

THE LEGAL PERSPECTIVE

Real estate investment in France

Some French specificities

- Commercial lease: 3/6/9 years (see section 6.2 below);
- highly protective legal status for tenants (which may nonetheless be contractually adapted to aim for a “triple net” rent);
- pre-emptive right of commercial tenants (see section 3.3 below);
- intervention of the notary in the due diligence process (acquisition, financing,...);
- ownership: check (by the notary) the chain of owners over 30 years.
- Acquisition of a building under construction:
 - To guarantee the completion of the building, the seller generally gives to the buyer a financial guarantee of completion of the works (GFA) taking the form of a first demand bank guarantee.
 - The payment of the price is spread out according to the stage of progress of the constructions.
- Construction insurances
 - Ten-year warranty for defects that compromise the solidity of the building or make it unfit for use.
 - Two-year warranty for separable equipment elements;
 - One year warranty for defects of conformity.

Main documents to be drawn up in the context of a transaction

- Non-disclosure Agreement (NDA) prepared by the seller or the seller’s advisors (in French and/or in English)
- LOI prepared by the purchaser or the purchaser’s advisors (in French and/or in English)
- **Asset Deal**
 - Promise to sell
 - The draft of the promise to sell is typically prepared by the seller’s notary assisted by the seller’s lawyer.
 - The promise to sell must be drafted in French.
 - The promise to sell is generally subject to the fulfilment of conditions precedent such as the non-exercise of a pre-emption right. Negotiations can take place either in French or in English and translations of the promise of sale into English can be made.
 - Deed of sale
 - The draft of the deed of sale is typically prepared by the seller’s notary assisted by the seller’s lawyer.
 - The deed of sale must be drafted in French (in accordance with Article 1 of the Law of 4 August 1994
- *(Loi Toubon)*, which mandates the use of French for all official documents to ensure their legal validity and comprehension by the parties and authorities). Negotiations can take place either in French or in English and translations of the deed of sale into English can be made.
- Ownership is transferred on the day of payment of the purchase price and signature of the deed of sale.
- **Share Deal**
 - The draft SPA is typically prepared by the seller’s lawyer. The SPA can be drafted in French and/or in English.
 - The actual transfer of the shares (and the completion of the transaction) may be subject to the fulfilment of conditions precedent such as the non-exercise of a pre-emption right (potentially applicable in case of transfer of the shares in a French SCI). Negotiations can take place either in French or in English.
 - Ownership of the shares (and underlying asset(s)) is transferred on the day the of payment of the purchase price.

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1. Ownership of real estate

1.1 Freehold ownership

French real estate is mainly acquired through freehold ownership (*pleine propriété*). Freehold ownership consists of the right to enjoy and use the property in the most unrestricted way. The rights of a freehold owner extend to anything above and below the property, including buildings and vegetation. Therefore, the owner may use its property without restriction provided that the intended use complies with applicable laws and regulations. Hence, the owner is also entitled to mortgage, grant easements over, grant leases of any type and sell the real estate at any time.

In certain cases, freehold ownership may also be split into two real estate interests known as bare ownership (*nue-propriété*) and usufruct (*usufruit*). Bare ownership of the property is thus detached from the usufruct which grants the right to receive the income and proceeds from the asset.

Any real estate interest must be publicly registered with the relevant land registry (*Service de Publicité Foncière*) in order to be enforceable against third parties. Such registration requires the involvement of a notary public.

1.2 Condominium

Condominium (*copropriété*) is a form of real estate ownership where the owner receives title to a particular unit and has a proportionate interest in certain areas which are common to some or all of the units.

The legal framework of condominium is defined under law n°65-557 dated 10 July 1965 and applies automatically to any existing building or group of existing buildings owned by several persons or entities, where such building(s) contain(s) private areas and common areas. Each co-owner has full ownership of the relevant private areas, has joint ownership of common areas and is liable for the payment of service charges regarding common areas.

The co-owners must set up binding rules in a particular agreement (*règlement de copropriété*) providing for the rights and covenants of each member with respect to the use and enjoyment of the premises and the management of the building. Condominium is not supposed to limit the co-owner's right to transfer its own co-ownership unit without restrictions. However, the *règlement de copropriété* may provide that specific formalities are to be satisfied beforehand (e.g. specific notification, obligation to provide information).

1.3 Volumetry

The division into volumes, or "*volumetry*," is a legal technique developed through practice that allows a building to be divided into completely independent three-dimensional fractions. Unlike the condominium governed by the French law dated 10 July 1965, it separates the various elements of a real estate complex without creating common areas, thereby enabling total individualization of ownership.

Initially employed to manage the coexistence of public and private domains, volumetry has expanded to include complex real estate projects, where differentiated uses and management are often indispensable, effectively bypassing the application of the condominium regime. Today, volumetry is a key legal tool for addressing the flexibility and specialized management demands of modern projects.

1.4 Leasehold ownership

Among the categories of property rights that can be acquired, the French system recognizes leasehold rights whereby the tenant is granted with real property rights over the property.

The owner of a plot of land is entitled to enter into either a construction lease (*bail à construction*) or a long-term lease (*bail emphytéotique*), both leases being granted for a minimum period of 18 years and a maximum period of 99 years. Unlike a construction lease, which requires the tenant to build on the land at its own cost, a long-term lease only imposes an obligation on the tenant to maintain the property at its own cost and to pay a fee to the landlord.

On termination of the construction lease, the ownership of the building is transferred to the landlord without any compensation being due unless otherwise agreed between the parties. Likewise, at the end of a long-term lease, all improvements made to the property are transferred to the landlord. Since these two leases are granted for terms exceeding 12 years, they need to be registered with the land registry.

1.5 Restrictions

French law does not impose restrictions in connection with the acquisition by foreigners of property located in France, whether directly, or indirectly, through the purchase of a company holding real estate assets.

2. Acquisition of ownership

2.1 Formal requirements

The formal requirements involved in the acquisition of ownership of real property mainly depend on the acquisition process adopted – asset deal or share deal. Indeed, while the deed of sale of a real estate asset must be executed in front of a notary so that it can be valid and enforceable through registration at the land registry, a share deal is usually subject to a share transfer agreement where the assistance of a notary is not mandatory.

When contemplating a transaction and before any contract can be drafted, parties can enter into a negotiation process in many ways, mostly in writing.

Preliminary negotiations may create binding obligations as from the point at which any agreement on the price and on the property has been reached, since making negotiations subject to contract is not a concept recognized by French law. The parties must conduct their negotiation in good faith – an abrupt termination of negotiations may give rise to a claim for damages. The French contract law reform resulting from an order n° 2016-131 of 10 February 2016 which came into force on 1 October 2016 and was ratified by a legislative act n° 2018-287 dated 20 April 2018 (the Contract Law Reform) extended the obligation of negotiation in good faith to the phases of negotiation and conclusion of the contract (article 1112-1 of the French Civil Code).

As a consequence, parties often use a letter of intent in order to set out the main features of the contemplated acquisition such as its scope and timing. This document must be drafted very carefully so that any agreement from the purchaser is made subject to a satisfactory due diligence process, a corporate management agreement for the transaction and agreement as to the main terms of the sale agreement or share transfer agreement to be entered into. A letter of intent can contain details regarding the funding of the contemplated transaction (equity, bank facility) and the warranties the purchaser is expecting from the seller.

The execution of a letter of intent usually initiates a due diligence period during which the purchaser will conduct due diligence with the assistance of its lawyers and notaries. Lawyers and notaries share the responsibility for conducting the relevant investigations, with the former being responsible for tax, public and administrative matters, leasing and insurance issues, while the latter are normally responsible

for checking title, planning, construction and the property's commercial status. Due diligence is normally much more limited on smaller residential and commercial transactions.

Once the due diligence is finalized, parties usually agree on a preliminary agreement which can take the form of either a call option (*promesse unilatérale de vente*) or a bilateral undertaking to sell and purchase (*promesse synallagmatique de vente*). On signing this kind of preliminary agreement, a deposit (equivalent to 10% of the purchase price – or less for larger transactions) is usually paid by the purchaser and kept in escrow by a notary. The deposit is then offset against the purchase price when the sale is completed; returned to the purchaser if, for some reason, a clean title cannot be transferred to the purchaser within the stated period; or forfeited by the purchaser if they no longer wish to proceed with the acquisition.

Previously, while a bilateral undertaking to sell and purchase entitles the purchaser to seek specific performance from the seller, damages were only available under a call option in the event the seller gets out of the deal before the purchaser exercises its option.

However, the Contract Law Reform overturns pre-existing case law and provides for a call option that in the event the seller gets out of the deal before the purchaser exercises its option, it does not prevent the formation of the promised contract and the other party will be entitled to enforce the contract pursuant to the unilateral promise (article 1124 of the French Civil Code).

A contract entered into in breach of the call option with a third party will be null but only if the third party knew of the existence of the call option.

The time limit specified in a call option is normally set for a few weeks after the expiry of the public authorities' pre-emptive rights when applicable. During this time and in the case of an asset deal, the notary is responsible for securing official copies of entries from the mortgage registry that provide details of any recorded mortgages on the property, so that title can pass to the purchaser without any interference from creditors. The parties will then proceed to the execution of the deed of sale. Title passes to the purchaser on the execution of the deed, unless this states otherwise.

2.2 Asset deals

As notaries are more involved in asset deals than they are in share deals, due diligence covers title to property, easements, mortgages, construction and planning aspects. The tenancy situation and environmental law are also of major concern.

French law imposes various obligations and warranties on the seller. First, the seller must transfer the property in accordance with the agreement between the parties, as set out in the deed of sale: this includes the size, formal description and use of the building. Failing such transfer, the purchaser may claim damages if specific performance is no longer available.

The seller guarantees that the purchaser will not be dispossessed either by the seller's own personal action or the actions of any third party: the seller must ensure that the purchaser does not suffer any nuisance caused by the seller or third parties in relation to rights to the property such as easements, leases or any existing right being, for instance, granted to any other purchaser (i.e. a prior undertaking to sell, *pacte de préférence*, etc.). If the eviction is total or affects an essential part of the property, the purchaser is entitled to claim a refund, otherwise a claim for damages is available.

In addition, the seller must guarantee the purchaser against hidden defects (*vices cachés*) which may affect the normal use of the property so that it is not suitable for the purpose intended by the purchaser or there are defects that impair the property to the extent that the purchaser would have lowered the price or would not have proceeded with the acquisition.

The seller bears the obligation to deliver technical information about the property in relation to asbestos, lead, legionella, termites, certain equipment containing (potentially) dangerous substances, a risks statement (*État des Risques*), an energy performance diagnosis (*diagnostic de performance énergétique*), and a soil pollution information document (*document d'information sur la pollution des sols*) since 1 January 2023.

The obligations of the seller are stricter when the purchaser is not a real estate professional.

Ownership of real estate, as well as important matters affecting it, such as mortgages, lender's legal mortgages, easements and leases of over 12 years, must be registered with the registry maintained by the land registry (*Service de Publicité Foncière*) in each county (*Département*). The information recorded is generally available to the public at a nominal cost.

The sale of real estate is also subject to transfer tax at a rate ranging from 5.09% to 6.32% (depending on the location of the relevant property) if the property was built more than five years ago. Please refer to section 7 for more details.

For sales relating to disposals of office premises, retail premises and storage premises *in Ile de France* county, an additional tax of 0.6% of the sale price applies. As a result, the global rate of transfer taxes applicable to disposals for consideration in *Ile-de-France* county is increased from 6.32% to 6.92%. This additional tax does not apply to disposals for consideration that are subject to VAT.

Asset dealers who buy and sell properties as their normal business benefit from a reduced rate of transfer taxes (0.715%), provided that the properties are resold within five years following the acquisition. Please refer to section 7 for more details

Call options are not normally recorded at the mortgage registry but must be recorded with the tax authorities. The tax authorities keep this information confidential.

2.3 Share deals

Apart from the due diligence that is usually conducted in respect of real property in anticipation of an asset deal, the company whose shares are to be transferred, its equity, debt and shareholding should be covered by the investigations carried out by the purchaser's legal advisors.

A real estate holding company may be a limited liability company (usually an SAS or an SARL) or an unlimited liability company (usually an SNC or SCI) and is usually wholly owned by the seller (or the seller holds the majority of the shares, and an affiliate holds the outstanding share). The corporate form of the target, as well as the form of the investment vehicle, is often driven by the shareholding structure, and tax transparency and liability concerns.

The type of shares issued by the target company may affect the way the ownership of the shares is recorded. The ownership of SARLs, SNCs and SCIs' shares (*parts sociales*) depends on the company's bylaws and any subsequent share purchase agreements entered into since the incorporation of the company while the owners of SASs' shares (*actions*) are recorded in the share transfer register and shareholders' individual accounts.

The guarantee that the purchaser will not be dispossessed that is applicable in an asset deal applies in a share deal as well, but the guarantee is more limited as it covers the shares that are transferred rather than the underlying real property. Consequently, a share purchase agreement generally covers the issues affecting the property with respect to its construction, compliance with planning and environmental law, tenancies, insurance status, etc.

The obligation to deliver technical information about the property is not mandatory in the case of a share transfer agreement even though sellers usually agree to provide for the same level of information as that which would have been required under an asset deal.

In addition, although the due diligence usually conducted in an asset deal focuses on the property, due diligence in a share deal also focuses on the share capital of the target company, its equity and debt as well as its management.

The share purchase agreement then addresses specific representations and warranties in order to secure the purchaser and to make sure that the seller will hold the purchaser harmless against any unusual and outstanding liability which could not be covered during the due diligence process. Apart from the classic matters regarding the property that are covered under a deed of sale, tax and indebtedness are among the most discussed topics in the representation and warranties section of any share purchase agreement.

Warranties from the seller are not always stated in the share transfer agreement and may be covered under a separate warranty agreement. It is common practice for seller to give the purchaser some comfort regarding the execution of the warranty agreement either through a specific amount of money put in escrow during a certain period of time or through a guarantee (a joint and several guarantee, a first demand guarantee, letter of credit, etc.) granted by a third party (an affiliate of the seller or a bank). In addition, specialized insurance companies provide for insurance policies covering specific liabilities such as tenancy risks, planning law or identified tax risks.

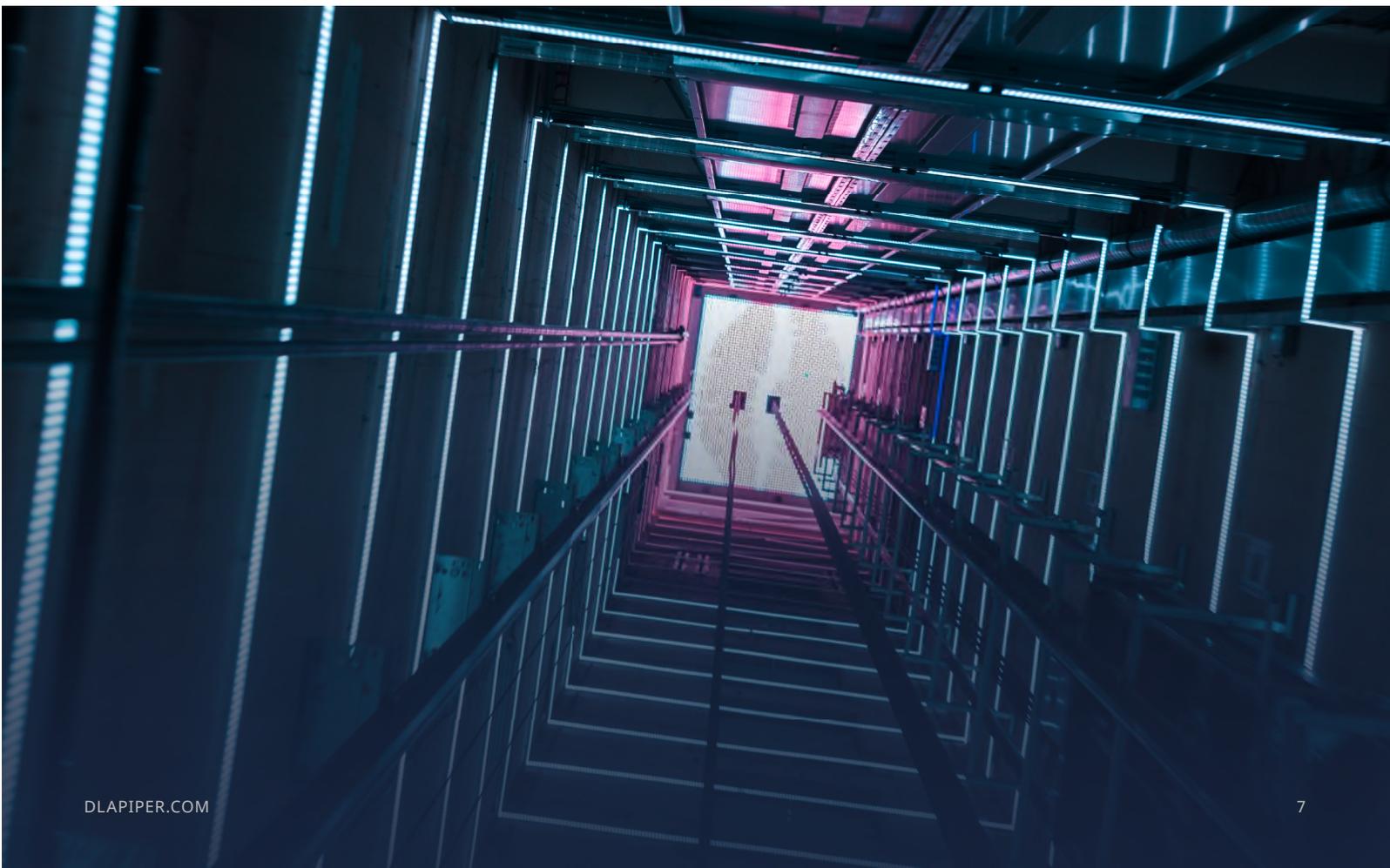
Since the transfer of shares does not trigger the transfer of ownership of the underlying real property, it is not subject to registration at the land registry. However, transfer tax must be paid to the tax authorities at a rate of 5% assessed on the sale price of the shares (or the fair market value if higher), i.e. in the case of a special purpose vehicle, on the fair market value of the real estate asset owned by the entity reduced by the entity's debt. Please refer to section 7 for further details.

2.4 Public auctions

Public auctions can be organized either voluntarily or by judicial order; however, this is not a usual mean of acquisition for a real estate investor due to the higher risks and procedural constraints compared to private sales.

Voluntary auctions are organized by notaries, while involuntary ones are carried out at the instigation of the court. Auctions are brought to an end after a limited period of time so that the last bid is considered for the sale of the property, and the sale is completed unless a later bid (raising the price by 10% or more) is made within a certain subsequent period of time following the last bid. In such a case, another auction is organized.

Even if inspections of the property are organized and despite the fact that the terms of the sale must include mandatory provisions, sometimes no due diligence process or negotiation with the seller is carried out as is common practice in the framework of a mutually agreed sale, thus making public auctions much riskier.



3. Other rights to property

3.1 Easements

Under French law, ownership rights can be encumbered by easements for public use (*servitudes d'utilité publique*) which are incorporated into planning documents such as the local land use plan. This may refer to easements for the protection of nature or cultural heritage, easements for the use of energy resources (electricity, gas, hydrocarbons, etc.) and infrastructure (mines and quarries, roads and other networks, sewers, telecommunications etc.) as well as easements relating to health and public safety.

In addition, ownership rights can often be limited by easements agreements for private use (*servitudes conventionnelles*) granted by a landowner over its property or to the benefit of a third party (e.g., the owner of the neighbouring property) provided that they are not contrary to public policy. Such easements are widely used to establish rights of way, rights of use, rights to erect and maintain electrical or other supply lines, and to control development on certain land.

3.2 Charges

There are two types of charges:

- a mortgage (*hypothèque conventionnelle*); and
- lender's legal mortgage (*hypothèque légale spéciale du prêteur de deniers – PPD*).

A mortgage is an *in rem* security interest (*sûreté réelle*) governed by the French Civil Code which may be created either legally, judicially or by agreement (referred to below as a conventional mortgage). A mortgage may be granted over a property in favour of a creditor at any stage (not only in connection with financing the acquisition) and without the owner of the property being dispossessed. This security will guarantee the repayment of the principal amount secured, the payment of interest and additional expenses.

The mortgage must be entered into by notarial deed and executed in front of a French public notary. This deed must state the obligation secured and the amount of the secured debt. The mortgage will then be registered with the land registry. There is no time limit for registering a mortgage, but in the absence of registration, the mortgage will not be enforceable against third parties.

A lender's legal mortgage is also an *in rem* security interest which, can, however, only be entered into to secure the financing of the acquisition. The loan agreement must be executed by notarial deed and the funds borrowed will have to be used to pay the purchase price of the property. This security has the advantage of being cheaper than a conventional mortgage (for further references see section 8 below).

3.3 Pre-emption rights

Pre-emption rights exist either for the benefit of French local government and administrative bodies or of landowners themselves. They carry with them the right to become priority acquirers in certain predefined zones according to town planning regulations or as agreed between the parties. There are several pre-emption rights of significance here.

Where the municipal council has implemented a legal pre-emption right, the municipality in which the property is located has first call on the property itself and/or on the shares of any real estate company (*droit de préemption urbain*). This right arises following the filing of a declaration of intent to sell (*Déclaration d'Intention d'Aliéner – DIA*) by the owner of the property. The relevant municipality is entitled to purchase the property and/or the shares on the same terms and conditions as set out in the declaration. The pre-emption right must be exercised within two months of the date the declaration is filed, although, in practice, municipalities often agree to waive their right sooner.

Agricultural organizations often have a right of pre-emption over agricultural assets (*droit de préemption de la SAFER*). This allows them to consolidate farmland into larger units if this would be of benefit to the local economy.

In addition, any sale of a craft business, going concern (*fonds de commerce*) or any assignment of commercial leasehold rights covered by regulations for the protection of local shops (*commerces de proximité*), located within an area covered by a decision of the municipal council, may be subject to a pre-emption right in favour of the municipality. This pre-emption right is applicable to the sale of a going concern, the sale of a craft business, an assignment of commercial leasehold rights, or land accommodating or intended to accommodate shops with a sales area of between 300 m² and 1,000 m² (*droit de préemption commercial*).

In addition, a pre-emption right in favour of the tenant of a commercial lease has been implemented by law n° 2014-626 dated 18 June 2014 (the Pinel Law). This applies if the owner intends to sell by way of asset deal the premises where their business (either a retail operation or a craft business) is operated (*droit de préemption du locataire*). There are some exceptions to this pre-emption right, in particular when the landlord intends to sell several premises in the same commercial complex (e.g., several premises in a shopping mall) or when the landlord intends to sell several separate premises in geographically distinct locations.

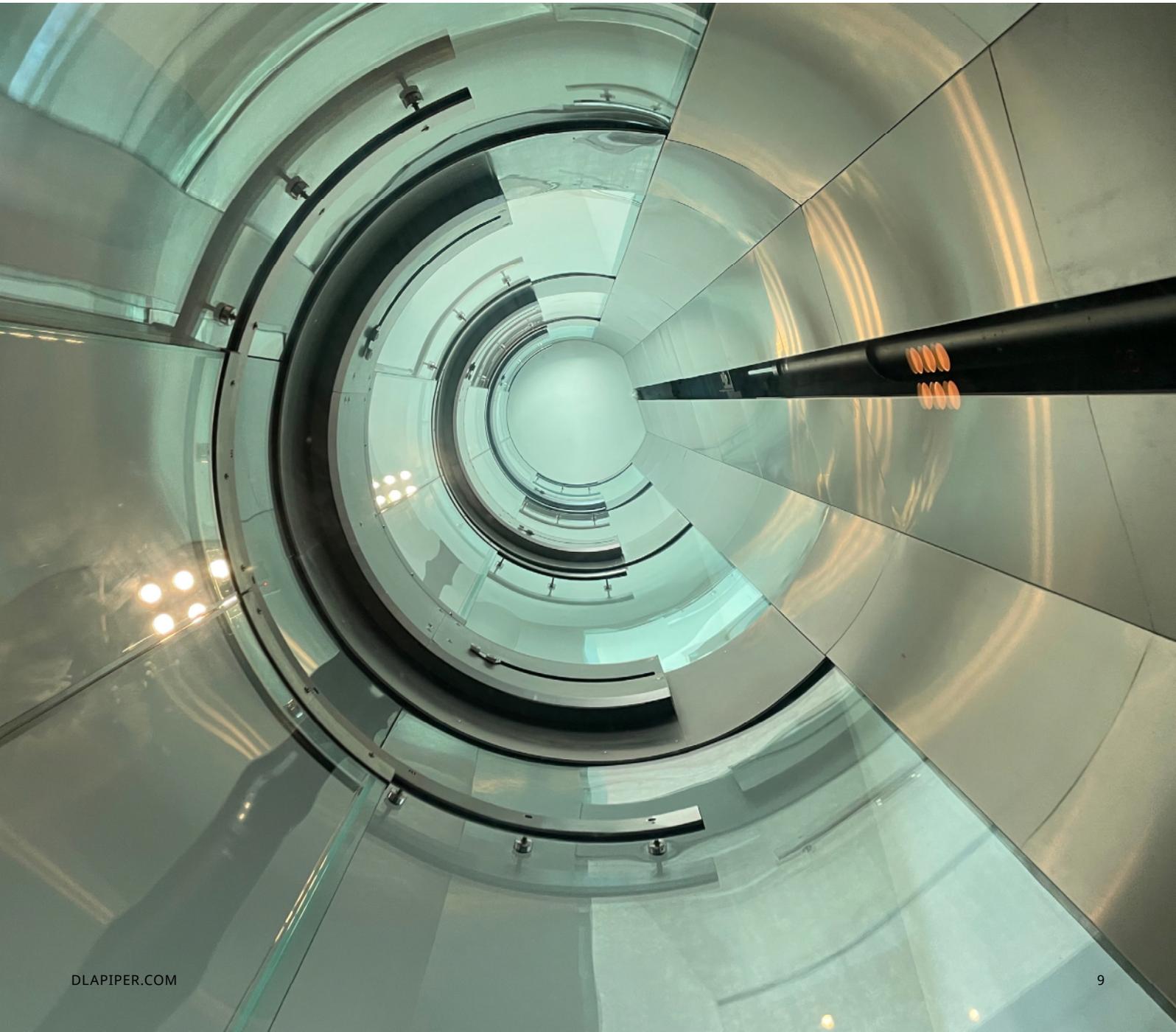
These pre-emption rights must be exercised within two months of the date the landlord informs the tenant of the intended sale. This two-month period can be extended for up to four months if the tenant takes out a loan to finance the acquisition. This pre-emption right for the benefit of the tenant does not apply in the case of an indirect sale of property through a share deal.

Finally, the parties may agree upon a conventional pre-emption right (*droit de préemption conventionnel*), which can be waived when appropriate prior to any real estate sale or purchase.

3.4 Land registration

Any mortgage, lender's legal mortgage or easement created by contract must be registered with the relevant land registry to be binding against third parties.

Nonetheless, registration does not in itself create an absolute and unchallenged right. The land registry that carries out the registration records all information relating to mortgages, charges and encumbrances. Anyone can order a land registry certificate (*état hypothécaire*) at the relevant land registry which includes information relating to all transfers of ownership, the identity of current and past owners, the date of acquisition and price paid, and any easements, encumbrances or charges with respect to any property.



4. Zoning and planning law permits

For the purposes of urban development, zoning and planning are governed by a combination of national and local regulations in France. Whereas most national regulations are contained in the French planning code (*Code de l'urbanisme*), local regulations are mainly prescribed by the relevant municipality and are covered in local development plans (*Plans Locaux d'Urbanisme*).

In practice, public law controls whether a landowner may construct a new building or refurbish an existing building by means of prior planning authorization, usually by a building permit. Other types of authorization may be required, depending on several factors such as the location of the building, its future intended use and the extent of any contemplated works (these can include a declaration of works, an authorization to create commercial space, and an authorization for high rise buildings or premises open to the public, etc.).

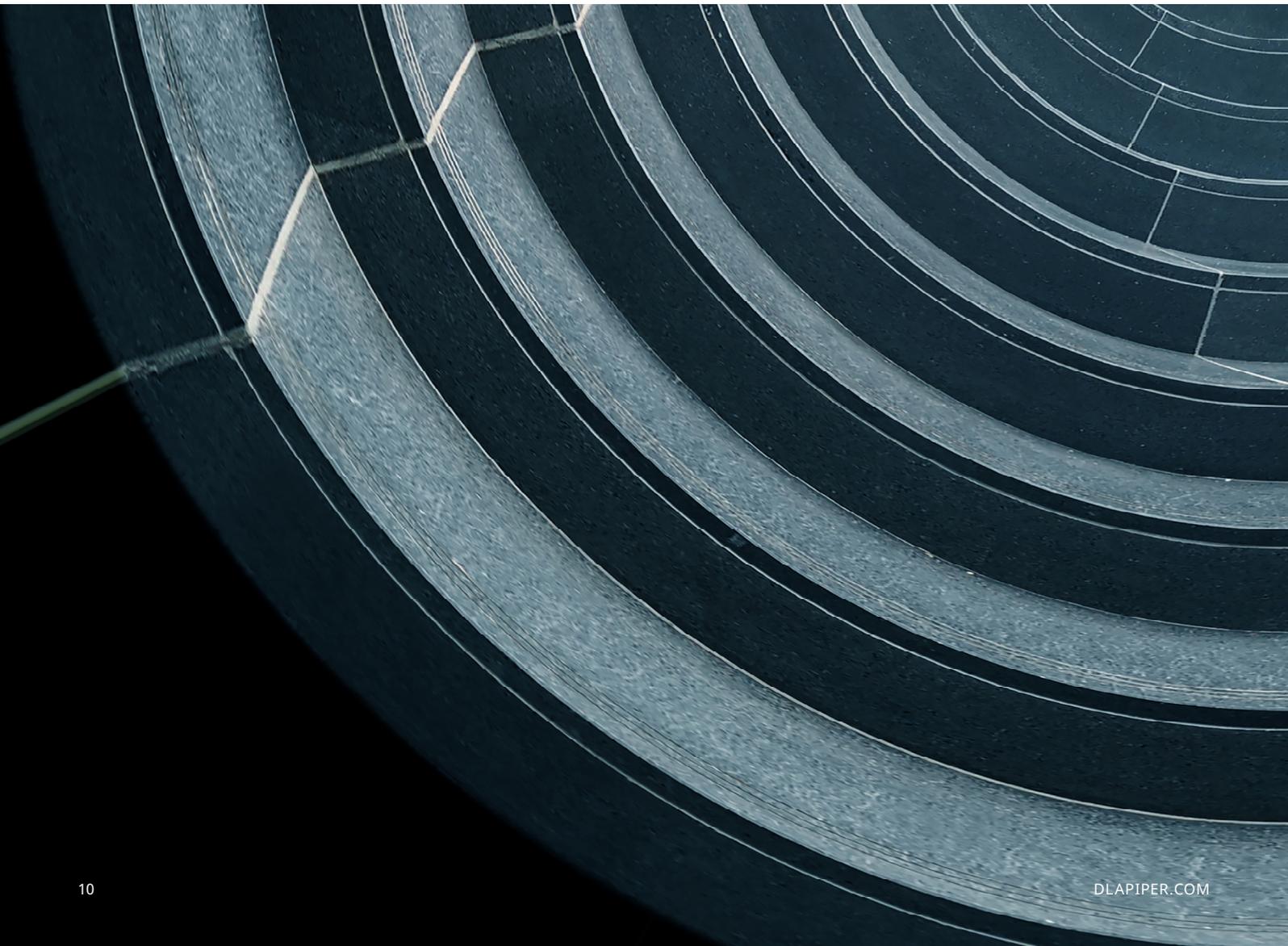
Overall, responsibility for regulating development and the designated use of the land largely lies with local authorities, as the mayor of the municipality is, in almost all cases,

responsible for issuing building permits. As a consequence, the process for obtaining an authorisation generally involves the filing of a building permit application within the municipality where the building is located.

Once granted, the building permit can, for a limited period of time, be withdrawn by the municipality or be challenged either by third parties (such as neighbours) or the Prefect.

Building permits are valid for a period of three years, during which time the works must have started (provided that extensions of time may be granted by the authorities). Furthermore, once started, the works must not cease for any period longer than a year.

Several sanctions may apply if the owner fails to obtain and comply with the required planning authorizations, including injunctions requiring cessation or demolition of the works, criminal law sanctions (fines, and in some cases, imprisonment), connecting the building to public utilities, a prohibition on reconstructing the building in the event of destruction, or a prohibition on obtaining new planning permissions on the site.



5. Environmental liability

When an investor contemplates the purchase of a property, environmental liabilities must be considered. Under French Law, the last person undertaking an industrial activity said “last operator” (i.e., generally the last person holding an operating permit to carry out classified activities for the purposes of environmental protection, ICPE) is liable for any clean-up works even though damage may have been caused at an earlier stage.

Therefore, in the context of an asset deal, environmental liability is automatically transferred to the purchaser provided that it becomes the last operator by maintaining the activity of the previous operator and becoming the last ICPE permit holder. However, if the purchaser does not carry on the same activity, the seller remains the last operator and retains environmental liabilities. In the same manner, there is no impact on the last operator if the property is purchased by means of an acquisition of the shares of the company which owns the land and/or the plant – provided that this company is not also the operator of the site/plant.

Given the above, it is common to undertake environmental due diligence in real estate transactions. However, the scope of these investigations depends on the nature of the target’s activity. The investor should pay particular attention to any historic environmental reports, surveys or audits (including those relating to the presence of asbestos), environmental permits required to operate legally and the seller’s compliance with all applicable environmental laws. In the course of an asset acquisition, such liabilities may be limited by warranties or indemnities granted by the seller in favour of the purchaser.

The transfer of environmental liabilities from the last operator to a third party can be agreed on the parties and, since the ALUR law (law n° 2014-366), such a transfer is enforceable against the competent authorities provided that the conditions of substitution (e.g. the agreement of the Prefect) as defined by the application decree have all been fulfilled. Note that the modalities of such a substitution have been slightly modified since the Law on Green Industry of 23 October 2023.

6. Leases

This guide only covers commercial lease agreements in depth as these are the most commonly used forms in the professional real estate sector, but it should be noted that other kinds of lease agreements are subject to specific regulations (e.g. civil leases, professional leases, residential leases, short-term leases, and precarious leases).

6.1 Negotiations

Since the Contract Law Reform, the articles 1112 of the French Civil Code expressly provides that the initiative, conduct and breakdown of pre-contractual negotiations are free but shall necessarily take place in good faith. This obligation to negotiate in good faith strengthened the pre-contractual duty to inform and disclose any information which is significant in determining in the other party's consent.

The Contract Law Reform also defines the concept of standard-form contract (*contrat d'adhésion*) as a commercial lease including a set of non-negotiable clauses determined in advance by one of the parties (e.g., investor leases in shopping center). In accordance with the article 1171 of the French Civil Code, in the event where a standard-form contract is used, any non-negotiable clause, determined in advance by one of the parties, which creates a significant imbalance between the rights and obligations of the parties shall be deemed not to be written (and therefore will have no effect).

Furthermore, it shall be noted that the Contract Law Reform introduced a specific obligation to comply with confidentiality during the negotiations. The current practice of drafting specific confidentiality agreements will likely continue since the new provisions do not expressly define the confidential information nor the duration of such obligation.

6.2 Duration

A commercial lease cannot be granted for a period of less than nine (9) years but there is no legal restriction as to its maximum duration. However, any commercial lease with a duration exceeding twelve (12) years is subject to mandatory registration with the land registry (insofar as it is deemed to grant an *in rem* right). This mandatory registration triggers land registry tax and notary's fees, to be borne by the tenant (it being specified that the landlord is, however, jointly liable for the payment of such tax), equal to approximately 0.715% of the total amount of the rent and service charges due over the whole duration of the lease (within the limit of 20 years).

Notwithstanding this, it is possible to enter into a short-term lease (or successive short-term leases) for a maximum cumulative period of 36 months which will not be subject to the French commercial lease regime.

Under a commercial lease, the tenant benefits from a right to terminate the lease at the end of each three-year period by serving six months prior notice (served by a bailiff or by registered letter with acknowledgement of receipt) although that the parties are to some extent free to negotiate a period that is longer than six months. This termination right can be waived for a lease: of premises for exclusive office use, of the premises suitable only for the carrying out of a specific business activity due to their particular layout (*locaux monovalents*), of storage premises, with a duration exceeding nine years.

6.3 Rent

The parties are free to fix the initial rent, which generally corresponds to the market rental value, before the execution of the lease. The parties may decide to set and/or index the initial rent at the lease start date when that date is significantly later than the execution date (e.g., especially for leases on premises under construction).

Variable rents are not usual in leases relating to office premises but constitute a common feature of leases relating to hotel and retail premises. Such variable rents commonly comprise both a variable portion based on a percentage of the tenant's annual turnover and a fixed portion that corresponds to a guaranteed minimum rent.

Should the landlord opt for VAT (this option is made by letter filed with the French Tax Authorities), the rent will be subject to VAT (at the then applicable rate, currently 20%). Should the lease not be subject to VAT and should the asset be completed for more than 15 years, the rent will be subject to rental income tax (*Contribution sur les Revenus Locatifs/CRL*) currently amounting to 2.5% of the rent.

6.4 Rent review

The parties are free to provide for an automatic annual indexation of the rent in line with the variation in an index which depends on the nature of the activity operated by the tenant in the premises. This index is usually one of the Tertiary Activities Rent Index (*Indice des Loyers des Activités Tertiaires/ILAT*), the Construction Costs Index (*Indice du Coût de la Construction/ICC*) or the Commercial rent Index (*Indice des Loyers Commerciaux/ILC*), published by the INSEE (the French state Statistical Institute).

In theory, the rent could go up and down depending on the movement in the index. However, in the context of investor-type leases, landlords endeavour to guarantee that rent can only increase with a floored indexation clause. During the past decade, it has also become market practice for tenants to demand that the risks of highly variable upwards movements in the index are limited and

thus to negotiate capped indexations. Such provisions circumscribing the natural variations of the index have given rise to important case law in the last few years, some of which has challenged successfully the validity of such tailored indexation clauses.

In addition to contractual indexation of the rent, statutory rent review includes the three-year rent revision (*révision triennale*) governed by article L.145-38 of the French Commercial Code (which is generally inapplicable if the lease contains an annual indexation clause) and a legal revision of the rent upwards or downwards at market value should the successive annual indexation result in a change of 25% or more in the rent compared with the initial rent or the last reviewed rent (article L.145-39 of the French Commercial Code).

In addition, rent at lease renewal is also regulated if the French commercial lease regime applies, but these regulations are not mandatory and can be waived by the parties. Thus, the parties are free to determine the rules governing the setting of the renewed rent (by reference to the market rental value, specific cap, or minimum amount etc.) in the initial lease.

6.5 Operating expenses, tax and service charges

If there are several tenants, costs and charges incurred by and/or relating to common areas, equipment or services are usually allocated on a pro rata basis determined with regard to the aggregate area of the building and the area leased to the relevant tenant. If there are vacant premises, the costs and charges incurred by and/or relating to the common parts, facilities or services will be borne by the owners in proportion to the total area of the building and the vacant area. Since the Pinel law (law n° 2014-626) enacted on 18 June 2014, major works listed under article 606 of the French Civil Code and all fees incurred by such works are not rechargeable to tenants and are to be borne by the landlord exclusively. However, should part of these works be classified as improvements, the part of the cost exceeding the basic cost of replacement can be recharged to tenants.

Land tax¹ and insurance premiums relating to the building may contractually be recharged to the tenant subject to any express provision in the lease. Rental management fees relating to the premises or the building are no longer legally rechargeable to the tenant.

The provisions of the lease relating to service charges and taxes to be borne by the tenant must be very clear, otherwise the courts will construe the provision in the tenant's favour. Since enactment of the Pinel law, an inventory of the charges, taxes and contributions to be borne by the tenant must be provided in the lease; this inventory usually takes the form of a specific appendix.

6.6 Alterations

Since enactment of the Pinel law (law n° 2014-626), works impacting on the structure of the property (walls, floors and roof), altering the premises' character or permitted use are usually only permitted with the landlord's prior approval.

6.7 Maintenance, repair and renovation at end of lease

Maintenance and repair works are usually borne by the tenant whereas structural works listed under article 606 of the French Civil Code are borne by the landlord since the enactment of the Pinel law (law n° 2014-626).

The liability for the works required by the administration (e.g. municipality, prefecture) can be contractually transferred to the tenant except if such conformity works relates to structural works listed under article 606 of the French Civil Code.

Leases usually provide that, on expiry, any improvements made by the tenant automatically become the property of the landlord without compensation being payable, unless the latter requests that the premises are returned to their original state.

6.8 Hardship

As one of the main innovations, the Contract Law Reform introduced the concept of hardship (*imprévision*) in the article 1195 of the French Civil Code, a doctrine that French courts have long been rejecting.

In accordance with this concept, where a change in circumstances, unforeseeable at the time of the conclusion of the contract, makes the performance of the contract excessively onerous for a party who had not accepted to bear the risk, such party may apply to the contracting party to re-negotiate the contract. Should the other party refuse to renegotiate the contract or if renegotiation fails, a party can ask to the court to amend the contract or terminate it.

However, this provision is not mandatory. Therefore, the contracting parties may expressly derogate from it or contractually define the applicable criteria (e.g. definition of unforeseeable circumstances).

6.9 Assignments/transfers

Any lease assignment to a third party is strictly prohibited or requires the landlord's prior written consent except when this assignment relates to a sale of the tenant's ongoing business (*fonds de commerce*).

¹ A law proposal provides that only 50% of the land tax can be recharged to the tenant. The law is yet to be discussed by the parliament.

6.10 Subleases

Unless otherwise provided, sub-letting is not permitted. Where sub-letting is authorized (either in the lease or at any point following a request by the tenant), the tenant must comply with a specific procedure set out in article L. 145-31 of the French Commercial Code (requiring prior approval by the landlord and an opportunity for the landlord to be party to the sublease).

6.11 Termination

The French commercial lease regime gives the tenant security of tenure at the premises, i.e. the tenant benefits in principle from a right to renew its lease (subject to specific conditions).

If the tenant wishes to renew the lease and has not received a termination notice from the landlord including a refusal to renew, they may apply for a renewal within the six-month period preceding the expiry or at any time during the lease extension.

Should the landlord refuse to renew the lease, it must pay compensation to the tenant (*indemnité d'éviction*) unless its refusal is based on the following grounds: serious and legitimate reasons (usually a default by the tenant under the lease); certain other circumstances provided by law.

6.12 Unilateral remedies

In addition to the right to unilaterally terminate the contract, the provisions arising out of the Contract Law Reform allow the non-breaching party to suspend the performance of its own obligation in advance of a breach by the other party should the performance default be obvious (*manifeste*), sufficiently serious, and notified as soon as possible by the non-breaching party (*exception d'inexécution*).

6.13 Interrogatory actions

Since the Contract Law Reform, three interrogatory actions (*actions interrogatoires*) have been created relating to nullity of a contract, prior undertaking to sell, and to the scope of the representative's authority.

The purpose of those actions is to enable a party to put an end to an ambiguous situation by forcing the other party to take position within a six-month period as from the application to either confirm the contract or take legal action (e.g. for nullity of the contract).

In practice, such actions may be helpful where there are uncertainties in the relationships between the parties (for instance, with respect to indexation clause).

6.14 Sale of leased property

In principle, the landlord is free to sell the leased premises. Such a sale will not affect the lease, and the tenant will become liable to the new landlord for compliance with the terms of the lease.

Since the enactment of the Pinel law (law n° 2014-626), the tenant benefits from a pre-emption right in the event of a sale of the rented premises in which the business (either a retail operation or a craft business) is carried on.



7. Tax

The acquisition and use of real estate in France involves complex tax considerations giving rise to unavoidable costs. Among the applicable taxes, the transfer of a French property is normally subject to indirect taxation which includes registration duties and/or value added tax.

7.1 Value added tax and registration duties

All operations (i.e. contributions or sales) carried out in relation to real estate in the course of an economic activity by a VAT taxable person (legal entity or individual) are mandatorily subject to the standard VAT rules to the extent that they are related to new buildings (i.e. completed or renovated less than five years ago) and comparable property rights or building sites. Other operations are exempt from VAT but can be subject to VAT upon election.

The following rules apply to transactions entered into by a French SPV (registered for French VAT or not registered for French VAT) as buyer and a seller registered for VAT:

- (a) Transactions involving unbuildable/ undevelopable land are exempt from VAT (unless an election for VAT to be payable is filed in which case the VAT is due on the total purchase price) and are subject to transfer tax at a rate between 5.09% and 6.32%, depending on location of the land.

Transactions involving developable land are subject to VAT on the total price where VAT on the acquisition cost was deducted when the land was acquired by the seller and are subject to transfer tax at a rate of 0.715%. Where VAT on the acquisition cost was not deducted when the land was acquired by the seller VAT is payable by the seller on the capital gain realized. In addition, transfer tax is payable at a rate between 5.09% and 6.32%, depending on the location of the relevant property.

- (b) Transactions involving new buildings for VAT purposes, including transactions involving a new property known as a sale before completion, are subject to VAT on the total purchase price and to transfer tax at 0.715%.
- (c) Transactions involving other properties (i.e. building completed more than five years ago) are exempt from VAT and are subject to transfer tax at a rate between 5.09% and 6.92%, depending on the type and location of the relevant property.
- (d) Moreover, transactions involving real estates or rights on real estates are subject to a real estate security contribution (*contribution de sécurité immobilière*) of 0.10% of the price paid for the real estate or for the rights on real estates.

By exception, in the situations (a), (b) (c) and (d), if the buyer is registered for VAT and commits to re-sell the property within five years, transfer taxes are reduced to 0.715%. Similarly, in situations (b), (c) and (d), if the buyer is registered for VAT and undertakes to develop a building within four years, transfer taxes are limited to EUR125.

Please note that, regardless of the buyer's registration in France for VAT, if the seller is not registered for French VAT, the transaction is not subject to VAT. Transfer taxes are due at the 5.09% to 6.92% normal rates specified above, unless the buyer is indeed registered for French VAT and undertakes either to re-sell or to erect a building (see the specifics above about these undertakings).

The transfer tax regime also differs if the seller is registered for VAT in France, but the buyer is not: in this case, the benefit of the reduced rates of transfer taxes subject to the abovementioned undertakings are not available.

The sale of shares in a company holding real estate (where the value of the real estate represents more than 50% of the company's assets) is subject to a transfer tax of 5% of the price paid for the shares (or fair market value if higher).

Moreover, transactions involving real estates or rights on real estates are subject to a real estate security contribution (*contribution de sécurité immobilière*) of 0.10% of the price paid for the real estate or for the rights on real estates.

Registration duties are generally payable by the purchaser (unless otherwise agreed in the SPA or the acquisition deed). However, the purchaser and the vendor are jointly liable to the tax authorities for the payment of registration duties. From a practical point of view, the tax authorities only ask the vendor to pay registration duties when the purchaser is insolvent or is located in a foreign country which may result in the tax authorities encountering difficulties in collecting the tax due.

7.2 Other real estate taxes

- Property tax (*taxe foncière*) is payable for the whole calendar year by the owner of a property asset on 1 January of each calendar year. The taxable value is equal to the net cadastral income (*revenu net cadastral*) which is obtained by applying a reduction of 50% (20% for non-developable lands) to the local rental value (*valeur locative cadastrale*) (after updating and upgrading).

The amount of property tax is calculated by applying the rate of the tax set by each local authority to the cadastral income.

- The housing tax (*taxe d'habitation*) is payable by the occupier of property (as of 1 January) or premises used for housing, car parking or for both personal and business purposes. The tax is calculated on the cadastral rental value of the dwelling and outbuildings. The housing tax on the main dwelling has been removed since 1 January 2023 but remains due for secondary dwellings.

If you own a primary or secondary residence, a declaration of occupancy must be made to the tax authorities before 1 July each year, unless there has been no change since the last declaration.

- Tax on offices and premises for commercial, storage and car parking use in the Ile-de-France and the PACA region (*taxe sur les bureaux, les locaux commerciaux, les locaux de stockage et les surfaces de stationnement en Ile-de-France et en région Provence-Alpes-Côte-d'Azur*) is payable (yearly as of 1 January and by 1 March) by the owner of the relevant premises in the Île-de-France (i.e. Paris and the surrounding areas) and, from 1 January 2023, in Provence-Alpes-Côte d'Azur. The tax is equal to the surface area in m² multiplied by a fixed unit rate. A number of exemptions apply.
- Office premises development tax (*Taxe pour création de bureaux, de locaux commerciaux et de stockage en Ile-de-France*) is a specific tax for development of office, commercial and storage premises in Paris area whose rates vary from EUR0 to EUR469.99 per square metre depending on the district the office, commercial or storage premises is located in. This tax has to be paid by the owner of the premises. It is not allowed as a deduction in computing rental income because it is deemed to be part of the acquisition cost of the land (neither deductible nor depreciable).
- Tax on unoccupied premises (*Taxe sur les logements vacants*) is payable by the owner of premises located in municipalities with more than 50,000 inhabitants that have been unoccupied for at least one year (as of 1 January). The tax is calculated on the basis of the rental value of the premises at the rate of 17% in the first year and 34% thereafter.
- Local development tax (*Taxe locale d'aménagement*) is payable in relation to building, rebuilding or extension projects for all types of premises when an administrative approval is required. The tax is calculated by multiplying the taxable value of the property and the rate set by the local, departmental and regional authorities.

- A 3% tax (*Taxe annuelle de 3% sur les immeubles*) applies on the market value of real estate properties (real estate assets or rights such as usufruct, bare ownership, etc.) owned in France, directly or indirectly, by French or non-French entities. Exemptions are available under certain conditions, for:

- (i) sovereign states, public bodies and entities with or without legal personality held for more than 50% by a sovereign state or a public body;
- (ii) for entities where the stocks are admitted to negotiation on a regulated market and are regularly and significantly traded (including their wholly owned subsidiaries);
- (iii) for companies which do not qualify as French real estate companies (i.e. companies where the value of French real assets represents less than 50% of their total French assets; and
- (iv) for certain organizations that are headquartered in France, in the EU or in a country that has concluded a tax treaty or a treaty of reciprocal taxation with France (pension funds and other non-profit organizations, investment funds and companies such as SPPICAVs and REITs, companies whose stake in the underlying French real estate asset is valued at less than EUR100,000 or 5% of the fair market value of the asset and entities that disclose on a yearly basis or undertake to disclose² certain information regarding their ultimate investors and the real estate asset to the French tax authorities, provided for the latter that it complies with the required filing obligations).

7.3 Taxation of income from real estate

Owning a property in France does not itself constitute a permanent establishment.

If a permanent establishment exists or if the property is owned directly by a French corporation, current income is fully taxable in France at the rate of 25% (as of 1 January 2022) on top of which miscellaneous contributions are added which may lead in certain cases to an effective tax rate of up to 25.83%.

The 2025 Finance Law introduced an exceptional contribution on the profits of large companies with at least EUR1 billion in turnover. Initially applicable to financial years ending on or after 31 December 2025, this contribution – calculated on the average corporate tax due – The 2026 Finance Law extended it. However, its scope is narrowed: in 2026, only companies with a turnover of at least EUR1.5 billion will be subject to this surtax, with the threshold assessed solely on the 2026 financial year.

² There is a current law proposal to remove the “commitment to disclose” exemption but such removal is subject to the final adoption of the draft law on the combat against tax and social fraud, which would soon be debated.

If the property is owned by a French transparent entity, the shareholders will be taxed in France on their share of profits.

For direct investment without a permanent establishment, foreign owners are generally subject to French tax on rental income. The same applies to property owned by a transparent entity. Depending on the applicable tax treaty, tax paid in France may generate a tax credit or otherwise be taken into account in the owner's country of residence.

It is normally possible for any interest paid on debt used to finance the acquisition of property to be set off against income generated by the property. There is no mandatory debt to equity ratio (except in the case of loans from related companies) but the tax authorities may disallow interest set off if this exceeds the borrower's repayment capacity.

Moreover, the French Finance Law for 2019 transposing the anti-avoidance Directive (UE/2016/1164) has introduced, as from 1 January 2019, new interest deduction limitations. This text, provides in particular that net financial charges may be deductible up to the higher of the following two amounts:

- (i) EUR3 million; and
- (ii) 30% of the adjusted taxable income, before offsetting of tax losses.

If the owner of the property is a company subject to corporate income tax, depreciation is allowed (on a straight-line basis) on the acquisition value of the buildings but not of the land (generally at rates between 2% and 5% per year for commercial buildings). Accelerated tax depreciation is possible for industrial buildings if their expected lifespan is less than 15 years.

If some elements of the building are expected to have a shorter lifespan than the building as a whole then the depreciation value is broken down into different categories of asset, each with its own depreciation rate.

It should be noted that depreciation on land is not permitted (unless the land contains a quarry in which case the value of materials to be sold after treatment can be depreciated).

7.4 Taxation of dividends from a company owning real estate

As regards individuals, the French Finance Law of 2018 introduced a flat tax (PFU) applicable to capital gains, interests and dividends income. The rate is set to 30% (12.8% of individual income tax and 17.2% of social contributions) and applies to dividends distributed as from 1 January 2018. However, the 2026 Social Security Financing Law increased the CSG rate applicable to dividends by 1.4%, raising the total social contributions from 17.2% to 18.6%, leading to an overall PFU rate of 31.4%.

Previous to the introduction of the PFU, dividends were subject to French individual income tax at a progressive rate, after a flat-rate rebate of 40%. As from 1 January 2018, individual taxpayers may still elect for dividends to be taxed at the progressive income tax rate. However, please note that:

- this election is global for all capital gains, interests and dividend income received within the fiscal year and it is thus not possible to combine the PFU and individual income tax at a progressive rate; and
- when the PFU applies, the 40% rebate as well as the deduction of 6.8% out of the 18.6% social contributions are not applicable.

With respect to non-residents individuals, tax rates depend on the applicable tax treaties.

The French standard withholding tax rate on dividend distributions to non-resident individuals is aligned on the PFU rate (12.8%).

As regards corporate shareholders, dividend paid to companies which are subject to French corporate income tax are in principle included in taxable income.

However, under the French participation exemption regime, 95% of the dividend is tax exempt. The participation exemption is available for dividends received from their resident and non-resident subsidiaries. The parent company may benefit from the participation exemption if the parent company holds a participation in the subsidiary equal to at least 5% of its share capital and has held or commits to holding – the participation for at least two years.

Dividends paid to a transparent entity by a company which is subject to corporate tax are declared at the level of the entity but taxed at the level of the shareholder.

Since 1 January 2022, dividends arising in France distributed to non-resident corporate shareholders or entities are subject to withholding tax in France at the rate of 25%, unless a treaty provides for a lower rate. Please note that the rate of such withholding tax is aligned on the corporate income tax rate.

The withholding tax is reduced to nil for dividends paid by a French resident company to a qualifying EU parent company if the parent company holds at least a 10% participation in the French subsidiary for at least two years.

In all cases, dividends paid on a bank account located in a Non-Cooperative State or paid or accrued to persons established or domiciled in such a Non-Cooperative State are subject to a 75% withholding tax in France.

7.5 Taxation of capital gains on sale of real estate

Capital gains on the disposal of real estate assets located in France are subject to French capital gains tax.

a) For real estate assets held by foreign investors directly without a permanent residence in France (subject to tax treaty exemptions):

Gains (other than usual profits derived by asset dealers) on the sale of a French property by a non-resident company are subject to a 25% tax in France (for corporate taxpayers whose turnover exceeds EUR7,630,000 and are thus subject to the social contribution to corporate income tax, the effective tax rate of 25.83%).

Gains on the sale of a property by a foreign individual are subject to a 19% tax, plus 17.2% of social contributions, leading to a taxation at a total of 36.2%. Allowances increasing with the holding period can be deducted from the taxable gain, leading to a full exemption of individual income tax after 22 years of holding and social contributions after 30 years of holding. In case of capital gain exceeding EUR50,000, a surtax of max. 6% may also apply. Such surtax applies indifferently on real estate rights or assets other than building lands.

b) For real estate assets held by foreign investors through a permanent establishment in France:

Capital gains realized on the sale of French real estate assets by a French permanent establishment are subject to corporate income tax at the rate of 25.00% on top of which miscellaneous contributions are added which may lead in certain cases to an effective tax rate of up to 25.83%.

It shall be noted that in case of sale of an asset by a foreign non-EU company, a tax representative will have to be appointed and will guarantee the tax authority payment of any further withholding tax which may be due. This representative could either be the purchaser if they are a French resident or more likely any other institution approved by the tax authorities.

7.6 Taxation of capital gains from the disposal of shares in a company owning real estate

In the case of a sale of the shares in a real estate company, the taxable profit is equal to the difference between the sale price and the purchase price of the shares.

Subject to tax treaties, capital gains upon the sale of real estate shares by local and foreign companies are taxed at 25%, which is the standard corporate income tax plus a 0.83% social surcharge for companies whose global corporate income tax exceeds EUR7,630,000, leading to an overall effective corporate tax of 25.83%.

However, capital gains made by corporate shareholders located in the EEA upon the sale of listed real estate shares are taxed at a reduced corporate tax rate of 19% where the shares are held for at least two years (*régime des plus-values professionnelles*).

Gains on the disposal of shares in a company owning real estate by a foreign individual are subject to a 19% tax, plus 17.2% social taxes, leading to a total taxation at 36.2%. Allowances increasing with the holding period can be deducted from the taxable gain, leading to a full exemption of individual income tax after 22 years of holding and social contributions after 30 years of holding. In case of capital gain exceeding EUR50,000, a surtax of max. 6% may also apply.

7.7 Real estate collective investment vehicles

A specific tax regime applies to listed real estate companies (*sociétés d'investissement immobiliers côtées*) or to the collective investment scheme known as an OPCI (*organisme de placement collectif en immobilier*) which can have the form of *Fonds de Placement Immobilier*, having no legal personality (tax transparency) or *Société de Placement à Prépondérance Immobilière à capital variable* (SPPICAV), which is more commonly used and which has a legal personality.

At least 60% of the assets of a SPPICAV must consist of eligible real estate assets.

SPPICAVs are expressly exempt from corporate income tax and investors of such vehicles are only taxed on the distributions received from the SPPICAV or gains in respect of its shares. However, SPPICAVs are not subject to corporate income tax provided that they comply with the conditions set out in the approval from the AMF (French securities and markets authority) authorizing the setting up of the SPPICAV and with legal distributions obligations. Indeed, under the French regulation, in consideration of the SPPICAV's corporate income tax exemption, the company is required to distribute significant part of the net income and net capital gains realized.

7.8 Replacement of the wealth tax (ISF) with real estate wealth tax (IFI)

The Finance Law for 2018 provided that ISF is repealed and replaced, with effect from 1 January 2018, by a new real estate wealth tax (IFI). IFI is assessed on the real estate owned by individual taxpayers to the extent that the value of the taxpayer's real estate net assets exceeds EUR1.3 million.

The definition of taxpayers, the triggering event as well as the tax threshold and the tax scale as regards IFI are similar to those that were applicable to the previous wealth tax.

The main change concerns the IFI's tax base, which is defined as all the real estate owned directly or indirectly by the taxpayer via companies or collective investment vehicles when it is not allocated to the business of the relevant entities. Taxation is not limited to shares in real estate companies.

Measures are designated to exclude from the taxable fraction, on the one hand, professional real estate owned by companies and, on the other hand, real estate held by taxpayers through operating companies in which their shareholding is less than 10%. Tax-exempt status may be granted to taxpayers holding less than 10% interest in non-operating companies if they establish that they are not in a position to obtain the information necessary for the assessment of the taxable portion of their shares. A similar exclusion applies in the case of holding less than 10% of the rights in an investment fund or in a collective investment vehicle, provided that these funds hold (directly or indirectly) less than 20% of their assets in property and real estate rights taxable to the IFI. Finally, goods of a professional nature are, under certain conditions, also excluded from the IFI's tax base.

The French law sets out the list of deductible debts (in particular, expenditure on the acquisition of taxable property or real estate rights and shares, in proportion to the value of taxable real estate assets) and provides for a deduction cap for large heritage assets. The Finance Law for 2024 specified that, for the purposes of valuing real estate company shares, no account should be taken of debts that are not related to a taxable real estate asset. French law also lays down special deduction rules for "in fine" loans designed to take account of theoretical amortization. An anti-abuse clause is also provided for the deduction of intra-group loans limiting the deduction of the debt, except in the event that the borrower is able to justify the normal nature of the loan terms and conditions (i.e. on an arm's length basis), in particular compliance with due dates, the amount and the actual effectiveness of repayments.

In this respect, it should be noted that the provisions exempting financial investments of non-residents from ISF have been repealed, so that, subject to tax treaties, non-residents holding corporate securities will henceforth be liable to the IFI for the part of the value of such shares corresponding to real estate, whereas they were previously subject to ISF only on shares in real estate companies and shares in companies held more than 50% by the family group.

8. Real estate finance

Acquisitions of commercial real estate in France are commonly financed through a combination of equity and quasi-equity, and senior debt in the form of a loan or sometimes bonds, which may be completed with junior (subordinated) debt depending on the risk profile of the transaction, the size of the portfolio and the required loan-to-value ratio.

8.1 Assets held as security

For the financing and refinancing of the acquisition and/or development of real property, lenders are commonly granted security interests over the property. Such security interests are considered as providing the highest protection. They can consist of either a lender's legal mortgage or, more frequently, a mortgage as referred to in section 3.2 above.

A lender's legal mortgage (*Hypothèque légale de prêteur de deniers - PPD*) has a more restricted scope than a mortgage, as it can only secure the reimbursement of sums due under a loan used, in whole or in part, to finance the acquisition of real estate assets. Money used for other purposes, such as the financing of capex works, is not covered. The lender's legal mortgage must be registered and will rank as from the registration.

However, a lender's legal mortgage carries a financial advantage for lenders. Unlike a mortgage, it is exempt from land publicity tax (see section 8.5 below).

8.2 Other collateral agreements

Lenders can be granted security interests over other type of assets.

Receivables from third parties (rents, insurance proceeds, VAT, or sums due under intercompany loans or hedging agreements) can also be used as collateral. The most effective security interest over receivables is the *Daily assignment (cession Dailly)* as it temporarily transfers the ownership of the receivable as from the date mentioned on the statement of assignment (*bordereau Dailly*), until the reimbursement of the sums due. Therefore, a *Daily assignment* is not affected by the opening of insolvency proceedings after that date. However, its scope is limited: a company can only assign its professional receivables to a credit institution.

Another option is a pledge over receivables, which can be used for non-professional receivables or be granted to lenders which are credit institutions. Like a *Daily assignment*, a pledge does not need to be notified to be enforced against third parties. However, the borrower is entitled to receive the payments until there has been a notification. A pledge can provide for automatic enforcement provisions (*pacte commissaire*), which allows the transfer of ownership to the lenders without judicial intervention.

The loan can be secured by a pledge over the shares. Depending on the form of the company, the pledge may be a *nantissement des parts sociales* (for partnerships *sociétés en nom collectif* or civil real estate companies *sociétés civiles immobilières*) or a *nantissement de compte-titres* (for limited liability companies (e.g. *sociétés anonymes, sociétés par actions simplifiées*). In the latter case, the pledge is granted over the financial instruments account held by the shareholder.

A lender may also ask to receive a pledge over the bank accounts held by the borrower (*nantissement de comptes bancaires*). The amount standing to the credit of such bank accounts are pledged in the lenders' favor. The loan agreement can provide that, in the absence of default, the excess cash be used by the borrower freely.

8.3 Limitation on the creation of security

Financial assistance rules and corporate interest rules must be complied with before a corporate entity can give valid security over its real estate assets.

To be valid, the security interests must be granted in accordance with the corporate interest of the grantor, a concept which is quite narrowly defined. This principle limits the ability of French companies to give upstream guarantees or guarantees to affiliated companies. An upstream guarantee may give rise to management liability if it is considered to be a misappropriation or misuse of the subsidiary guarantor's corporate assets or credit (*abus de biens sociaux*).

The French Commercial Code prohibits a target company from granting advances, loans or any security in connection with the subscription or purchase of its own shares by a third party. This prohibition applies to limited liability companies (e.g. *sociétés anonymes, sociétés par actions simplifiées*) and does not apply to partnerships or civil real estate companies (e.g. *Sociétés en Nom Collectif, Sociétés Civiles, Sociétés Civiles Immobilières*). This prohibition is subject to criminal and civil sanctions.

8.4 Interest rate risks

The interest rate applied to the loan can be a fixed rate, but the most common type is the floating rate. The floating rate will be calculated by the bank according to the cost of liquidity (usually the EURIBOR rate) and the credit risk (expressed by the margin).

In order to prevent the risk of rising interest rates, a hedging agreement is usually entered into. The hedging bank can either be a lender or a third-party bank. The most common types of hedging are caps or swaps. Caps are purchased for a premium and provide the purchaser an interest rate ceiling (cap or strike rate) on interest payments on floating rate loans. If the floating rate exceeds the strike, the hedging bank

pays the difference. Swaps, which are suitable for long-term loans, allow the interest rate to be in effect changed from a fixed rate to a floating rate (or vice versa) or from one floating rate to another.

Under French law, it is mandatory to set out the global effective interest rate (*Taux Effectif Global*) in all written agreements. The absence of the required provisions or a miscalculation of such rate in loans agreements may result in the deprivation of the right to interest in the proportion determined by the judge, taking into account the damage caused to the borrower.

8.5 Taxation on the creation of security

Costs relating to the creation of security interests include the public notary's proportional fees, which are based on a sliding scale.

These costs depend on the type of security granted, for which the mortgage and lender's legal mortgage differ, and are similar, as follows:

Registration fees

Mortgage: 0.715% of (the amount of receivable + additional costs (usually between 5% and 20% of the amount of receivable)) **Lender's legal mortgage:** between EURO and EUR25.

Notary's emoluments 0.45375% of the amount of receivable + VAT (20%) on that amount.

Real estate security contribution 0.05% of the amount of receivable.

8.6 Security agent reform

The security agent directly holds the security interests and acts in its own name on behalf of the secured creditors. The security agent can also register, manage, and enforce the security interests in its own name.

The rights and assets granted to the security agent, and the proceeds of enforcement of the security interests, are separated from the security agent's own assets. The assets acquired in the exercise of its mission can only be seized by the beneficiaries of the related security interests. Such assets are not affected by the opening of insolvency proceedings against the security agent.

8.7 Reform of the French security law

A French security interests law reform has been introduced pursuant to the ordinance n°2021-1192 dated 15 September 2021 which came into force on 1 January 2022 (the "*Reform*"). The Reform has an impact (mainly technical and from a drafting perspective) on the security package described above such as modifications regarding personal guarantees and mortgage security and creation of a new civil assignment of receivables by way of security as an alternative to the Dailly assignment by way of security.

8.8 Enforcement of security

The secured creditor can enforce the mortgage following three different ways:

- (a) The beneficiary of a mortgage may apply to the court for an order to seize the property (*commandement aux fins de saisie*) to be served on the debtor by a bailiff (*commissaire de justice*). Following the proceedings, the property is sold by way of a public auction at a hearing before a civil court (*Tribunal Judiciaire*), where bidders must be represented by an attorney at law and where the lawyer of the creditor may not bid.
- (b) The beneficiary of a mortgage may also apply to the court for the attribution by court order of the property to the beneficiary of the mortgage, in accordance with the *attribution judiciaire* procedure pursuant to article 2454 of the French Civil Code. This option is not available to the creditor if the property is the main residence of the debtor.
- (c) Pursuant to the French Civil Code, it may be agreed in the mortgage deed that the creditor is to become the owner of the mortgaged property (*pacte comissoire*).

In the event that (i) the loan agreement has not been contracted in the form of a notarial deed executed in front of a French notary or (ii) the notary mortgage deed does not reiterate the existence of the obligation to pay, the mortgage is not enforceable immediately and the beneficiary of the mortgage will have to go to court to have the existence of its claim recognized. The court order will be notified by bailiff to the borrower.

Such procedure:

- will be in addition to the non-insolvency procedures;
- is lengthy; and
- requires the payment of lawyers' fees, bailiff's fees and other costs.

Glossary

TERM	EQUIVALENT
Bail à construction	Construction lease
Bail emphythéotique	Long term lease
Copropriété	Condominium
Déclaration d'Intention d'Aliéner, DIA	Declaration of intent to sell
Diagnostic de performance énergétique, DPE	Energy performance diagnosis
Etat des Risques et Pollutions, ERP	Statement on risks and pollutions
Hypothèque conventionnelle/ hypothèque légale de prêteur de deniers – PPD	Mortgage/Lender's legal mortgage
Indemnité d'éviction	Eviction indemnity to be paid to the tenant should the landlord refuse to renew the lease
Etat hypothécaire	Land registry certificate
Nue-Propriété	Bare ownership
Fonds de commerce	Going concern
Pacte de préférence	Prior undertaking to sell
Pleine Propriété	Freehold ownership
Promesse unilatérale de vente	Preliminary agreement with a call option
Promesse synallagmatique de vente	Bilateral undertaking to sell and purchase
Service de Publicité Foncière	Land Registry
Servitudes d'utilité publique	Easements for public use
Usufruit	Usufruct
Vices cachés	Hidden defects

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In short, we are one team, no borders, providing a real advantage to clients in France and beyond.

This guide was written predominantly by Myriam Mejdoubi and Gabriel Dalarun of our Real Estate practice group.

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