



Real estate investment in Hungary

COUNTRY OVERVIEW

Introduction

In Hungary, and also in the wider CEE region, investors are entering uncharted territory as the strong domestic economic picture fuels robust development and investment activity, while in more mature markets there are already some signs of a slowdown. In addition to the beneficial market conditions, companies are also subject to favorable tax treatment in Hungary. Investment activity is also encouraged by the fact that yields in Hungary are still significantly higher compared to those in Western Europe and the yield premium continues to be very attractive to international investors.

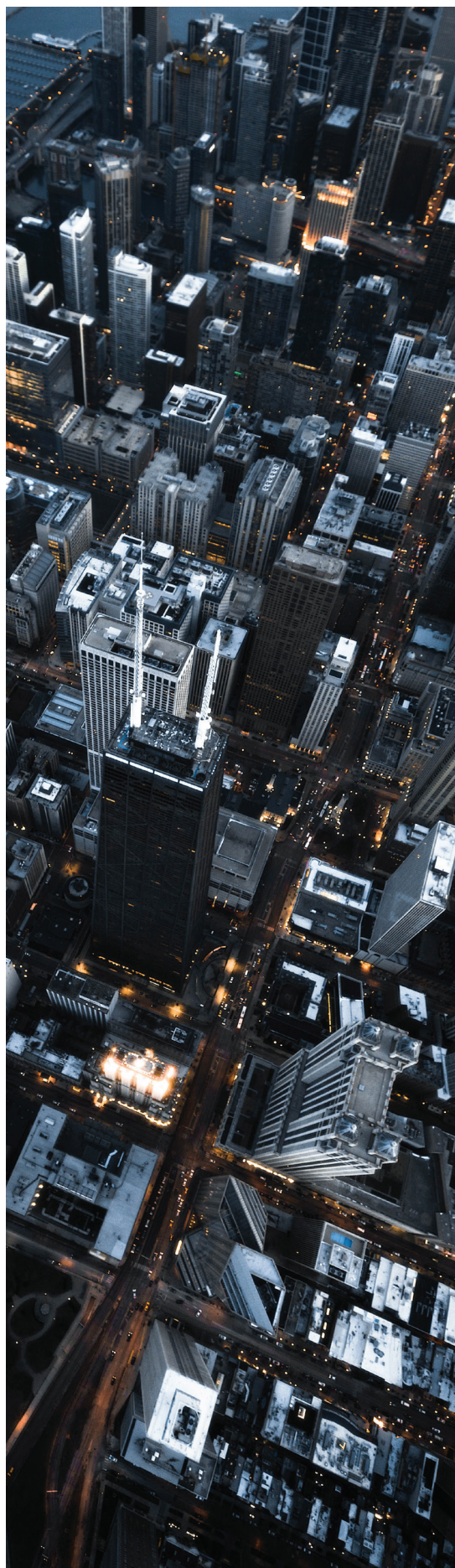
On the development front, several new developments are being announced and a substantial part of them are already leased to tenants, which signals that quality products will continue to come to the market in the next few years. While vacancy rates in Budapest are at a record low, developers are also faced with challenges in the form of increasing construction costs and labor shortages.

In recent years the Hungarian real estate market has also shown signs of maturing and this trend seems to be continuing in the

future. The structure of real estate deals and the legal documentation has become more and more sophisticated and the quality of advice rendered to investors by the various consultants has clearly increased.

We hope that this brief summary on the most relevant legal aspects of investing in real estate in Hungary will be helpful for those who want to get a snapshot of the Hungarian legal surroundings of real estate investment before making an entry to the Hungarian market. We are keen to help you with any questions and issues you may have relating to the real estate investment plans, so please do not hesitate to contact us.

With DLA Piper's Hungary Real Estate team on board, you will be provided with commercial and innovative advice that adds value at all stages of the investment and development cycles of your real estate transaction as we cover all aspects of property law, as well as full-scale tax and business advisory services providing our clients with 360-degree business support.



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1. Ownership of real estate

1.1 Ownership of real estate

The ownership of real estate is recognized by Hungarian law and the right of ownership is protected under constitutional provisions and may only be restricted or limited by law. The expropriation (i.e. compulsory purchase) of a real estate by the Hungarian state and the local municipalities is only possible for public purposes and under certain exceptional circumstances regulated by law (e.g. national defense, energy supply, development of traffic infrastructure, large-scale greenfield developments creating a large number of workplaces), subject to providing complete, immediate and unconditional fair compensation to the owner.

The owner of the real estate is entitled to possess, use and dispose of the real property and such rights of the owner can be exercised exclusively and absolutely, without the interference of any other persons.

REGISTRATION OF OWNERSHIP

Ownership and certain other rights and facts relating to real estate must be registered in the Hungarian land registry. The Hungarian land registry includes all real properties located in the territory in Hungary and besides general data (topographical lot number, classification, area, ownership etc.), the land registry also includes other information relating to real estates, such as details of encumbrances and easements; however, the land registry does not include information on lease agreements.

Transfer of title and the establishment of certain rights (e.g. mortgage right, usufruct right, easement right) is subject to registration with the Hungarian land registry. The transfer of title and the establishment of these certain rights are registered with the effect of the date when the request for registration was filed with the land registry office.

The data registered on the land registry sheet of the properties is public information and is freely accessible. Furthermore, the Hungarian land registry is very reliable and suitable to evidence the data of the real properties since, by virtue of law, the information indicated therein shall be deemed true until proven otherwise.

Although the Hungarian land register is robust and reliable, it is also possible to obtain title insurance for real estate.

COMMON OWNERSHIP

Hungarian civil law also regulates the common ownership of properties in which case the property is owned by the co-owners in a proportion corresponding to their ownership ratio and each co-owner is entitled to possess and use the entire property, but in no case can this right be exercised in such a way that would adversely affect the rights and rightful interests of the other co-owners. Likewise, the burdens and benefits of the co-owned property are split between the co-owners based on their ownership ratio.

CONDOMINIUM

Hungarian law also enables the establishment of condominium properties where a single building is divided into several separately

owned units which are serviced by common areas that are jointly owned by the owners of the separate units. The land on which the condominium is situated is also jointly owned by the owners of the separate units. A condominium property may be established by the agreement of all co-owners incorporated into a deed of foundation and the subsequent registration of the condominium into the Hungarian land registry by the land registry office.

1.2 Ownership restrictions

As a general rule, companies registered in Hungary are able to acquire real property in Hungary, irrespective of the nationality of their owners i.e. even if the owners of such companies are foreigners.

However, there is a prohibition on the acquisition of arable land (such as agricultural land or forests) by legal entities (whether foreign or domestic) and there are certain restrictions on the acquisition of arable land by non-EU citizens. Since 2014, EU citizens are entitled to acquire arable land under the same terms as Hungarian citizens; nevertheless, the acquisition of arable land is subject to certain special conditions, even if acquired by Hungarian or EU citizens.

In addition, non-EU citizens and legal entities residing outside the EU may acquire real estate (other than arable land) only with the consent of the relevant administrative office. While EU citizens and legal entities residing in the EU may acquire real estate (other than arable land) under the same terms as Hungarian citizens and legal entities.



2. Acquisition of ownership

2.1 Deal type: asset v share deal

Real estate transactions are either executed in the form of an asset deal (i.e. acquiring the real estate itself), or in the form of a share deal (i.e. acquiring the special purpose vehicle (SPV) holding the property itself). Each has its own advantages and disadvantages and different tax treatments.

A share deal is generally easier to execute as only the share in the SPV needs to be transferred. External financing already in place may also be retained provided that the bank is happy to continue lending to the new owner. The drawback is of course that the SPV is inherently acquired with all historic liabilities, these however, can be mitigated to some extent with thorough due diligence, warranties and indemnities given by the sellers ideally backed up by a security.

An asset deal is a bit more complicated to execute. Although lease agreements are automatically transferred to the new owner of the property by the force of law, tenant securities, architect and contractor warranties, supply agreements and other contracts of interest have to be transferred to the new owner, requiring the approval of a third party not involved in the transaction. On the other hand, in an asset deal the property is acquired clear of any historic liabilities incurred by the seller.

2.2 Before the acquisition

Prior to the acquisition of real estate (irrespective of whether it is structured as an asset or a share deal), investors usually carry out legal, financial, technical

and environmental due diligence on the target property and the target SPV (in case of share deals). The legal due diligence exercise is usually carried out with respect to the title, building, occupancy and other permits, leases and contracts relating to the real estate and the target SPV (in case of share deals).

Due diligence is usually started after the signing of a letter of intent (heads of terms) including also an exclusivity period in most cases and is completed before the acquisition document is executed as the issues discovered during the due diligence process are usually resolved in the acquisition document.

Before acquiring real property, it is customary to investigate the following main topics: (i) applicable zoning and town planning provisions which will regulate whether the proposed use of the property is permitted; (ii) encumbrances of the property, as well as restrictions and special obligations relating to listed or protected buildings; (iii) building permit; and (iv) occupancy permit which certifies that the building meets the environmental, fire, and health and safety requirements prescribed by the building permit and is safe for use.

2.3 Preliminary consents, pre-emption rights

In specific cases, special consents may be required for the completion of the proposed transaction (e.g. non-EU citizens or legal entities residing outside the EU must obtain specific permission from the competent authority before acquiring property in Hungary).

In addition, if the real property is encumbered by a pre-emption right (right of first refusal), then the acquisition may only be completed in case the beneficiary of the pre-emption right does not exercise its right or fails to make any declaration in a specific timeframe. Based on its pre-emption right, the beneficiary is entitled to purchase the property under the same terms and conditions as included in a third party's purchase offer. Pre-emption rights may apply to real properties on the different grounds, the most common being: (i) the property is under historical, monumental or cultural heritage protection or is situated within a UNESCO world heritage site, in which case the Hungarian state and the local municipalities may have pre-emption rights; (ii) the property is in joint ownership, in which case the other co-owners have pre-emption right; (iii) the property is owned by a local municipally in which case the Hungarian state has pre-emption right; (iv) if the property is arable land then the current occupiers, neighboring landowners and the Hungarian state (in that order) have pre-emption rights; and (v) if a building is constructed on a plot that is not owned by the owner of the building, then the land owner has pre-emption right over the building and the building owner has pre-emption right over the land etc.

2.4 Acquisition document

The transfer of the title to the real estate requires that the parties conclude a written acquisition document (e.g. sale and purchase agreement) and submit that to the competent land registry office for registration.

FORMALITIES

In order to register the transfer in the Hungarian land register, the acquisition document must be prepared and countersigned by an attorney-at-law or a public notary and further specific requirements set out in the applicable legislation must also be fulfilled.

CONTENT OF THE ACQUISITION DOCUMENT

The content of the acquisition document may be freely negotiated by the parties. However, essential elements include:

- **description of the property** including its location and topographical lot number;
- **purchase price and payment details** where the purchase price may either be fixed or variable amount (usually in asset deals a fixed purchase price is agreed and any event occurring between the signing and the closing of the acquisition document is addressed by a covenant/ warranty, claim or a right to withdraw; while in share deals a variable purchase price is usually agreed which addresses the issue that the value of the SPV changes between the signing and the closing of the acquisition document);
- **date and method of handover;**
- **representation and warranties**, which can be negotiated by the parties depending on the specific

circumstances of the transaction; however, sellers will always try to agree in warranty periods that are shorter than the statutory warranty periods (i.e. the limitation period for a breach of a commercial warranty is five years from the date on which the purchaser incurred the damage as a result of the breach of warranty), while in the case of title warranties claims can be brought without any time limit; and

- **seller's consent to the registration of the purchaser's title.**

The acquisition documents often include provisions regarding securing the parties' obligations. The most commonly used securities on the Hungarian market for commercial real estate deals are (i) corporate guarantee (which works the same way as a bank guarantee i.e. as a standalone undertaking, the only difference being that it is issued by a parent company and not a third-party bank), (ii) surety (under which a third person undertakes to perform the obliged contracting party's obligation towards to the other contracting party in the event if the obliged contracting party itself fails to perform) and (iii) W&I insurance (which is a form of insurance taken out to provide cover in respect of liabilities under warranties and indemnities given by the seller in the acquisition document).

2.5 Registering the acquisition in the Hungarian land registry

Within 30 days from the conclusion of an acquisition document, an application for the registration of the change of ownership must be submitted to the competent land registry office. The transfer of ownership will be effective towards other persons once the registration process is completed by the land registry office.

The registration of the ownership change can be based on a sale and purchase agreement prepared and countersigned by an attorney-at law or incorporated into a notarial deed.

Letters of intent and preliminary sale agreements cannot be registered with the Hungarian land registry. However, if the real property is sold with title retention (i.e. the final acquisition document has been signed but the transfer of title is still subject to the payment of the full purchase price), then the fact of the sale with title retention can be registered in the land registry, effectively preventing the seller from selling the property to a third party.



3. Other rights to property

In Hungary the following separate rights may be exercised in relation to real estate:

- **Land use right**, based on which the owner of a building which was built on a land owned by a different person has the right to use the land to the extent required for the access and use of the building, during the lifetime of the building.
- **Usufruct right**, based on which a person is entitled to possess, use and collect income and other proceeds from a real property owned by someone else; however, the beneficiary of the usufruct right cannot sell or otherwise dispose of the
- **Real property.** Usufruct right can be granted for (i) the lifetime of a private individual beneficiary or (ii) for maximum 50 years, if the beneficiary is a legal entity.
- **Right to use (beneficial use)**, which is similar to the usufruct right, but (i) the private individual beneficiary can only use the property to meet their own needs and those of their relatives living in the same household or (ii) the legal entity beneficiary may only use and collect the benefits of the property in accordance with its purpose and activity set out in its foundation document.
- **Easement right**, based on which the possessor of a real estate is entitled to use someone else's

property for a specific purpose or require the owner of such other property to refrain from certain activities. Easement right may be granted for granting of rights of way, supply and drainage of water, building of a cellar, etc.

All the above rights can be established by the agreement of the relevant parties, by a court decision or by virtue of law. If any of the above rights is established by the agreement of the parties, then such contract shall be countersigned by an attorney-at-law or public notary and be registered with the Hungarian land registry.



4. Zoning and planning law permits

4.1 Planning/zoning regulations

The general sources of law with respect to planning and zoning are the Hungarian Construction Act (Act LXXVIII of 1997) and Government Decree No. 253/1997 on the National Settlement and Building Requirements. These primary sources of zoning laws apply throughout the entire country.

Based on these primary sources, local municipalities (in Budapest the district municipalities) must adopt their local development plans, zoning maps, as well as local building and townscape codes applying to the given locality or municipality. The local development plan and local building code describe the uses allowed in different areas of a city in a very detailed manner, specifying building heights, maximum floor-space ratios, minimum landscaped areas, etc. As far as appearance and method of constructions are concerned, local municipalities may also introduce specific requirements in their local building codes or their townscape regulations. Requirements may vary between different zoning blocks of a municipality. Any change to the zoning of property requires an amendment of the applicable local development plan and/or local building codes.

4.2 Development agreements

Large-scale developments often require the modification of the zoning requirements applicable to the respective area. Such modifications are usually associated with the conclusion

of a development agreement between the developer and the local municipality.

Under a development agreement the developer normally undertakes to carry out certain infrastructural works, such as creating roads, public parking spaces, green areas etc. which would then be handed over to the municipality free of charge; while the local municipality undertakes to make its best effort to proceed with the requested modification of the zoning requirements.

4.3 Obtaining permissions for developments

BUILDING PERMIT

Construction of a new building and major refurbishment of existing buildings are both, as a main rule, subject to the permit of the relevant building authority and the works may not be commenced before the final building permit is issued. Depending on the technical contents of the works, in certain cases no building permit is required, although a notification may need to be delivered to the building authority before commencing certain construction works. In case of proposed developments on arable land, the reclassification of the arable land as non-agricultural land and the acceptance of a modified zoning plan are preconditions to the issuance of the building permit.

Additionally, depending on the applicable local regulations, the specific opinion of the municipality's competent body may be required with regard to the conformity of the planned works

with the municipality's townscape requirements. Additional restrictions may apply to buildings that are subject to some form of heritage protection (either national or local), in these cases the building authority may prescribe the use of certain materials, colors or design elements for the refurbishment of the building and additional consents may also need to be obtained from the building authority for refurbishment works.

As a general rule, the building permit is issued by the notary of the local municipality.

Building permits may be challenged by third parties who took part in the first-instance building permits proceedings as clients. Generally, the owners of the plot on which the construction is planned, the third parties who hold a registered right over the plot on which the construction is planned (e.g. easement right holders), and the owners of plots adjacent to the plot on which the construction is planned are invited to participate in the building permit proceeding as clients. Additionally, in the case of industrial or large-scale developments, a wider range of stakeholders may be invited as clients, such as NGOs, environmental protection associations or owners of properties located within a given radius of the planned development.

Once the building permit became final and binding, the construction works must start within three years from such date and must be completed in a ready-for-occupancy condition within five years of commencing construction works;



however, such deadlines may be extended twice for a period of one year respectively.

OTHER RELEVANT STATUTORY REQUIREMENTS

Depending on the nature and volume of the planned development, certain other requirements may apply to the development, such as:

- **an environmental impact assessment** must precede the construction works and the licensing process, where the development is likely to have a significant impact on the environment;
- **an archaeological study** must be prepared, if the development is planned on a site that is subject to some form of archaeological protection, and on the basis of the study the archaeological authority may require the developer to carry out excavations or to employ an archaeologist during the groundwork phase to continuously monitor and direct the works;

- **a project fund manager** is to be involved in the development process to ensure that the funds earmarked for certain construction and building activities are used for the purposes specified in the construction contract, if the value of the construction works exceeds EUR5,548,000 (specified for 2019);
- **special licensing procedures** apply in the case of certain retail buildings or units with a gross floor area of over 400 m²;
- **additional special permits** may be required for special building projects (e.g. permits for power plants and industrial facilities).

Usually, in order to ensure that the permission process is carried out in the most cost- and time-efficient way, the developers decide on the planning and permission strategy and the sequence of obtaining the various permits,

after having consulted with an engineering consultancy and the competent authorities.

OCCUPANCY PERMIT

After the completion of the construction works in accordance with the building permit, an occupancy permit must be applied for the development as the completed development may only be used if a final and binding occupancy permit is issued. Once issued, the occupancy permit is valid for an indefinite period of time.

For the purpose of issuing the occupancy permit the representatives of the relevant authorities conduct a site visit in order to determine whether the works have been carried out and completed in compliance with the applicable laws, regulations and the building permit and whether the building is suitable for the intended use and occupation.

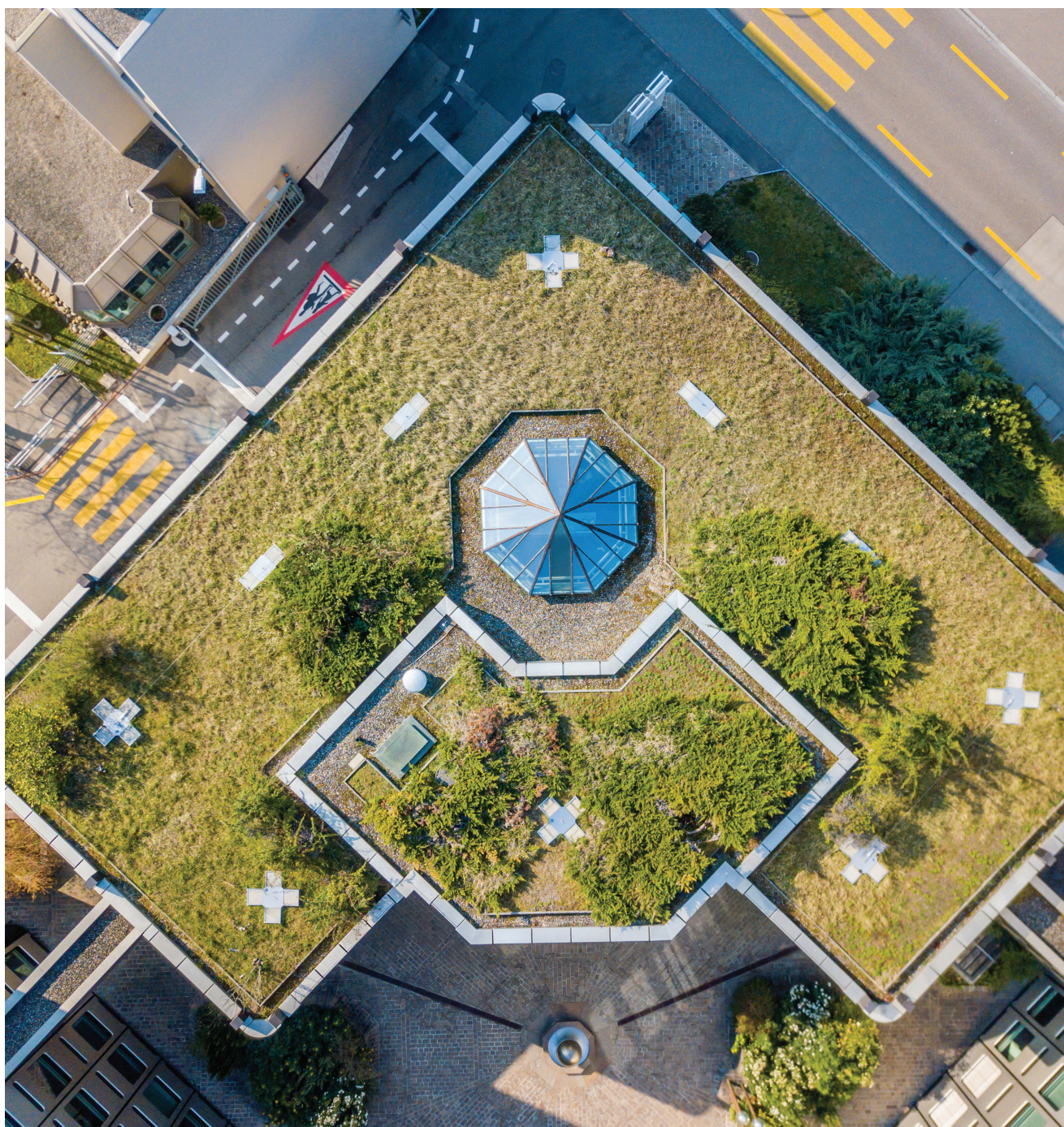


5. Environmental liability

Under Hungarian law, the purchaser of a real estate may be held responsible for the environmental contamination of the purchased property under certain circumstances.

As to environmental liability, Hungary follows the “polluter pays” principle, which basically means that the person causing the contamination will be liable for the damages. Nevertheless, until proven otherwise, the owner and the occupier of the real property (if they are different people) shall

be jointly liable for any historical contamination of the property. The owner can only escape liability for the contamination of the property if they can prove beyond doubt that they did not cause the contamination and can identify the polluter, such as the previous owner or occupier of the real property.





6. Leases

6.1 Lease types

Hungarian law differentiates between regular property leases that are used for leasing commercial and residential buildings or units and usufructuary leases that are used for leasing agricultural land. While a regular lease entitles a tenant to use the relevant property, under a usufructuary lease agreement a tenant is entitled to use and collect income from the agricultural land.

Commercial property leases follow the general rules applicable for regular property leases and more often than not are signed on a triple-net basis in line with international standards. The most common commercial leases are office leases, where the fit-out works and delivery of premises, repair and maintenance, the allocation of service costs and the grounds for termination are, as a rule, regulated in great detail. Retail leases may have provisions enabling the landlord to maintain a healthy mix of tenants in the shopping center and may contain obligations which exist for the benefit of the shopping center as a whole, such as keep-open obligations and obligations to contribute towards the marketing of the shopping center. Hotel leases are similar to office leases and often contain detailed provisions relating to the management of the property.

6.2 Legal nature of commercial leases

In commercial leases the parties enjoy great contractual freedom and are able to contract out of most provisions of the Hungarian Civil Code and the Leasing Act, allowing landlords to implement standard, institutional lease agreements in Hungary.

6.3 Duration

Leases in Hungary can be entered into for a definite or an indefinite period of time. There is no statutory time limitation as to the term of a lease. However, the usual term for Class A office and retail premises is between five and ten years, sometimes with an option for the tenant to unilaterally extend the term by three to five years. For industrial buildings the usual term is somewhere between three and five years.

6.4 Rent, rent review and operating expenses

Due to the contractual freedom of the parties, in case of commercial leases the amount of the rent is subject to the negotiation of the parties.

In case of leases for longer terms, the annual indexation of the rent is a general practice on the basis of a specified index: (i) in case of rent denominated in Hungarian forints, the consumer price index published by the Hungarian Central Statistics Office is used; or (ii) in case of rent determined in EUR, the Monetary Union Index of Consumer Prices (or Harmonised Index of Consumer Prices) issued by Eurostat is generally used for indexation.

As a general principle, besides the rent, tenants shall contribute to the operating expenses and costs of the entire building on a pro-rata basis, by paying common service charge. This generally includes expenses related to common areas of the building, services obtained in connection with the upkeep and maintenance of the building and the common areas, property-related taxes, landlord's property insurance etc.). Usually, for the

purpose of such common service charge, tenants pay monthly lump sum advance payments which are to be settled yearly on the basis of the actually accrued costs.

6.5 Security

Though the parties enjoy contractual freedom to agree in any form of security, such as bank guarantee, parent company guarantee or cash deposit, the tenant is entitled under the Hungarian Civil Code to challenge any security greater than three months' rent where the security is excessive, taking into account the lease term, the landlord's fit-out costs and other business terms of the lease.

Usually tenants are required to provide a security equal to approximately three months' rent and service charge either in the form of a cash deposit or an unconditional bank guarantee. Although less frequent, a corporate guarantee from the tenant's parent company may sometimes be acceptable for the landlord.

The landlord also has a statutory lien on a tenant's moveable property placed in the leased premises as security for any unpaid rent and costs. The landlord is entitled to prevent the removal of such property as long as its lien remains in effect.

6.6 Maintenance and repair obligations

As a general rule, the landlord is obliged to maintain the common areas, repair defects in the structure and the interior of the building, and to maintain the central appliances in the building. The landlord may also be obliged (as far as legally, economically

and technically possible) to make beneficial improvements, such as the installation of appropriate waste disposal systems, sanitary appliances, lifts and sound insulation.

Unless the parties agree otherwise, the tenant, at its own expense, is responsible for the day-to-day maintenance and upkeep of the leased premises.

6.7 Assignment, transfer and sublease

Under Hungarian law it is legally possible to assign or transfer commercial leases provided that this is done with the consent of the other party. The law requires that such consent should be given in writing.

The sublease of the lease premises or any part thereof is also subject to the consent of the landlords as a general practice.

6.8 Termination

When the lease agreement is entered into for a definite period of time, the agreement terminates upon the expiry of the lease term and no party is entitled to terminate the lease before the expiry via ordinary termination (i.e. unilaterally without cause). Lease agreements entered into for an indefinite term may be unilaterally terminated by either party via ordinary termination, by delivering a termination notice to the other party. In such case the lease will terminate after the laps of a certain notice period which is set out by the lease agreement.

If any party seriously breaches the provisions of the lease agreement or fails to fulfil its material obligations, then the other party may terminate the lease agreement with extraordinary termination provided as a general practice that such other party sent preliminary written warning to the breaching party

requesting the reinstatement of the lawful situation within a reasonable deadline. Generally, the lease agreements include detailed rules on the parties' rights to terminate the lease, as well as the processes to be followed.

6.9 Sale of the leased property

In case of sale of the leased property the lease agreement concluded for the property will not be affected in any way and the new owner of the leased property will replace the seller in the landlord position of the lease by virtue of law; therefore, no consent or approval is required from the tenant for such change in the lease agreement.





7. Tax

7.1 Tax on acquisitions

TAXATION OF ACQUISITIONS

The acquisition of real estate in Hungary as part of a purchase, exchange or similar transaction is normally subject to real estate transfer tax, payable at 4% of the market value. A reduced rate of 2% applies to the value above HUF1 billion. Nevertheless, the transfer tax payable cannot exceed HUF200 million per real estate asset. The tax authority will normally accept the consideration stated in the transfer agreement as the market value unless it is obviously too low.

The main exceptions to the general transfer tax rate are:

- a 2% rate applies to the purchase of property by Hungarian real estate funds;
- a 2% or 3% rate applies to the purchase of property by certain property dealers and finance lease providers (providing the property is sold/leased within two years); and
- a 2% rate applies if the property is purchased by a REIT (real estate investment company) or one of its wholly owned special purpose vehicles.

The acquisition of 75% or more of the shares (including shares held by close relatives, related parties, etc.) in a company holding Hungarian real property is subject to transfer tax provided that the balance sheet value of the company's Hungarian real property (or properties) exceeds 75% of the company's total balance sheet value (subject to certain adjustments). In such cases the general tax rate, i.e. 4% applies. Nevertheless:

- a reduced rate of 2% applies to the value above HUF1 billion, and the transfer tax payable cannot exceed HUF200 million per real estate asset, and
- if the acquirer is a REIT (real estate investment company), a reduced 2% rate applies (regardless of value).

The definition of a company holding Hungarian real property also includes companies which themselves are not owners of real property, but have, directly or indirectly, an equity interest of at least 75% in another company (other companies) owning Hungarian real property. If no adjustment applies as prescribed by the Duties Act, the tax base is the market value of the real property (or properties) owned by the acquired entity (or entities) in proportion to the shares held by the acquirer.

The transfer tax is paid by the buyer.

VAT ON AN ACQUISITION

As a general rule, the transfer of real estate is exempt from VAT, unless the seller opts to charge VAT at the rate of 27%. The seller may choose to apply VAT to the sale of real property other than residential properties. If the transfer is subject to VAT, then the reverse charging mechanism applies and the buyer is liable for the VAT.

The transfer of new buildings and building plots is always subject to VAT, and the seller is liable for the VAT at the rate of 27% (i.e. no reverse charging applies). The VAT payable on the completion of a purchase of real estate may be reclaimed in accordance with the provisions of the VAT Act.

OTHER COSTS OF ACQUISITION

A service fee is payable to the land registry office. Legal and notarial fees may also be incurred. Such additional costs are usually borne by the buyer unless otherwise agreed.

Any costs incurred in connection with the discharge of existing encumbrances are paid by the seller.

7.2 Recurring taxation

ONGOING TAXATION

Building tax is payable on the ownership of buildings.

The taxpayer is the person who owns the building on January 1 of each tax year. Local authorities determine the level of taxation.

The maximum rate of building tax per annum is:

- HUF1,100 per m², or
- 3.6% of the adjusted market value of the building

Vacant plots of land situated in inner-city areas may also be subject to tax, depending on the choice of the local municipality.

The maximum rate of tax per annum is:

- HUF200 per m², or
- 3% of the adjusted market value of the plot

The adjusted market value for buildings and vacant plots is 50% of the actual market value.

ONGOING COSTS OF OWNERSHIP

Costs and charges depend on the characteristics of the real estate. Generally, repair, maintenance and insurance costs, as well as utility

fees, are payable. In the case of condominiums, common charges are payable (in some cases these include the cost of utilities).

As a general rule, these costs are paid by the owner of the real estate. However, where the property is leased, some or all of these costs are normally met by the tenant.

7.3 Tax on income from real estate

TAXATION OF INCOME

Income generated by a Hungarian company or by a limited or unlimited partnership from letting real estate is, in general, subject to tax at a rate of 9%. Corporate taxpayers are also subject to the local business tax of up to 2%, which is based on the net sales revenues after tax deductions (costs of goods sold, value of mediated services, sums paid to subcontractors, material costs, R&D costs) and adjustments have been made.

Real estate investment funds, however, are not subject to direct taxation. In general, the letting of Hungarian real estate by a non-resident company creates a permanent establishment in Hungary. Income generated by a permanent establishment is also subject to tax at the general rate of 9%. Local business tax at a rate of up to 2% also applies.

REITs and their wholly owned special purpose vehicles are, as a rule, exempt from corporate income tax and local business tax.

TAXATION OF DISTRIBUTIONS

Dividends paid to shareholders who are not private individuals are not subject to withholding tax.

Dividends paid to non-resident private individuals are taxed according to the rate applicable under the relevant double taxation treaty. If no double taxation treaty applies, withholding tax is payable at the rate of 15%.

Dividends distributed to Hungarian business entities are exempt from tax at source and in the hands of the shareholders.

7.4 Tax on disposals

TAXATION OF DISPOSALS

Capital gains from the sale of real estate by a Hungarian company, limited partnership or unlimited partnership are subject to tax at a rate of 9%. In certain circumstances, local business tax (at a rate of up to 2%) may also apply.

Capital gains from the sale of real estate by a non-resident investor are also subject to tax at the general rate of 9% if the income is attributable to a permanent establishment in Hungary. In certain circumstances, local business tax (at a rate of up to 2%) may also apply if there is a permanent establishment for tax purposes.

Real estate investment funds are not subject to direct taxation in Hungary.

REITs and their wholly owned special purpose vehicles are, as a rule, exempt from corporate income tax and local business tax.

As from January 1, 2010, the Corporate Income Tax Act introduced non-resident taxation in respect of real estate companies. The term real estate company refers to a business entity (and its related parties owning Hungarian real estate), other than a company listed on a regulated market, whose assets include Hungarian real estate with a fair market value exceeding 75% of the total assets (on a consolidated basis).

Also, for a company to qualify as a real estate company, at least one of the owners (including the owners of the company's related parties if such related parties own Hungarian real estate and are subject to the Corporate Income Tax Act in Hungary) must be tax resident in a country which does not have a double taxation convention with Hungary or, if it does, the convention allows the taxation of capital gains in Hungary.

Taxpayers are obliged to report to the tax authorities if they qualify as (or no longer qualify as) a real estate company.

A foreign tax resident company is subject to a 9% tax in Hungary if it realizes a gain on transferring its shares in, or reducing the capital of, a real estate company.

OTHER COSTS OF DISPOSALS

A service fee is payable to the land registry office. Legal and notarial fees may also be incurred. These additional costs are usually paid by the buyer unless agreed otherwise.

Any costs incurred in connection with the discharge of existing encumbrances are met by the seller.



8. Real estate finance

8.1 Forms of security

TYPES OF SECURITY

Under Hungarian law the following type of securities are used in real estate transactions:

- mortgage over real estate;
- pledge of quota (business interest) in Hungarian limited liability companies (*korlátolt felelősségű társaság*)/security deposit of shares held in Hungarian companies limited by shares (*részvénytársaság*);
- pledge over receivables (for instance rental income, insurance policies);
- pledge (without blocking or control) and/or security deposit (with blocking) over bank accounts;
- pledge over all present and future circumscribed rights, receivables and moveable assets;
- call option over real estate for security purpose; and
- corporate guarantees/sureties.

REAL ESTATE AS SECURITY

Ownership title to real estate is the right over which the mortgage (and/or call option) can be granted. Only real estate registered in the Land Registry can be subject to a mortgage (and/or call option).

TRADING OF DEBT

Claims and receivables are normally transferred under Hungarian law by assignment. The Civil Code regulates also the transfer of a contractual position (including all rights and obligations of the transferor arising from the contract). Receivables can also be assigned under factoring transactions.

As a result of the assignment or transfer of the lender's contractual position, accessory mortgages and pledges securing the transferred claim transfer to the assignee, but its registration with the Land Registry, Company Registry or the Credit Collateral Registry (*HBNY*) (depending on the type of the security) is also advisable. Call options, independent type mortgages and independent guarantees do not travel with the transferred claim automatically. The Civil Code also introduced a form of security trust, such security trustee shall continue hold the mortgage or pledge on trust for the benefit of the assignee as secured creditor also following the assignment of the secured receivables.

Furthermore, section 17/A of Act CCXXX of 2013 introduced a special regime enabling financial institutions to transfer a portfolio of contracts or a portfolio of claims to another financial institution, subject to specific approval by the National Bank of Hungary.

8.2 Creating security

RESTRICTIONS ON FOREIGN LENDERS

There are no additional restrictions on security providers regarding the granting of security over real estate due to the mortgagee being a foreign lender. The lender however shall comply with all mandatory provisions of Hungarian law applicable to providers of financial services as cross border services.

TAXES AND FEES

No tax is payable upon granting of a security. There is a small fee payable to the Land Registry for the

registration of a mortgage (and/or call option). In addition, to enhance enforcement via judicial execution, banks normally require security agreements to be concluded in the form of a notarial deed and to notarize the terms of the secured credit facility agreement. The fees payable to the notary public for such notarization are regulated and depend on the value of the secured obligation and certain other circumstances (e.g. number of pages of the document), but also the notary public has some room for interpreting some of the mandatory provisions of law regulating the pricing.

In the event that security is enforced, transfer tax (at a rate of 4%) is normally payable. VAT (at a rate of 27%) may also apply. Additional costs include notarial and legal fees, registration fees etc.

CORPORATE GOVERNANCE

Currently, there are no statutory restrictions on financial assistance in Hungary, other than in relation to public limited companies (*nyilvánosan működő részvénytársaság*). Public limited companies may only provide financial assistance for the purchase of their shares if:

- the financial assistance is provided at market conditions;
- the source of the financial assistance is such fund of the company that could be used for the payment of dividends; and
- the shareholders' general meeting, on the basis of the proposal of the board of directors, consented to the financial assistance with at least a three-quarter majority.

Hungarian law does lay down corporate benefit rules. For example, the directors of a company must exercise the levels of care generally expected from people occupying such positions and act in the best interests of the company as long as the company is solvent. If the company becomes insolvent, directors must act in the best interests of creditors.

The articles of association of a company may contain provisions requiring the shareholders' prior approval for certain transactions, such as granting security over the assets of the company.

RESTRICTIONS ON PAYMENTS TO FOREIGN LENDERS

There are no additional restrictions on payments being made to foreign lenders in Hungary. Depending on the lender's tax residence, a withholding tax may apply to interest payments.

PRIORITY OF SECURITY

Under Hungarian law it is possible that a secured creditor subordinates its pledge or mortgage to that of another secured creditor, by way of an agreement on the swap of the ranking position of their mortgages in the Land Registry or of their pledges in the Credit Collateral Registry (HBNY) or other applicable registry. These require the agreement of all parties affected by such subordination, including the mortgagor (or pledgor), even if different from the borrower. In addition, the parties may also sign agreements on contractual subordination of ranking of payments (including, for example, payment of proceeds upon security enforcement or

liquidation), such agreements are not binding on third parties and the obligations under such agreements may not necessarily be specifically enforceable in accordance with their terms.

8.3 Consequences of taking security

JURISDICTION

The parties are free to choose the governing law of the security agreement subject to and in accordance with Regulation (EC) No 593/2008 of the European Parliament and of the Council of June 17, 2008 on the law applicable to contractual obligations (the Rome I Regulation). However, the mortgage/pledge, as an in rem right, shall also be governed in such case by Hungarian law if the security asset is located in Hungary, therefore it is not customary to stipulate a foreign law to govern the security agreement. Furthermore, in relation to pledges over claims the Rome I Regulation provides the law governing the pledged claim shall determine whether it may be pledged, the relationship between the pledgee and the debtor, the conditions under which the pledge can be invoked against the debtor and whether the debtor's obligations have been discharged. Also, certain Hungarian regulatory (administrative law) requirements will apply to the parties even if they stipulate a foreign law to govern their contract.

IMPERFECT SECURITY

In order to be effective vis-à-vis third parties mortgages must be registered at the Land Registry, pledges must be registered at the relevant registry (Credit Collateral Registry (HBNY), Court

of Registration or other relevant registry) and security deposits need to be duly perfected (e.g. by way of handover). In the absence of compliance with the above requirements, the lender will not be regarded as a secured creditor with respect to the relevant security asset in an enforcement, bankruptcy or insolvent liquidation procedure of the security provider. However, according to the court practice, subject to the final registration of its mortgage with the Land Registry, the mortgagee can be regarded as a secured creditor if at least the pending registration of the mortgage is shown as side note on the land registry extract of the property at the time of the opening of the insolvent liquidation.

8.4 Borrower insolvency/enforcement

ENFORCEMENT OF SECURITY

The mortgagee/pledgee would be able to enforce the security interests only if it has an overdue monetary claim against the debtor under the secured finance documents (in the case of an independent mortgage also termination of the mortgage may be required). In the case of an event of default other than non-payment, in order to enforce its security, the secured creditor must first terminate the secured loan agreement or accelerate the borrowers' payment obligations thereunder, in accordance with the terms of the particular loan agreement etc. The method in which a lender may enforce its security will vary depending on the type of security and the terms agreed by the parties.



NON-INSOLVENCY PROCEDURES

A debtor company and its creditors may enter into any voluntary arrangement they choose to deal with the debtor's financial difficulties. Such agreements may, for example, suspend payments and/or the enforcement of the creditors' claims (including security interests) for a mutually agreed period of time or extend the original repayment term to accommodate the borrower's financial position. Such an agreement is normally not binding on any third parties not being parties thereto.

Furthermore, as an alternative to insolvent liquidation, the directors or creditors (in each case subject to further requirements) of a debtor company may file for bankruptcy procedure (*csődeljárás*) with the court. Such bankruptcy proceedings are voluntary reorganization proceedings, during which a preliminary statutory moratorium applies and the debtor endeavors to obtain a further moratorium in order to agree on a settlement (composition) with its creditors.

EFFECT OF BORROWER'S INSOLVENCY

If insolvent liquidation is ordered against a debtor, all enforcement/foreclosure proceedings against such debtor are terminated, all of its assets are placed under control of the liquidator appointed by the court. Claims against the insolvent company and security interests

created over its assets (including, for example, the mortgage over its property, or the pledge created over its receivables) can be enforced only within the framework of, and according to the rules applicable to, the insolvent liquidation proceedings controlled by the liquidator. The lender must register with the liquidator within strict statutory deadlines in order to be able to assert its claims against the debtor and achieve due priority in the order of payments made by the liquidator to the creditors. In addition, in insolvent liquidation of the security provider, the liquidator or other creditor may file for legal action before the court to challenge any transactions concluded by the debtor (including, for example, granting of a mortgage) if it qualifies as either a fraudulent transaction, an undervalued transaction or a preferential transaction within the meaning of the Bankruptcy Act, in each case subject to other conditions (e.g. suspect periods) set out in the Bankruptcy Act. Furthermore, for the purpose of exercising the call option, only those claims can be set off against the insolvent debtor which have been registered by the liquidator and which has not been assigned following the commencement of the liquidation.

In addition, in the bankruptcy proceedings (*csődeljárás*) initiated against the security provider,

enforcement of security is not possible under a moratorium applicable to the debtor company.

Under Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (the Bankruptcy Act), insolvent liquidation proceedings (*felszámolási eljárás*) are involuntary or voluntary insolvent winding up proceedings. The aim of such proceedings is to satisfy creditors' claims through the distribution of the proceeds of the debtor's assets, and termination of the debtor company without legal successor.

ORDER OF PAYMENT

If a mortgaged or pledged asset is sold during the liquidation proceedings, after the deduction of certain costs and the liquidator's fees, the remainder of the sale proceeds shall be applied for discharge of the claim secured by such asset, with priority over other or unsecured creditors. In the event that there is more than one mortgage or pledge over the same security asset, the order of priority is determined by the date of their creation. Furthermore, only those creditors' claims can be satisfied in the liquidation proceedings which have been registered by the liquidator (late registration will result in a disadvantageous position in the distribution order and, most probably, result in the final loss of the claim).





