

# Commercial real estate in Japan: overview

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## THE CORPORATE REAL ESTATE MARKET

### 1. What have been the main trends in the real estate market in your jurisdiction over the last 12 months? What have been the most significant deals?

2014 was an active year, with increasing deal flow and interest from foreign investors growing towards the end of the year. A consumption tax rise in April 2014 tipped the economy back into recession. However, the Prime Minister, Shinzo Abe was still able to easily win his re-election in December 2014. This helped to ensure the continuation of his plan for Abenomics (the stimulus program to boost the economy, which includes aggressive monetary easing).

The following have contributed to Tokyo being named as the top Asian city for real estate investment in many investor surveys:

- The yen's depreciation of nearly 15% against the dollar in 2014.
- An attractive spread between property yields and financing costs.
- Signs of the return of rising rents after many years of rent declines.

JREITs continue to be active purchasers of commercial real estate.

### Real estate transactions

Recent major real estate transactions include:

- Mizuho Bank acquired a 30% ownership of Otemachi Tower for reportedly JPY178.2 billion from Tokyo Tatemono Co. Ltd.
- Mori Trust Co Ltd. acquired Meguro Gajoen, a complex of office, retail and hotel facilities for reportedly JPY130 billion from Lone Star.
- GIC acquired the office component of Pacific Century Place Marunouchi in Tokyo for reportedly JPY170 billion from Secured Capital.
- Funds affiliated with Blackstone Real Estate Partners Asia make an investment in connection with an agreement to acquire GE Japan Corporation's owned residential real estate business of approximately 200 residential properties for reportedly over JPY190 billion.

### J-REITs

Initial public offerings and follow-on offerings completed in 2014 include Hulic Reit, Inc., Invesco Office J-REIT, Inc., Tosei Reit Investment Corporation, Sekisui House Reit, Inc., Mori Hills REIT Investment Corporation, and Invincible Investment Corporation. The Bank of Japan continued its acquisition of J-REIT shares as part of its programme of monetary easing and supporting the stock market.

## REAL ESTATE INVESTMENT

### 2. What structures do investors typically use for real estate investment in your jurisdiction and what are the main advantages and disadvantages of each (for example, flexibility and tax transparency)?

There are two structures commonly used for private real estate transactions in Japan: the GK-TK Structure and the TMK Structure.

#### GK- TK Structure

A TK is a contractual arrangement under which one or more silent investors (TK investors or *tokumei-kumiai-in*) makes a contribution into an operating company (the TK operator or *eigyosha*) in return for a share in the profit/loss of a specified business conducted by the TK operator (TK business). The TK operator is effectively a pass-through vehicle as it receives a pre-tax deduction for income allocated to each TK investor.

The TK operator, rather than the TK investor, holds title to the assets that are the subject of the TK business. The investment by the TK investor does not represent equity in the TK operator, nor does the TK investor gain any ownership interest in the underlying assets of the TK operator. Further, the TK investor is not permitted to participate in the management or operation of the TK business, but is intended to take a passive investment role.

In real estate transactions, the entity used for the role of TK operator is usually a Japan *godo kaisha*. Further, the TK investment in real estate normally takes a form of trust structure, since if the TK operator acquires a fee simple interest instead of a trust beneficiary interest (TBI) in real estate, the TK operator is required to be licensed under the Real Estate Specified Syndication Law (Fudosan Tokutei Kyodo Jigyo Ho, Law No. 77 of 1994, as amended (Syndication Law) subject to limited exceptions. Recent amendments to the Syndication Law allow an SPC (like a GK which acts as TK operator) to acquire and own real estate if the GK retains a licensed real estate syndication business operator pursuant to the Syndication Law provided that the TK Investors are "special investors" that includes a foreign corporation (but not a partnership).

A TK is a collective investment scheme and therefore must comply with the registration requirements applicable to its self-offering and self-investment management activities under the Financial Instruments and Exchange Law unless an exemption is available.

If a TK investor were to participate in the management of the TK operator's business, the TK could be recharacterised as a Japanese general partnership (*nin' i kumiai*) with respect to the TK investor, which could have both negative tax and legal implications:

- From a tax perspective, a non-resident TK investor would risk being deemed to have a permanent establishment in Japan and

subject to full national and local taxes rather than a lower rate typically received by non-resident TK Investors under applicable treaties.

- From a legal perspective, if the TK is deemed to be a general partnership, the TK investor may become subject to unlimited liability for the debts and obligations of the TK operator.

### TMK Structure

A TMK is a special purpose corporation created to securitise assets using asset-backed securities. A TMK is subject to tax on its taxable income at the entity level at the full Japan income tax rate of about 36%, but it may deduct dividend payments to investors from its current taxable income if certain statutory and tax requirements are satisfied, including the following:

- The TMK must be registered under the Law Relating to Securitisation of Assets (Law No. 105 of 1998, as amended) (TMK Law).
- The TMK must conduct its asset securitisation business and acquire assets in accordance with an asset liquidation plan. The asset liquidation plan:
  - delineates the TMK's capital structure, assets to be acquired, the term of the TMK, plans for managing and disposing of the TMK's assets, the issuance of any asset-backed securities (TMK preferred shares or bonds) and any borrowings to be made by the TMK; and
- is filed with the Kanto Local Finance Bureau (KLFB) or other applicable local finance bureau of the Ministry of Finance, which acts on behalf of the Financial Services Agency.
- The method of raising financing must meet one of the following conditions:
  - the TMK issues specified bonds in the amount of at least JPY100 million through a public offering or an offering to only qualified institutional investors (QIIs) that satisfies special requirements under the tax laws (Tax QIIs); or
  - the TMK issues preferred shares to 50 or more investors in a public offering or only Tax QIIs.
- The TMK must issue more than 50% of common shares or preferred shares within Japan.
- The TMK's fiscal year cannot exceed one year.
- The TMK must not be a closely held company within the meaning of the Corporate Tax Law, except in cases where the conditions in the sixth bullet point above are satisfied.
- At least 90% of the TMK's distributable income for each fiscal year must be paid out as dividends to equity holders.
- The TMK must delegate the management of its assets to a third party or enter into a trust agreement with a third party trustee.
- If the TMK borrows funds from financial institutions, they must be Tax QIIs and cannot be common shareholders of the TMK.

Unlike with a TK investment, the investors in a TMK can have control of the investment decisions regarding the real estate.

Each TMK must file an asset liquidation plan. Due to recent legal changes providing more flexibility, it is now possible for a TMK to add additional TBIs to an asset liquidation plan. However, due to certain regulatory requirements it is still difficult to add new real properties to an asset liquidation plan, therefore a single TMK is considered not suitable for an ongoing acquisition and warehousing facility for real properties. As many real estate transactions in Japan involve acquisition of a TBI rather than the real estate itself, this limitation can often be managed by investors.

### REITs

The J-REIT (Japanese real estate investment trust) generally refers to a financial product using a vehicle formed or incorporated pursuant to the Investment Trusts and Investment Corporation Law (ITICL) with certain preferential treatments in respect of taxation granted to the investors. While the ITICL makes a trust-type investment fund available for purposes of J-REITs, J-REITs are, in practice, all formed as an investment corporation.

While a J-REIT is subject to tax on its taxable income at the entity level at the full Japan income tax rate of about 36%, it can deduct dividend payments to investors from its current taxable income if certain statutory and tax requirements are satisfied, which are similar to TMK taxation (*see above, TMK Structure*).

### 3. What are the main sources of finance and types of investors for real estate investment in your jurisdiction? Does your government encourage overseas investment into real estate in your jurisdiction, for example through real estate investment legislation?

Institutional investors are involved in the market in a number of roles. They invest in fee properties directly, indirectly invest as equity investors, or invest as lenders.

Private investors also play any number of roles in the market. Private investors tend to invest more in fee properties as compared to institutional investors, who tend to acquire properties in trust rather than in fee. The asset size of transactions involving private investors are generally smaller and often do not justify the costs and fees necessary to pay a trustee when an asset is entrusted in a trust structure. Private investors also participate in J-REITs.

The Financial Services Agency (FSA) oversees private financial institutions and transaction of securities including TBIs ([www.fsa.go.jp/en/index.html](http://www.fsa.go.jp/en/index.html)).

The Real Estate Companies Association of Japan contributes to the development of the real estate system, and proposes real estate legislation to the government ([www.fdk.or.jp/en/index.html](http://www.fdk.or.jp/en/index.html)).

### Restrictions on foreign ownership or occupation

### 4. Are there restrictions on foreign ownership or occupation of real estate, or on foreign guarantees or security for ownership or occupation?

There are no restrictions on foreign ownership or occupation of real estate, or on foreign guarantees or security for ownership or occupation.

### TITLE TO REAL ESTATE

### 5. What constitutes real estate in your jurisdiction? Is land and any buildings on it (owned by the same entity) registered together in the same title, or do they have separate titles set out in different registers?

Real estate consists of land and anything attached to the land on a continuous basis, such as buildings and timber. Land and buildings can be owned independently from one another and are separately registered. If a building owner does not hold title to the land, it must ensure that it has a right to access the relevant land, such as by way of leasehold and surface rights.

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**6. How is title to real estate evidenced? What is the name of the public register of title and the authorities responsible for managing it? Is electronic access and electronic conveyancing available?**

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Title to real estate is evidenced by a real estate registry (*fudosan toukibo*) in one of 50 Legal Affairs Bureaus in Japan. These are local organisations under the Ministry of Justice, each of which manages its own real estate registry with respect to real estate located in its region.

In Japan, title to real estate can be transferred by an agreement between a transferor and a transferee and no formalities are required. However, since a transferee, in principle, cannot assert title as against third parties unless the transfer is registered, the transfer is almost always registered in practice. While registration does not guarantee good title to real estate, it is the best evidence to establish that the registry title holder has title.

For a TBI of a trust which holds real property, the trustee of the trust is registered in the real estate registry as the legal title owner of the real property. Title to the TBI is evidenced by the trust agreement between the trustee and the settlor of the trust. If the TBI is transferred by the initial holder to a third party, the transfer of title to the TBI is evidenced by written consent of the trustee to the transfer, with the date certified by a notary public.

**Information in the public register**

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**7. What are the main information and documents registered in the public register of title? Can confidential information or documents be protected from disclosure in the public register of title?**

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The real estate registry is divided into the following parts:

- Description of real estate.
- Register of rights and interests: ownership and interests other than ownership such as mortgages and surface rights.

The description of the real estate includes the location, number, type and area of the real estate.

The register of ownership includes the:

- Name and address of the owner.
- Date of acquisition of the real estate.
- Method of acquisition of the real estate, such as sale, gift, entrustment and inheritance.
- Type of title such as co-ownership.

If real estate is entrusted, the trust information is registered in the trust list attached to the real estate registry.

The register of interests other than ownership includes:

- The name and address of the holder of interests.
- The date of creation of the interests.
- As applicable, basic information for the interests (for a mortgage, the principal amount, interest rate and default rate of the secured obligations, the names and addresses of the obligor of the secured obligation and the mortgagee).

The information provided in the real estate registry is publicly available. However, the information in the underlying documents such as a sale agreement, mortgage agreement and trust agreement are not publicly accessible.

**State guarantee of title**

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**8. Is there a state guarantee of title? Is the authority that manages the public register liable to pay compensation for any errors it makes in relation to title registration? Is title insurance available and is it commonly used?**

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There is no governmental guarantee of title. Real estate registration does not guarantee ownership of the registered interest. In general, there is no title insurance product currently offered by insurance companies in Japan.

**Tenure**

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**9. How can real estate be held (that is, what types of tenure and other main ownership rights exist over land)?**

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Real estate can be typically held as freehold (title in fee) or leasehold.

**Freehold**

In addition to sole ownership, there are typically two types of tenure in freehold: co-ownership and sectional ownership.

The Civil Code contains some basic provisions on co-ownership whereby parties can each take an agreed percentage share in the freehold interest in a property. Unless otherwise agreed among the co-owners, changes to the property cannot be made without the consent of all of the other co-owners, but each co-owner is entitled to freely dispose of its share.

The Law concerning Condominium Unit Ownership provides for the physical subdivision of a property into separate units. This is used for more complex co-ownership arrangements such as office apartment blocks and shopping malls. The ownership of the freehold of each unit is registered in each owner's name. The owners make decisions affecting common parts such as the exterior of a building or common areas.

**Leasehold**

Japanese law recognises two types of leasehold interests in respect of land, namely a surface right (a real property lease interest) and a contractual lease interest. All lease interests in buildings are contractual. A surface right is usually registered in the real estate registry. A contractual lease interest can also be registered in the real estate registry, but this is not the usual practice.

**Others**

There are a number of other rights over property, some of which can be registered in the real estate registry, such as an easement (*chieki ken*).

**SALE OF REAL ESTATE**

**Preliminary agreements**

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**10. What types of preliminary agreements are typically used in the sale of real estate? Are they legally binding?**

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A seller usually either seeks a bid or directly contacts potential buyers through a real estate broker.

If a broker acts as an intermediary between the seller and the purchaser or an agent of the seller or the purchaser, the broker needs to be licensed as a real estate transaction broker (*takuchitatemono torihiki gyousha*) under the Real Estate Transactions Business Law. A licensed broker acting as an intermediary between the seller and the purchaser needs to disclose important information about the subject real estate to both the seller and the purchaser. When a licensed broker is acting

as an agent of the seller or the purchaser, the broker needs to disclose important information to the party who retains the broker as the agent.

If the sale is of a trust beneficial interest in real estate, and not a sale of the real estate itself, if the broker acts as an intermediary between the seller and the purchaser or an agent of the seller or the purchaser, the broker must be registered as a person conducting type II financial instruments business under the Financial Instruments and Exchange Law, and is subject to its regulations.

Actual commercial negotiation is initiated by a purchaser delivering a letter of intent and a seller delivering an acceptance letter, under which a purchaser is often granted an exclusivity period during which a seller agrees not to negotiate with other potential purchasers.

A letter of intent and acceptance letter are often exchanged between a seller and a purchaser. These letters typically outline:

- An indicative sales price.
- Key conditions of the sale (for example, whether full warranties will be given, or whether the property is to be sold as it is).
- Anticipated timing for closing.
- Exclusivity regarding the potential sale.
- Time and information to conduct due diligence on the real estate.

These letters are generally subject to conclusion of a more definitive contract and are often not legally binding (except for exclusivity and confidentiality).

### **Sale contract**

#### **11. Briefly outline the typical main provisions of a corporate real estate sale contract and main real estate provisions of a typical share purchase agreement.**

##### **Real estate contract**

The main provisions of a real estate contract in Japan are:

- Purchase price and payment mechanism, including deposit provision (if applicable).
- Prorations.
- Closing deliveries and activities.
- Conditions precedent.
- Representations and warranties.
- Pre-closing covenants (if not simultaneous sign and close).
- Risk of loss (for example, casualty).
- Termination: Default and remedies, indemnification and limitations on indemnity (caps, baskets, survival).
- Miscellaneous provisions (for example, notice, confidentiality).

##### **Share purchase agreement**

The main provisions of a share purchase agreement in Japan are:

- Purchase price and payment mechanism, including deposit provision and provisions relating to post-closing purchase price adjustment (if applicable).
- Prorations.
- Closing deliveries and activities.
- Conditions precedent.

- Representations and warranties.
- Pre-closing covenants (if not simultaneous sign and close).
- Risk of loss (for example, casualty).
- Termination: Default and remedies, indemnification and limitations on indemnity (caps, baskets, survival).
- Tax matters.
- Miscellaneous provisions (for example, notice, confidentiality).

### **Due diligence**

#### **12. What real estate due diligence is typically carried out before an acquisition and what key areas does it cover? Which documents are typically reviewed? Which specialist advisers are usually involved and which reports do they typically produce?**

The following due diligence is typically carried out:

- Legal due diligence covering title confirmation, boundary confirmation, planning and land use issues, lease terms and other key agreements such as trust agreements, agreements among co-owners and management rules for sectional ownership.
- Physical/environmental investigation (an engineering report/environmental report is produced).
- Valuation (an appraisal report is produced).

The title confirmation for real property is usually conducted by reviewing the real estate registry. For the title confirmation of TBIs, the trust agreement and trustee's consents to the historical transfers from the initial beneficiary to the seller are reviewed, as well as the trust register in the real estate registry.

### **Sellers' warranties**

#### **13. What real estate warranties are typically given by a seller to a buyer in the sale of corporate real estate and what areas do they cover? What are the main limitations on warranties, for example are they typically qualified by disclosure?**

Real estate warranties by a seller to a buyer are typically as follows:

- Sole ownership of real estate.
- No encumbrances.
- No condemnation.
- No defects.
- Compliance with law including the Building Standards Law.
- Boundary confirmation and no encroachment.
- No litigation.
- No hazardous materials in or on the property.
- No termination of and no default under leases.
- In the case of a TBI, sole ownership of the TBI, due establishment and valid existence of the TBI and validity and enforceability of the trust agreement.

However, the types of warranties made by a seller to a buyer vary depending on each party's negotiating position, the type of property and other factors. Some transactions are as is, with few real estate representations and warranties.

## Liability

### 14. Does a seller have any statutory or other liability to the buyer in a disposal of real estate?

Under the Civil Code, the seller has latent defect liability (*kashi tanpo sekinin*). If there is a latent defect in the property and the purpose of the sale contract would not be achieved due to the defect, the buyer can cancel the sale contract. In addition, the seller must indemnify the buyer for its damage arising out of the defect. However, the latent defect liability can be contracted out by an agreement between the seller and buyer, except to the extent:

- The seller had actual knowledge of a defect and did not inform the buyer of the defect.
- The seller holds a real estate broker licence under the Building Lots and Buildings Transaction Business Law and the buyer does not hold the same.
- The subject building is a newly constructed building for residence (the Law concerning Promotion to Ensure Quality of Residence).

### 15. Briefly outline the environmental legislation and potential liability for a buyer in a purchase of real estate. Is it common to carry out environmental surveys and searches and to obtain environmental insurance? How is environmental liability typically dealt with in the sale contract?

The Basic Environmental Law is at the top of the Japanese environmental regulatory scheme. There are numerous other laws and regulations that impose restrictions on a company's environmental activities, including the:

- Soil Contamination Countermeasures Law.
- Air Pollution Prevention Law.
- Water Pollution Prevention Law.
- Noise Prevention Law.
- Vibration Prevention Law.
- Noxious Smell Prevention Law.
- Law Concerning Special Measures for Classes of Dioxins.

The Soil Contamination Countermeasures Law provides that a current owner of land can be held strictly liable for the removal or remediation of hazardous or toxic substances on or under the land (whether or not the current owner knew of, or was responsible for, the presence of the hazardous or toxic substances). In addition, under the Civil Code the owner of a building is liable for damages arising from certain hazardous substances contained in the property, for example asbestos (even if the hazardous substance had existed before the owner acquired the building) (*see Question 16*).

Since a buyer in a purchase of real estate may be held liable, an institutional investor investing in real estate will typically retain an environmental or engineering firm to conduct environmental due diligence/survey on the property. However this may not be adequate to identify all potential environmental problems that may be hidden or otherwise impossible to detect. It is not very common to obtain environmental insurance in Japan, although some investors do obtain it for certain properties.

One of the typical points of negotiation between the seller and buyer is whether to cover environmental issues in representations and warranties or indemnities in the sale contract, in addition to the limitation period.

### 16. Can an owner or occupier inherit liability for other matters relating to the real estate even if they occurred before it bought or occupied it? Can a seller or occupier retain any other liability relating to the real estate after it has disposed of it?

Under certain environmental laws such as the Soil Contamination Countermeasures Law, the owner or occupier of assets that include hazardous materials is liable to remove hazardous materials. In addition, under the Civil Code the owner of the building is liable for damages arising from the defects of the property, even if the defects had existed before the owner acquired the building. To that extent, the owner or occupier may inherit liability for matters relating to the real estate, even if such matters existed before acquisition or occupation.

The seller may be liable for soil contamination as the polluter under the Soil Contamination Countermeasures Law and may incur defect liability under the Civil Code. In addition, the seller may be liable to the buyer if representations and warranties or indemnities are agreed under the sale contract, depending on the limitation period under the sale contract.

## Completion arrangements

### 17. What are the typical arrangements and main documents required for completion of the sale? When does title transfer and what are the formal legal requirements to execute the sale documents, transfer the real estate and register the change of title? Is notarisation required?

If exclusivity is provided by a seller, then the seller and a purchaser negotiate and execute a sale contract before the expiration of the exclusivity period. The parties are legally bound when they execute the sale contract.

At closing, the seller delivers the title documents (registration certificate (*touki zumi sho*) or information for registration identification (*touki shikibetsu jouhou*) for the seller's ownership of the property) and documents for registration of the transfer of ownership to the purchaser, in exchange for the purchaser's payment of the purchase price to the seller.

An application to register the title with the local real estate registry is usually made immediately after the closing meeting (but generally on the closing date). The registration is usually completed within one or two weeks. Once the registration is completed, the change of title will be registered as of the date of the application.

In principle title to the real estate is transferred when the parties even verbally agree to sell and purchase the real estate. However, in practice the sale contract normally provides that the title to the real estate will transfer from the seller to the purchaser when the purchase price is paid to the seller.

The registration of the title is not required to effect the transfer of the title. However, such transfer is almost always registered in practice.

## Real estate tax

### 18. Is stamp duty/transfer tax (or equivalent) payable on the purchase of real estate? Who pays, what are the rates and are there any exemptions? Does it apply to the transfer of shares in a company holding real estate and at what rate?

## Stamp duty

Stamp duty is payable on the preparation of certain documents. An agreement to transfer real property is subject to stamp duty

ranging from JPY200 to JPY600,000 (currently JPY540,000 until 31 March 2014 and will be reduced to JPY480,000 until 31 March 2018), depending on the purchase price stated in the sale contract.

Stamp duty is generally paid by attaching revenue stamps on the original of the sale contract and cancelling them by way of placing a seal or signing a signature on them. This should be done on or before the execution of the sale contract. The buyer and seller typically pay the stamp duty on their respective originals of the sale contract.

#### Real estate acquisition tax

When real property is acquired, real property acquisition tax is imposed at the rate of 4% on the assessed value (determined by the local government) of the real property acquired. The tax rate for land and residential buildings is reduced to 3% for real property acquired on or before 31 March 2015. The tax base of land is reduced to half where the land acquired is classified as land for building, and the acquisition is made on or before 31 March 2015.

#### Registration tax

Registration tax on the acquisition of real property is levied at the rate of 2%, based on the assessed value of the real property, when a change of the ownership is registered with the local real estate registry. The tax rate for land is currently reduced to 1.5% for registration until 31 March 2015 if the ownership change occurs due to a purchase of the land.

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### 19. Are any methods commonly used to mitigate real estate tax liability on acquisitions of large real estate portfolios? What is the general approach of the tax authorities in your jurisdiction to such schemes?

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#### Entrustment and transfer of TBI

A transfer of the TBI is not subject to stamp tax, acquisition tax and registration tax as described in Question 18. Instead, only nominal stamp tax (JPY200 on each original sale contract) and registration tax (JPY1,000 on each property) will be imposed on such a transfer.

However, if the real estate asset is being newly entrusted into a trust structure by the seller, the entrustment is subject to registration tax (but not acquisition tax) at 0.4% of the assessed value of the land and buildings. A temporary reduced rate of 0.3% is available for entrustments of land made by 31 March 2015. In practice, such registration tax is borne by the buyer of the TBI according to the sale contract. In addition, if a trust structure is used, upfront and ongoing trust fees are generally payable to a trustee.

In a large real estate transaction, the registration tax for entrustment and the trust fees payable to a trustee during the holding period of the TBI are often lower than the acquisition tax and registration tax that would have been imposed on the buyer if the real estate itself had been transferred to the buyer. This advantageous tax treatment is one of the reasons for acquiring a TBI rather than the real estate itself.

#### TMK and J-REIT

Temporary reductions in real estate acquisition and registration tax are available for TMKs and J-REIT which meet certain requirements. The following relief is currently available:

- Real estate acquisition tax: 0.6% (land for building), 1.2% (other land), 1.2% (residential buildings) and 1.6% (other buildings) until 31 March 2015.
- Registration tax: 1.3% until 31 March 2015 (land and buildings, other than warehouses and land for warehouses).

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### 20. Is value added tax (VAT) (or equivalent) payable on the sale or purchase of real estate? Who pays? What are the rates? Are there any exemptions?

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The seller is liable to account for consumption tax at 8% of the purchase price of a building (expected to be increased to 10% from 1 April 2017). The seller usually passes on the cost of the consumption tax to the buyer by adding it to the purchase price. Consumption tax is not imposed on the land portion of the purchase price.

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### 21. Are municipal taxes paid on the occupation of business premises? Are there any exemptions?

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A fixed assets tax and a city planning tax, with standard rates of 1.4% and 0.3% respectively, are levied every year on a tax base assessed by the local tax authority. These taxes are exempt if the value of land or buildings is less than the exemption thresholds (land JPY300,000 and buildings JPY200,000). Certain types of residential property are eligible for a reduced tax rate.

#### CLIMATE CHANGE ISSUES

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### 22. Are there targets or incentives to reduce greenhouse gas emissions from buildings in your jurisdiction? Is there legislation requiring buildings to meet certain minimum energy efficiency criteria?

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Japan submitted to the United Nations Framework Convention on Climate Change its target of reducing emissions by 3.8% below 2005 levels by 2020. The target does not currently take into account the emission reduction effect resulting from nuclear power, given that the energy policy and energy mix, including the utilisation of nuclear power, are still under consideration. A firm target, based on further review of the energy policy and energy mix, will eventually be set.

In May 2013, the Law Concerning the Promotion of Measures to Cope with Global Warming was amended, so that the national government is required to prepare a detailed plan setting out, among others, targets to reduce emissions.

The Tokyo Metropolitan Government aims to reduce greenhouse gas emissions by 25% below the 2000 levels, by 2020. In addition, the city aims to reduce energy consumption by 20% by 2020 below the 2000 levels. It has introduced a greenhouse gas emission cap-and-trade programme. This imposes reduction obligations on certain buildings (generally large scale commercial buildings) through local regulations. If those buildings do not meet the targets, the Tokyo Metropolitan Government can issue an order to reduce greenhouse gas emissions, followed by a fine for further non-compliance.

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### 23. Are provisions relating to the energy efficiency of buildings commonly included in contracts for the sale of real estate or in leases (for example, green leases)?

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There are no typical provisions relating to the energy efficiency of buildings yet. In 2014, to encourage discussion between practitioners, a few model provisions to be provided in green leases were proposed by the Green Building Promotion Study Committee (*kankyo fudosan fukyu sokushin kento iinkai*) formed under the Ministry of Land, Infrastructure, Transport and Tourism, which is comprised of, among others, major real estate companies, banks and professors. Such provisions include:

- A tenant's obligation to bear a part of the capital expenses for energy retrofits to the building as a "green lease fee" in exchange for tenants receiving the financial benefits of energy savings.
- An agreement to share certain information between the owner and the tenants, including the amount of energy consumption, water consumption, greenhouse gas emissions, wastes and the state of disposal and recycle thereof.

A guideline of green leases (including a model contract) is expected to be announced by the Study Committee by March 2016.

## REAL ESTATE FINANCE

### Secured lending involving real estate

#### 24. Briefly outline the typical security package required by lenders in relation to real estate lending. How are the most common forms of security interest relating to real estate created and perfected (that is, made valid and enforceable)?

Real estate acquisitions are generally financed by debt and equity.

In a TK-GK structure, the investment by the TK investor, while technically a contract and not equity (see Question 2), functions as equity.

In a TMK structure, part or all of debt financing needs to be made by the TMK issuing specified bonds, so that it can achieve conduit tax treatment under Japan tax law. The TMK must meet a number of conditions to achieve tax qualifying status including, critically, the issuance of bonds (see Question 2). In addition, one requirement for tax qualifying status is that the TMK effectively issues more than 50% of its equity onshore in Japan.

A mortgage is the most common form of security granted over fee property. It is created by agreement and perfected by registration at the local real estate registry.

A pledge is the most common form of security granted over TBIs. It is created by agreement and perfected by a consent from the trustee with the date certified by a notary public.

With respect to specified bonds issued by TMKs, security is usually taken over fee property or TBIs in the form of a statutory lien (*ippan tanpo*). It is automatically created by issuing specified bonds. With respect to a:

- Fee property, it is possible to perfect the *ippan tanpo* by registration at the local real estate registry, though this is not often done in market practice.
- TBI, there is no way to perfect the *ippan tanpo*. If a TMK transfers a TBI to a third party and the third party obtains consent from the trustee with the date certified by a notary public, the bondholder cannot claim its *ippan tanpo* against the third party.

#### 25. What other real estate related measures do lenders typically take to protect themselves against default by the borrower?

Lenders typically take some or all of the following measures to protect themselves against default by the borrower:

- Loan agreement provisions including conditions precedent, representations and warranties and covenants of borrower.
- Non-recourse carveout sponsor guaranties/indemnities by credit-worthy entities for typical "bad-boy" acts (including, without limitation, fraud, intentional misrepresentation,

misappropriation, insolvency, violation of single purpose entity requirements), and may also include environmental issues.

- Reserves for taxes and insurance, immediate repairs and capital improvements, security deposits and leasing commissions.
- Up-front and annual appraisals.

#### 26. Can lenders incur environmental liability? What measures do lenders typically take to manage potential environmental liability?

There are no environmental laws that impose environmental liability on lenders. Therefore, lenders are not liable, in principle, to implement remediation measures. However, theoretically a lender may be subject to tortious liability if it exercised control on the polluter. If a lender acquires land that requires temporary remediation measures under the Soil Contamination Countermeasures Law as a result of the foreclosure of a mortgage, the local government may order the lender to take remedial actions. However, the applicable enforcement order provides that such remedial actions are limited to sealing off the area or monitoring the groundwater pollution.

There are no typical measures that lenders take to manage potential environmental liability, while lenders sometimes seek recourse obligations from sponsors with respect to environmental issues.

#### 27. Briefly outline the main remedies for lenders in relation to the secured real estate if the borrower defaults on the loan. What is the effect of the borrower's insolvency on the lender's remedies?

There are several remedies for the lender in relation to the secured real estate if the borrower defaults on the loan.

##### Real Property: mortgages

- Court-administered remedies: The foreclosure on a mortgage in Japan is court administered. There is no non-judicial foreclosure of mortgage in Japan.
- If the secured creditor purchases the real property in a foreclosure, acquisition and registration taxes will be assessed
- If a foreclosure is not contested, it will usually be completed within a year from the date of initial application. If the foreclosure is contested, it can take considerably longer.

##### TBI: Pledge of TBI

- Non-judicial remedies: The pledge of TBI can be foreclosed upon non-judicially (that is, outside a court process).
- The terms of the financing documents typically provide that on a default by the debtor, the secured creditor is entitled to enforce the pledge and to transfer the TBI from the debtor to the secured creditor or its designee.
- Trustee consent: The trust bank that owns the real properties typically reserves its right to consent to any transfer (or other disposition) of TBI to a third party. If the trust bank gives its consent, the pledge can be exercised immediately (subject to any notice period in the financing documents). If the trust bank refuses to give its consent, the transfer of TBI is not valid and the transferee may not assert itself as the new owner of TBI against the trust bank. In this case, a court procedure would need to be started, and there would be a delay with attributed costs that would depend on the facts of the case.

### Equity: Pledge of equity

- Non-Judicial Remedies. The following are usually set out in an equity pledge on acceleration of the loan or in the event of default (as applicable):
  - voting rights of pledgor (shareholder or member);
  - receipt of dividends;
  - sale of equity interest collateral;
  - accord and satisfaction (*daibutsubensa*).

In the event of the shareholder/member refusing to comply, the secured creditor will need to bring an action to enforce.

- Judicial Remedies: As a means of pledge enforcement, the secured creditor may bring an action to;
  - force the company and the applicable shareholder/member to take all necessary actions to transfer the equity interests to the secured creditor (including, without limitation, resolutions and consents);
  - foreclose on the equity interests.

If the borrower is a GK (*godo kaisha*) or a TMK, the borrower's insolvency would not affect the lender's remedies in that a GK or a TMK is not subject to a corporate reorganisation proceeding (*kaisha kosei*) and secured claims against a GK or a TMK are not stayed or discounted. In the case where the borrower is a KK (*kabushiki kaisha*) and the KK becomes subject to a corporate reorganisation proceeding, a court may stay the enforcement of security.

### 28. Briefly outline key additional issues for lenders in relation to construction and development projects.

Lenders typically review construction documents, including the construction agreement and the construction permit. A right to cure (including a right to receive cure notice) and a right to step-in are normally provided in the loan documents, such as a project agreement or collateral assignment of construction agreement.

#### Other real estate financing techniques

### 29. Are other real estate finance techniques commonly used in your jurisdiction? For example, real estate securitisation and sale and leasebacks.

Prior to the global financial crisis, Japan had an active securitisation market for commercial mortgages. However, the securitisation market has not yet recovered.

The Association for Real Estate Securitisation seeks to develop Japan's real estate securitisation market and expand the opportunities for institutional and individual investors ([www.ares.or.jp/en/index\\_en.html](http://www.ares.or.jp/en/index_en.html)).

## REAL ESTATE LEASES

### Negotiation and execution of leases

### 30. Are contractual lease provisions regulated or freely negotiable? Which legislation applies?

Lease provisions are generally freely negotiable. However, there are several mandatory provisions to protect tenants in the Land and Building Lease Law, especially relating to the landlord's right to terminate the lease (*see Question 37*). The Land and Building Lease Law applies to a lease of land for the purpose of owning buildings and a lease of a building.

### 31. What are the formal legal requirements to execute a lease? Does the lease have to be executed by certain parties or as a deed? How do the formalities differ for a company, partnership and for individuals?

There are formal legal requirements to execute certain types of fixed-term leases (*see Question 33*) while there are no such requirements to execute ordinary leases.

#### Rent levels and reviews

### 32. How are rent levels usually reviewed and are there restrictions on this? Is stamp duty and VAT (or equivalent) payable on rent? Is a rent security deposit required and does it have to be managed in a certain way?

In ordinary leases (*see Question 33*), landlord and tenant each have the statutory right to seek a rent adjustment. This right can be waived by the landlord, but not by the tenant. In fixed-term leases, there is the same statutory right to seek rent adjustment, which can be waived by both landlord and tenant.

Consumption tax is imposed (currently at the rate of 8%) on rent under a lease of commercial buildings, but generally not on rent under a lease of residential buildings or a lease of land.

#### Length of term and security of occupation

### 33. Is there a typical length of lease term and are there restrictions on it? Do tenants of business premises have security of occupation or rights to renew the lease at the end of the contractual lease term?

There are two types of real estate leases in Japan, ordinary renewable leases and fixed-term leases.

#### Ordinary leases

**Ordinary land lease.** A minimum 30-year term is statutorily required in an ordinary land lease for the purpose of owning buildings (*shakuchi ken*). It automatically renews for further ten-year periods (20 years, for the first renewal), unless otherwise agreed between the parties, provided that buildings are situated on the leased land at the time of the expiration of the lease.

**Ordinary building lease.** This is automatically renewable under the Land and Building Lease Law, and usually has an agreed term (typically, one to two years).

**Protection for tenants.** Lessees are generally given broad protection against termination by landlords. For a landlord to terminate a lease, a justifiable reason is required and the courts will consider various factors in determining whether a justifiable reason exists. Generally, it is often difficult for a landlord to establish a justifiable reason for lease termination. The following are some of the factors that are considered by the courts:

- Necessity of use by landlord and tenant.
- Past history relating to the lease.
- Current use and condition of the leased premises.
- Landlord's offer of certain benefits to the tenant in exchange for the tenant vacating the land.

## Fixed-term leases

**Fixed-term land lease.** There are the following types of fixed-term land leases:

- General fixed-term land lease for residential or commercial use, with a minimum term of 50 years. This must be created in writing.
- Commercial fixed-term land lease, primarily for commercial use, with a term of ten or more years but less than 50 years. This must be created in the form of a notary deed.
- Land lease under which the tenant assigns the building on the land to the landlord after at least 30 years at a reasonable price. This can be created orally, but in practice it is created in writing.

**Fixed-term building lease.** The fixed-term building lease is not renewable. However, the parties are not prohibited to agree to enter into a new lease once the term expires. The Land and Building Lease Law does not restrict the length of the term, but the following formalities are required:

- The lease must be in writing.
- The landlord must explain to the tenant in advance by delivering a separate written instrument setting out that the lease will not be renewed and will terminate on expiration of the term.
- If the lease term is one year or more, the landlord must give written notice to the tenant, between six to twelve months before the expiration of the term, to terminate the lease.

## Disposal

### 34. What restrictions typically apply to the disposal of the lease by the tenant? Can tenants usually share their business premises with companies in the same corporate group? What is the effect of a legal reorganisation or transfer/sale of the tenant on the lease and on a guarantee of the lease?

A disposal of the lease by the tenant is typically subject to the landlord's prior consent.

Subletting or sharing the premises with a third party (including a group company) is usually subject to the landlord's prior consent. However, some landlords agree in advance to allow the tenant to share with certain group companies.

### 35. Does a landlord or tenant retain any liability under the lease after the lease is assigned?

If a landlord is the owner of real property and transfers the title to the property, the transferee will assume all obligations (including the obligation to refund the security deposit) under the lease. This is provided that the lease has been perfected against third parties, and meaning that the previous landlord will be released from such obligations. If a landlord is not the owner of a real property (for example, where the landlord is the lessor under a master lease), the landlord remains liable for all obligations (including the obligation to refund the security deposit) under the lease unless the tenant consents to the assignment of the lease and releases the previous landlord from such obligations.

A tenant cannot assign the lease without the landlord's consent to the assignment. In consenting the assignment, the landlord can determine whether to release the tenant from all or a part of the obligations under the lease.

## Repair and insurance

### 36. Who is usually responsible for keeping the leased premises in good repair and for insuring the leased premises? Are there provisions for the ownership of lease improvements?

The landlord is usually responsible for keeping the leased premises in good repair. The tenant is usually required to bear the costs and expenses of repairs to the walls, ceilings, and floors of the leased premises and any other repairs due to the actions of the tenant.

Insurance depends on the lease terms. Typically, a landlord will require the tenant to purchase insurance (for example, fire insurance).

## Landlord's remedies and termination

### 37. What remedies are available to a landlord for a breach of the lease by the tenant? On what grounds can the landlord usually terminate the lease and what restrictions and procedures apply? What is the effect of the tenant's insolvency under general contract terms and insolvency legislation?

Landlords must have justifiable grounds to terminate or reject the renewal of a lease, excluding fixed-term leases (*see Question 33*).

Under Japan court precedents, a landlord cannot terminate a lease, even if the tenant breaches a term of the lease, unless the trust relationship between the landlord and the tenant has been destroyed. Typically, payment default for more than three consecutive months will constitute destruction of the trust relationship.

If a tenant becomes subject to civil rehabilitation, corporate reorganisation or bankruptcy proceedings, it (or the trustee if appointed by a court) can either terminate or continue the lease. A landlord can demand that a tenant or its trustee, as the case may be, decide within a reasonable period whether to terminate or continue a lease, but the fact that the tenant becomes subject to insolvency proceeding itself is not enough for the landlord to terminate the lease and take possession of the leased premises.

Under Japan court precedents, any provision in a lease that purports to terminate the lease based on the tenant's insolvency would be considered unenforceable.

### 38. Can the tenant withhold rent payments in certain circumstances, for example for serious damage to the leased premises? Can the tenant terminate the lease in certain circumstances?

Unlike landlords' termination, there is no restriction on tenants' termination of leases and it depends on the terms of leases. For commercial leases (for example, shopping mall leases) or large scale office leases, tenants generally have a right to terminate without any cause, subject to paying a termination fee in an amount equal to the rent for the remaining lease period.

Based on precedents and recent experience, a tenant's obligation to pay up to 12 months of rent as a termination fee would be enforceable, but longer periods may be denied by courts on public policy grounds. However, this is an evolving area of law, and depends on the facts and circumstances. In cases where a property can be shown to be unique (and therefore more difficult to lease), there is an argument that a longer period should apply.

For ordinary building leases, tenants can typically terminate small office and residential leases by giving between one to six months prior notice, or immediately terminate such leases by paying the amount of rent equivalent to the prior notice period.

## PLANNING AND DEVELOPMENT CONTROLS

### 39. In what circumstances can local or state authorities purchase business premises compulsorily? Is the purchase price market value?

Local authorities can force the sale of business premises for certain public purposes (for example, construction of infrastructure) (*Land Expropriation Act (tochi shuyo hou)*). The authority must purchase the business premises at fair market value and compensate for any ordinary losses.

In addition, local authorities can force the exchange of land for other land (*Land Rezoning Act (tochi kukaku seiri hou)*) in connection with a rezoning project. Compensation can be sought if there is no increased land value due to the rezoned land.

### 40. What authorities regulate planning control and which legislation applies? Is there specific protection for special categories of buildings such as historic buildings?

The City Planning Law provides the basic framework, and the procedures for the creation of a city plan, to achieve sound and organised urban development. There are various local laws established under the framework of the City Planning Law. Relevant local authorities are granted the power to control land use in accordance with the City Planning Law and the local laws.

The Building Standard Law provides regulations with respect to various standards for a building, including regulations with respect to the:

- Use of a building.
- Ratio of the total floor area of a building to the site area of the building.
- Ratio of the building area of a building to the site area of the building.

The Ministry of Land, Infrastructure, Transport and Tourism (MLIT) is the government branch that oversees the development and improvement of land, infrastructure and transport ([www.mlit.go.jp/en/index.html](http://www.mlit.go.jp/en/index.html)).

### 41. What planning consents are required for building works and the use of a building?

Under the City Planning Law, in urbanisation control areas (*shigaika chousei kuiki*), the development of land is subject to strict control. In areas designated for urbanisation (*shigaika kuiki*), developers are required to obtain permission for development from the relevant authority.

Among other things, the City Planning Law provides that a prefecture can create a city plan (*toshikeikaku*) regarding a land rezoning project (*tochi kukaku seiri jigyou*) under the Land Rezoning Law, and designate expected areas to be covered by the land rezoning project (Expected Rezoning Area). A land rezoning project means a project regarding modification of land zoning, and the formation, creation or renovation of public facilities, and related matters. Typically, any such land rezoning project will create or expand public roads or parks through the surrender of land, or the payment of money in lieu of it, by the parties in the

area, and through the process exchanged land will be assigned to the parties.

Under the Building Standards Law, building construction work needs approval by the relevant authority in advance of the work, and a completion inspection of the building by the relevant authority is required.

### 42. What are the main authorisation and consultation procedures in relation to planning consents?

#### Initial consents

The governor of a prefecture grants initial planning consents to a city plan to be operated by a municipality of the prefecture or an entity with an appropriate government licence. The Minister of Land, Infrastructure, Transport and Tourism grants initial planning consents to a city plan to be operated by a prefecture or a national agency or organisation.

The amount of time it takes to obtain an initial decision under the City Planning Law varies depending on the complexity of each plan.

#### Third party rights and appeals

Any relevant party or residents can make comments on a proposed city plan through a public hearing or otherwise. Regarding proposed city plans concerning a specified block (*tokutei gaiku*) defined in the City Planning Law, consents from stakeholders such as the owner of land and registered mortgagees, as stipulated by the Cabinet Order, must be obtained.

When deemed necessary in compiling proposed city plans, the prefectures or municipalities must perform any required measures, such as convening public hearings, to reflect the opinions of residents and other stakeholders.

Under case law, a city planning decision is not subject to appeal because the decision itself is a general decision and does not affect definite rights and obligations of each individual. Once the city planning decision is reviewed by the prefecture, the decision is subject to appeal.

## REFORM

### 43. Are there proposals to reform real estate law and are they likely to come into force and, if so, when?

The following areas of reform have been proposed in Japan:

- On 14 May 2014, the Financial Services Agency (FSA) published a proposed amendment to the regulations regarding the "Special Business Activities for Qualified Institutional Investors" (QII Exemption) provided under Article 63 of the Financial Instruments and Exchange Law. The QII Exemption is an exemption available for the manager of a collective investment scheme, such as a TK, from the registration requirements applicable to its self-offering and self-investment management activities (*see Question 2*). Under the current law, provided that there is always at least one qualified institutional investor (QII) among the investors in each fund, up to 49 non-QIIs may invest in the fund with no specific requirements for the non-QIIs. However, under the proposed amendment, non-QIIs will be limited to certain types of investors, such as a listed company, a foreign corporation, or an individual who is expected to hold investment assets of JPY100 million or more and who has maintained his account for securities and/or derivative trading for over a year.

The amendment was originally expected to become effective on 1 August 2014 but has not been effective because the cabinet has not yet issued the relevant cabinet order due to objections from

certain funds that have objected to limitations on the proposed scope of permitted non-QIIs. However, it is likely that the amendment is likely to come into force in the near future.

- Currently, a TMK that was incorporated on or before 31 March 2010 (Grandfathered TMK) is not subject to one of the requirements to satisfy its tax conduit status that it issue more than 50% of common shares within Japan (*see Question 2*). On 30 December 2014, the Liberal Democratic Party and the Komeito party proposed to amend the relevant tax law so that a Grandfathered TMK that fails to file the commencement of

business on or before 31 March 2015 with the applicable local finance bureau of the Ministry of Finance will be subject to the requirement that it issue more than 50% of common shares within Japan. The amendment is likely to come into force by 31 March 2015.

- The Building Standard Law was amended to relax the calculation of floor area ratio, the spaces used as elevator shafts are now excluded from the calculation of the floor area ratio. The amendment has been effective since 1 July 2014.

## ONLINE RESOURCES

### Japanese Law Translations, Ministry of Justice

W [www.japaneselawtranslation.go.jp](http://www.japaneselawtranslation.go.jp)

**Description.** This site contains unofficial translations of various laws and is run by the Ministry of Justice. Certain translations may not be up to date.

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