offer the residential tenants to acquire the property (through establishment of cooperative association) at the same price and terms before selling to a third party.

The mandatory pre-emption right applies to properties that are not divided into owner-occupied flats and that comprises a minimum six residential units in pure residential properties and a minimum 13 residential units in mixed-use properties.

The rule also applies in the case of an indirect sale by the transfer of the shares in the company owning the property. Triggering of such pre-emption right is most common in the case of the sale of town houses or older properties where division into owner-occupied flats is not possible.



## 7. Tax

### 7.1 Registration fee/ stamp duty

Registration of a conveyance in the Land Register is subject to a registration fee, which for commercial properties amounts to DKK1,660 plus 0.6% of the purchase price or the official property valuation, whichever is higher.

If the transaction is completed as a share deal, the fee for registration of the conveyance is avoided. In case of change in ownership for certain companies in certain circumstances as part of a merger, demerger, reorganization or transfer of assets, the registration fee for transfer of the title is reduced to the fixed fee of DKK1,660.

### 7.2 Value added tax

#### VAT ON TRANSFER OF REAL ESTATE

Sale of real estate is generally not subject to VAT. However, VAT of 25% will apply to the sale of land plots and new buildings, provided the sale is carried out as part of a business activity.

A building is considered new if it is sold prior to its first occupation, or if the first sale occurs less than five years after the date of completion. A building that has been rebuilt substantially within five years of the sale for an amount exceeding 25% of the official property value plus the value of the rebuilding or the purchase price, whichever is higher, is considered a new building. The sale of development properties with existing old buildings ripe for demolition may in some circumstances be regarded as the sale of a land plot.

Certain exceptions to a sale of land plots and new buildings being subject to VAT exist, including with respect

to properties constructed and used solely for VAT-free rental purposes, land plots previously used for VAT-free purposes, and sales constituting a VAT-exempt transfer of business (e.g. if the seller is voluntarily registered for VAT on rental of the property and the buyer is to continue the VAT-liable rental activities).

VAT is paid by the seller, and the purchase agreement will (or should) always include regulation as to whether the purchase price is inclusive or exclusive of VAT, especially in situations where it is not clear if the tax authorities will regard the transfer as subject to VAT.

The buyer generally has the right to recover VAT charged by the seller if the buyer is a VAT taxpayer carrying out transactions subject to VAT provided the acquired real estate forms part of these activities.

#### VAT ADJUSTMENT LIABILITY

The owner of a property used for VAT-liable purposes (e.g. a new building for resale or a rental building voluntarily registered for VAT) is entitled to deduct VAT on the acquisition price and construction costs in full in the year of acquisition or investment, including VAT on improvement works and maintenance works.

If VAT on the acquisition price or construction costs for the property has been deducted, a VAT adjustment liability will apply to the property, meaning that the deducted VAT must be repaid if the use of the property is changed from a VAT-liable purpose to a VAT-exempt purpose. The VAT adjustment liability applies for a period of ten years, over which the liability is decreased proportionately by one-tenth.

In the case of a sale of the property during the VAT adjustment liability period, the remaining VAT liability must be paid, unless the buyer takes over the adjustment liability, and provided the buyer is registered for VAT and has at least the same right to deduct as the seller. It is common for the buyer to assume the VAT adjustment liability if the buyer intends to continue the operation of the property. The assumption of the VAT adjustment liability must be regulated in the purchase agreement.

#### VAT ON RENTAL INCOME

For properties rented out for commercial purposes, the landlord has the option of voluntarily registering for VAT for rental of the property in full or in part, resulting in the rent being subject to VAT of 25%.

The VAT is collected and paid by the owner/landlord, and the commercial lease agreement will (or should) stipulate that all payments under the agreement are subject to VAT or that the landlord is entitled to register the premises for VAT.

### 7.3 Other real estate taxes

For commercial properties, land taxes are imposed on the value of the land. In addition, a municipal service charge is levied on certain properties. These real estate taxes are deductible when computing the taxable income.

With effect from January 1, 2018, a new Property Valuation Act has been passed comprising substantial changes in the property valuation system with the aim of making the property valuations more in line with market values.

## Land tax

The land tax is based on the land value according to the official property valuation as assessed by the Danish tax authorities (SKAT).

The land tax is currently levied based on a rate between 1.6% and 3.4% as determined by the municipality in question (for example, the land tax rate in Copenhagen is 3.4 % in 2019) of the taxable land value. The taxable land value is the lower of the (i) land value as assessed by SKAT, and (ii) the land value tax ceiling, which is the land value applied as the basis of the land tax the previous year increased with a fixed percentage (maximum 7% per year).

The land value is assessed every two years. The new assessments under the new valuation system are expected in 2019 for residential properties and in 2020 for commercial properties with effect for the property taxes per January 1, 2020 and January 1, 2021, respectively.

The land tax is not expected to change materially as a result of the new property valuation system. However, the land tax rate is expected to be reduced, as the future property valuations are expected to be higher.

## Municipal service charge

Municipal service charge is levied in some municipalities, and only for certain commercial buildings. The municipal service charge applies to buildings used for offices, shops, hotels, factories, workshops or similar purposes, provided more than half of the building value concerns such purposes. The municipal service charge is

based on the difference between the land value and the property value according to the official property valuation.

Each municipality determines whether to levy the municipal service charge, which may be levied at a rate of up to 1% of the difference between the land value and the property value (in most cases the value of the building). The municipal charge is levied primarily by municipalities near the major Danish cities (for example, the charge is levied in Copenhagen at a rate of 0.98% in 2019). The object of the municipal charge is to contribute to the maintenance of roads, streets, parking spaces, fire service, etc.

The levy of the municipal service charge is governed by the Danish Municipal Property Tax Act. In general, the Act has not changed as a result of the new valuation system. However, the municipal service charge rate will most likely be reduced, as the future property valuations are expected to be higher.

## Other taxes and duties

Other types of taxes and duties may be charged as part of the property tax demand note such as charges for rat extermination, refuse collection charges, pavement cleaning charges and chimney sweeping charges.

## 7.4 Taxation of rental income from real estate

Income from real estate forms part of the taxable income for the property owner (whether resident or non-resident). For corporate owners, such income is taxed at the corporate tax rate of 22%.

The tax basis will be the net rental income, i.e. the gross rent income less expenses such as maintenance, administrative expenses, property taxes and financial costs, including interest. Some commercial buildings may be depreciated for tax purposes, cf. further below.

Buildings (i.e. not including the land) used for commercial purposes are generally depreciable, with certain exceptions such as office buildings, buildings used for financial enterprise, post offices, buildings used for residential purposes, hospitals and clinics. Further, costs for refurbishment and improvement of depreciable buildings may also be depreciated, if such costs are not deductible when spent. The depreciation is calculated on a straight-line basis; however, the tax payer may each year determine the depreciation rate between 0% and 4% of the acquisition price. Costs related to maintenance can be deducted when spent.

Interest expenses are deductible. Restrictions on interest deductibility on intra-group loans may, however, apply. If the equity/debt ratio is below 1:4 (thin capitalization), interest on controlled debt exceeding the ratio of 1:4 is not deductible. This restriction does not apply, if the controlled debt is below DKK10 million.

Further, the net finance costs must not exceed the tax value of the assets (the property) multiplied by 2.7% (2019). This applies to all debt, not only controlled debt. Net finance costs up to DKK21.3 million are



deductible, unless comprised by the thin capitalization rule. Excess finance costs cannot be carried forward.

Finally, under the EBITDA rule, deductible interest cannot exceed 30% of the EBITDA; however, interest amounts of up to DKK22,313,400 are deductible. Interest amounts not deducted may be carried forward.

Denmark has entered into double taxation treaties with a large number of other countries. Most treaties are in accordance with the OECD Model Convention. Under these treaties, rental income from real estate in Denmark may be taxed in Denmark. The method for avoiding double taxation varies depending on the treaty.

### **7.5 Taxation of dividends from a company owning real estate**

In general, limited partnerships and limited partnership companies are transparent for Danish tax purposes. Consequently, the partners are the tax subjects.

Shareholders in an opaque company may be subject to taxation on dividends distributed from the company. Dividends received by a Danish company are generally tax-exempt under the participation exemption requiring a holding of 10% of the capital (such shareholding is also referred to as subsidiary shares or group shares).

Subsidiary shares are defined as shares where the corporate shareholder holds at least 10% of the nominal capital of the subsidiary, and group shares are defined as shares where the shareholder and the subsidiary are subject to mandatory Danish joint taxation or qualifies for a voluntary Danish

international tax consolidation. The general requirement for mandatory Danish national joint taxation or for qualifying for international joint taxation is that the parent company controls the subsidiary, i.e. holds more than 50% of the votes of the subsidiary, directly or indirectly.

Dividends on portfolio shares, i.e. shares that do not qualify as subsidiary shares or group shares (the shareholding is less than 10%), are taxed at the corporate tax rate of 22%; however, only 70% of the dividends from portfolio shares in unlisted companies are included in the taxable income, giving an effective tax rate of 15.4%.

Generally, a company resident in Denmark must withhold tax at a rate of 27% where dividends are paid to non-resident shareholders. The obligation to withhold tax applies to the payment of dividends to all types of shareholders, whether individuals or companies, resident in Denmark or abroad.

However, dividends paid to a corporate shareholder abroad are exempt from withholding tax if the shares in the distributing company qualify as subsidiary shares or group shares, cf. above, and the recipient is the beneficial owner and (i) is eligible to obtain benefits according to (a) the EU Parent-Subsidiary Directive or (b) a double taxation tax treaty, or (ii) a tax information agreement has been agreed with Denmark. Accordingly, most foreign companies may receive dividends tax-exempt from their controlled Danish subsidiary under the participation exemption.

### **7.6 Taxation of capital gains on real estate**

The transfer of real estate is subject to taxation of the capital gains in

Denmark, for both resident and non-resident property owners (limited tax liability). For corporate owners, the tax rate is 22% in 2019.

The capital gains are basically calculated by deducting the acquisition costs and transaction costs together with any improvement costs from the sales price. Any reversed depreciation is taxable as well.

### **7.7 Taxation of capital gains from the disposal of shares in a company owning real estate**

Capital gains from the sale of unlisted shares by a Danish corporate shareholder are generally tax-exempt with no minimum ownership or holding period requirement. Capital gains on listed shares are tax-exempt under the participation exemption, cf. section 7.5.

When transferring shares in a limited partnership company that is considered transparent for tax purposes, the net profits and losses as well as net assets are attributed to the individual partners in proportion to their partnership shares. Any gains generated by the sale of a partnership share in a limited partnership company owning real estate are taxed as capital gains from sale of the property on the part of the holder of the partnership share.

### **7.8 Real estate investment trusts**

There is no specific legal or tax framework for real estate investment trusts in Denmark.



## 8. Real estate finance

Real estate finance involves financing of acquisitions or developments of real estate where the debt is secured against the property and serviced by rental income.

Real estate acquisitions in Denmark is primarily financed by a combination of equity, mortgage financing and/or bank financing. Financing may also be obtained by private investors and debt funds, sometimes – although seldom – by way of the issuance of real estate bonds. In particular, it is worth noting that Denmark provides for a unique mortgage financing system with its unique features, making it a highly attractive way to leverage property investments.

### 8.1 The Danish mortgage system

The Danish mortgage system is unique, as there is a direct match between the mortgage loan and the covered bonds issued to fund the loan. This provides for a high level of financial stability and forms the basis of transparent competitive loan costs and a flexible early repayment system found nowhere else in the world.

The mortgage system is generally based on a match-funding principle, under which the mortgage loans are funded by the issuance and sale of covered bonds with matching payment terms. The market value of the underlying bonds at the time of the sale determines the mortgage loan rate, thereby ensuring a high level of transparency based on market pricing.

All mortgage loans are limited to the statutory maximum loan-to-value ratio based on the assessed value of

the property; 40% for development properties, 60% for commercial properties and 80% for residential rental properties.

The mortgage loans are committed loans meaning that the loans cannot be terminated by the mortgage credit institutions except in the event of default, and the loans are not subject to renegotiation every year as is sometimes the case with bank loans. The margin charged by the mortgage credit institutions may, however, be subject to adjustment during the term of the loan, unless otherwise agreed.

The Danish mortgage credit institutions offer three main types of mortgage loans with credit facilities up to 30 years; fixed-rate loans, adjustable-rate loans and floating-rate loans (with or without interest-rate caps), and almost all loans may be combined with interest-only periods for up to ten years, subject to individual credit approval. Whereas adjustable-rate and floating-rate loans provide a lower interest rate, fixed-rate loans provide for equity-value protection in a market with increasing interest rates, as the market value of the fixed-rate loans will decrease when interest rates increase, and this makes it possible to repay the loan at a lower amount.

Finally, a common feature of mortgage loans is the early repayment options, providing for a high degree of flexibility to the borrowers in terms of exit and mortgage refinancing in a changing market. These repayment options depend on the type of loan.

Fixed-rate loans are based on callable bonds and can always be

terminated for early repayment at par value. Adjustable-rate loans are based on non-callable bonds and can only be repaid at par value in connection with the interest-rate adjustment. Both types of loans may be repaid by purchasing and delivering the same type of bonds as those used to fund the loan. The repayment options for floating-rate loans depend on whether the loan is based on callable or non-callable bonds.

### 8.2 Interest rate risks/hedging

Whether commercial property financing is made on a long- or short-term basis, there is a risk of rising interest rates. Such risks may be mitigated by selecting fixed interest periods, but the borrower is still exposed to interest rate fluctuation on an extension of the loan or additional financing.

Generally, commercial banks require borrowers to hedge their interest rate risk on senior loans. The level of the hedge varies, but a borrower rarely hedges less than 50% of the debt. Junior or mezzanine lenders are less inclined to require hedges.

Providing a hedging policy to the senior lender is often a condition precedent to utilization of the loans, and amendment of the hedging policy often requires the consent of the senior lenders. If the financing is made through a bank, hedging is normally arranged by the lender, but may occasionally be provided by a separate financial institution.

Interest rate risk is commonly hedged by way of customary interest swaps documented by standard ISDA documentation (adapted to the Danish market). In the current market,



we see an increasing amount of fixed rate loans as well as foreign currency loans. Both alternatives bring about their own challenges (high break costs or currency risk), but in a lucrative market for both developers, sponsors and financiers, the willingness to take risks is increasing.

### 8.3 Collateral

In general, the security package for financing of acquisitions and development projects is tailored to each transaction, depending on the specific circumstances and the risk profile of the borrower.

Developments are often financed as ring-fenced project finance arrangements, where the lender will only have recourse against the project itself and not the owner. In acquisitions, the financing will most often be secured in the property itself, but with ratios which over-secure the senior lender by a minimum of 10-15%, depending on the projected cashflow of the property.

### Property

Security over real estate is always required by the lender. Such mortgage may be in the form of a regular mortgage or an owner's mortgage, cf. further section 3.2; however, the owner's mortgage may not be used by mortgage credit institutions.

In order to perfect the security, the mortgages and any sub-pledges must be registered in the Danish Land Register. Further, for secondary sub-pledge of an owner's mortgage, the secondary mortgagee must also give notice to the primary mortgagee.

As a general matter, it should be noted that in case of insolvency proceedings, any security perfected

less than three months before the reference date can be made void if the security has been granted after the creation of the debt (i.e. security for "old debt"), or if the security has not been perfected without undue delay after the creation of the debt.

### Shares

It is common in Denmark to own commercial property through a special purpose vehicle (SPV). It is therefore common for credit providers to require additional security in the form of pledge over the shares of the SPV.

In any case, if a pledge over the shares is not required or not possible, the loan documents will include covenants with restrictions on changes in ownership, i.e. if the shares of the SPV are sold, the borrower is in default and the loan may be terminated for repayment in full.

### Other assets and securities

Other types of security may consist of suretyship/guarantees, pledge over receivables, assignment of purchase agreements, lease agreements and insurances as well as pledge over bank accounts. For development projects the security will often be combined with a right of subrogation in the construction agreements, assignment of construction securities as well as shareholder loans. For newly built rental properties, the loan documents will often include a minimum letting ratio as a condition for disbursement of the loan, and if the ratio is not fulfilled, an escrow deposit must be made.

The loan documents will most often include certain covenants such as limitations in distribution

of dividends, restrictions in change in ownership, cf. above, etc. In addition, the loan documents most often include a negative pledge, according to which the property may not be transferred or pledged without the lender's prior approval, and such negative pledge may be registered in the Land Register.

### 8.4 Taxation on the creation of security

Registration of a mortgage in the Land Register is subject to a registration fee of DKK1,660 plus 1.5% of the mortgage amount. However, the borrower may under certain circumstances be able to reuse registration fees paid on mortgages already registered on the property.

Registration of a sub-pledge of an already registered owner's mortgage is only subject to the fixed fee of DKK1,660.

### 8.5 Financial assistance

The rules on financial assistance in the Danish Companies Act prohibit a company from (directly or indirectly) providing security for the acquisition of its own shares or the shares of its parent company. These rules must be complied with when financing and refinancing acquisitions.

Distribution of dividend takes precedence over the prohibition against self-financing meaning that a subsequent mortgage loan in the target company may be used to repay acquisition debt by distribution of the proceeds as dividend in accordance with the statutory requirements. Further, the prohibition does not apply to security granted for refinancing of existing debt in the target company.

# Glossary

TERM	EQUIVALENT
Afgiftspantebrev	Stamp duty mortgage
Aktieselskab	Public limited liability company
Anpartsselskab	Private limited liability company
Andelsboligforening	Cooperative housing association
Boligreguleringsloven	The Danish Housing regulation Act
Byggeloven	The Danish Construction Act
Bygningsreglementet (BR)	The Building Regulations
Byrde	Charge
Dækningsafgift	Municipal service charge
Ejerforening	Owners' association/house owners' association
Ejerlejlighed	Owner-occupied unit/owner-occupied flat
Ejerpantebrev	Owner's mortgage
Erhvervslejeloven	The Danish Commercial Lease Act
Fri lejefastsættelse	Unrestricted rent determination
Gennemgribende forbedret lejemål	Thoroughly improved lease
Grundskyld	Land tax
Hovedejendom	Main property
Lejedes værdi	Value of the leased
Lejeloven	The Danish Lease Act
Pant	Charge/pledge
Pantebrev	Mortgage
Planloven	The Danish Planning Act
Realkredit pantebrev	Mortgage securing a mortgage-credit loan
Servitut	Easement/restrictive covenant
Skøde	Conveyance
Tilbudspligt	Tenants' pre-emption right
Tingbogen	Land Registry/Land Register
Tinglysningsafgift	Registration fee
Underpant	Sub-pledge

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## About DLA Piper

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DLA Piper's offices in Denmark support clients with a strong team of more than 50 lawyers who handle the most complex legal matters within real estate.

The members of DLA Piper's Danish team have been involved in several major transactions in the Danish market and have comprehensive experience to solve the complexities of their clients' needs throughout the entire life cycle of investments.

This guide was written predominantly by Emilie Møller of our Real Estate practice group, Artur Bugsgang of our Tax practice group and Joachim Kundert Jensen of our Finance practice group.

The guide was prepared in March 2019. Subsequent changes in law are therefore not taken into account. This guide cannot be considered as a substitute for obtaining specific legal advice in individual cases. DLA Piper does not assume any liability in connection with this guide.

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