

Chapter XX

NORWAY

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I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In 2004, ownership of real estate in Norway changed drastically. Before the change, most income from real estate was taxed at 28 per cent at a company level. From 2004, any gain and most dividends related to shares in limited liability companies was tax exempt for corporate shareholders, resulting in a tax system where the difference between current income, sale of property and interest (taxed at 27 per cent) and income related to ownership of shares (taxed at zero per cent or 0.81 per cent), had a huge impact on the structuring of the real estate market.

Subsequently, nearly all commercial real estate was moved into separate limited liability companies, with each company functioning as a single purpose vehicle (SPV) for the property in question, with such SPVs typically again being owned by a limited liability company in a holding structure.

For these reasons, investments in the Norwegian real estate sector are now carried out through the acquisition of shares of property SPVs, property portfolios consisting of SPVs (in whole or in part) or through professionally managed funds.

Normally, the real estate ownership pertains to both the building and the plot of land upon which the building is standing.² However, ownership may be split between the building and the land upon establishment of a ground lease agreement³ with a duration exceeding 10 years (typically 99 years for commercial real estate).

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2 Freehold property, according to UK law.

3 Leasehold property, according to UK law, as regulated by the Norwegian Ground Lease Act of 20 December 1996 No. 106.

Due to historic reasons, some property is also owned separately from the title to the property, with such title being held elsewhere in the corporate structure.

ii System of registration

Norwegian properties are registered in a land register maintained and operated by the Norwegian Mapping Authority, which is the judicial authority for properties in Norway. The land register is the official register of legal rights and obligations associated with fixed property and housing cooperatives. The land register lists ownership in addition to rights and encumbrances such as mortgages, leasing rights and pre-emptive purchasing rights. Details of the physical aspects relating to a property, such as borders, areas, buildings and addresses, are registered in the new cadastre property register, which is maintained by the individual municipalities.⁴

Failure to register ownership of the property, rights, encumbrances, etc., does not alter the underlying legal situation between the original contractual parties. However, a third party may in good faith extinguish all rights, including ownership rights that are not registered prior to the time of the colliding right of the third party.

Registration of a transfer of title in the land register is therefore the only way to obtain legal protection against third parties. No notary public is involved during the registration process.

The Norwegian authorities do not hold a similar register for the purchase of shares. Even though the books of the company shareholders must always be updated according to ownership changes, there are no public disclosure obligations on the company or the shareholders themselves.⁵ This may make uncovering the ultimate identity of the property owner difficult.

iii Choice of law

The purchase of shares of property SPVs is regulated by the Norwegian Sale of Goods Act,⁶ while the purchase of the property is regulated by the Norwegian Alienation Act.⁷ This duality has raised certain questions in the past regarding the buyer's right to claim damages for defects in the property when the formal object of purchase has been shares. The Alienation Act is also fairly consumer oriented; thus, a commercial real estate transaction will normally be regulated by a customised standard agreement to cover both the aforementioned duality and the professional business aspects of the transaction.

The two standards prevailing today are issued by the Norwegian Business Real Estate Brokers Association et al. and Gyldendal Rettsdata respectively; the former is considered to be slightly more lenient towards the interests of the seller than the latter.

4 The municipality is the lowest level of local authority. As per 2013, there were 428 municipalities in Norway within 19 counties.

5 However, information about the ownership of shares in Norwegian public limited liability companies is available through the Norwegian Electronic Securities Register.

6 Norwegian Sale of Goods Act of 13 May 1988 No. 27.

7 Norwegian Alienation Act of 3 July 1992 No. 93.

II OVERVIEW OF REAL ESTATE ACTIVITY

As per Q3 2013, the Norwegian business real estate transaction market had seen over 100 transactions (exceeding 50 million Norwegian kroner) with a total transaction volume of 30 billion Norwegian kroner. After several years of the tightening of finance availability, the past few months have shown an improvement in the debt financing situation for low-risk, capital-intensive projects, but remains a challenge for housing developers. It is generally considered that the largest net buyers of commercial real estate will remain professional property companies as well as syndicates and funds, while Norwegian funds, life insurance companies and property users will be net sellers.⁸ In addition, there has been a large number of transactions with a property value of below 50 million Norwegian kroner.

Over the past year, one in four sales had a net yield of 6 per cent or less, fewer than 10 per cent of sales had a yield of over 8 per cent, and the OBX Real Estate Index showed growth of 8.31 per cent.⁹

At the monetary policy meeting in December, Norges Bank left its key policy rate unchanged at 1.5 per cent. The new projection is now a hold on the rate until 2015, when it is expected to gradually increase.¹⁰ Norges Bank has underlined that growth prospects for the Norwegian economy have, to a certain extent, weakened. House prices have somewhat declined recently, while household debt growth remains high. Unemployment is still low, but wage growth may be somewhat lower going ahead than was earlier projected. At the same time, the krone is weaker than assumed. Consumer price inflation is also projected to be rather lower than previously projected.

At the same time, demands for housing are sharply increasing in central areas, and particularly in the largest cities, indicating that correct timing in the private housing construction market will be key in the future.

III FOREIGN INVESTMENT

All acquisition of real estate ownership rights as well as right of usage are conditioned upon the applicable concession from the authorities.

However, there are no practical limitations on foreign investment in and ownership of Norwegian real estate, except for farmland, and some important exceptions within the industry and energy sectors (waterfalls, etc.).¹¹

The most important acts limiting acquisition and ownership of real estate are the Norwegian Concession Act¹² and the Act on Acquisition of Waterfalls, Mines and

8 UNION Market Report Autumn/Q3 2013, available at www.union.no.

9 OSE4040, as of 8 December 2013.

10 www.norges-bank.no/no/om/publisert/pressemeldinger/2013/pressemelding-5-desember-2013.

11 In accordance with the EEA Agreement, Annex XII, Norway adopted the free movement of capital effective from 1 January 1995, and all previous legal limitations on foreign ownership were cancelled.

12 Norwegian Concession Act of 28 November 2003 No. 98.

other real estate.¹³ In effect, the Norwegian Competition Act will also limit acquisitions of companies in possible violation of Norwegian and EU competition and anti-trust legislation.

A concession is generally not necessary for the acquisition of SPVs that have already obtained a concession; direct acquisitions of developed property when the plot of land is no larger than 100,000 square metres; or acquisitions of undeveloped land for the construction of a permanent residence or holiday home on plots of land no larger than 2,000 square metres. The purchaser must, however, obtain a confirmation by the municipality to document the fact that a purchase is concession free. Some concessions are also granted under certain conditions, for example, farmland where the acquirer normally must inhabit and operate the acquired land.

IV STRUCTURING THE INVESTMENT

Real estate may be held directly by domestic or foreign persons; however, real estate investments in Norway are normally made through domestic or foreign companies.

The general taxation on income or gains derived from real estate is 27 per cent from 1 January 2014; however, due to special regulations in the current tax regime, most gains will be tax exempt for investors. Current income derived from real estate investments (such as rent) will always be taxed at a rate of 27 per cent on the recipient. Subsequent taxation of the income will depend on the method of distribution up the ownership chain, and normally will be covered by the tax-exempt regime, as described below.

Income on interest will always be taxable at a rate of 27 per cent at every level in an investment structure and, due to a new regulation that will restrict deductions for net internal interest within a corporate group as of 1 January 2014, all larger debt-based investments with internal loans or cross securities are recommended to seek advice on the outcome of these rules before implementing the investment structure in Norway.

The normal Norwegian limited liability company (an AS) has a requirement of a minimum share capital of 30,000 Norwegian kroner, which is a recent change in the previous requirement of a minimum share capital of 100,000 Norwegian kroner. A Norwegian public limited liability company (an ASA) has a requirement of a minimum share capital of 1 million Norwegian kroner, and is the compulsory form if the shares are to be listed on the stock exchange. For other purposes, the company regulations are mainly similar, and both will provide limited liability for shareholders. Further, there are no general limitations on foreign ownership.

On a general basis, any income in the company is subject to general income tax at a rate of 27 per cent, and any distributions or gains to personal shareholders are taxed at a rate of 27 per cent; thus, the overall tax burden is 46.71 per cent.

However, to prevent chain taxation, any gains, losses or dividends related to shares will be tax-exempted under the current Norwegian Tax Exemption Method.¹⁴ A

13 Act on Acquisition of Waterfalls, Mines and Other Real Estate of 14 December 1914 No.16.

14 Norwegian Tax Act Article 2-38.

tax group is formed where a company shareholder holds at least 90 per cent ownership (and voting rights) in the underlying company. As a result, within the tax group there is no taxation between each company level on gains and dividends. Outside of the tax group, there is taxation on 3 per cent of any dividends for each company level, resulting in chain taxation for dividends but not for gains.

As a consequence of the Norwegian Tax Exemption Method on the sale of shares, it is reasonable to hold real estate in SPVs, normally through holding each property in a separate AS as an SPV. This structure will allow for the sale of the property through the sale of shares in the SPV if the property has risen in value, resulting in a tax-free gain. On the other hand, one may opt to sell the property directly in the event of a decline in value of the property, and thus be entitled to a tax deduction for such loss. Therefore, if the investment is structured correctly, the tax rules are asymmetrical in favour of the taxpayer. The current tax rules result in real estate investments in Norway being especially attractive for tax purposes.

Depending on the jurisdiction of the shareholder, there may also be withholding tax on distributions to foreign investors or entities outside the EU and the EEA. The normal rate is 25 per cent, but depending on the tax treaty between Norway and the jurisdiction of the foreign investor, the rate may be reduced to between 5 per cent and 15 per cent for some jurisdictions.

To ensure that the investment is structured correctly, it is advisable to plan the structure in advance of any acquisition of real estate, and thus set up the framework for the investment before acquiring the property. In any case, it is possible to structure the acquisition afterwards through, for example, mergers, demergers or a transfer of assets within the tax group. Such reorganisations may be done with tax continuity for both the investment company and the shareholders, but will in most cases be considerably more expensive and complicated than setting up the structure correctly from the start.

V REAL ESTATE OWNERSHIP

i Planning

The Norwegian Planning and Building Act¹⁵ contains rather detailed regulations related to planning on the national, regional and local levels; requirements for dispensation and exemption applications; regulations related to responsibility, control and supervision during the construction phase; and the main requirements during the completion and approval phase.

In addition, the Act also regulates the landowners' general right to compensation due to the compulsory acquisition by the authorities for planning purposes or by direct claim of public ownership (expropriation).

Planning is organised as a top down system, so that no plan at a lower (more local) level may be in conflict with plans higher in the hierarchy. Planning is generally a continuous and sector-dependent process at all governmental levels.

15 Norwegian Planning and Building Act of 27 June 2008 No. 71.

As an example, an upcoming revision of the national transport plan may influence regional zone planning, which again may have consequences for the approval or refusal of local construction projects that appear to be in line with current plans. A plan may also be objected against by any party directly affected by said plan, as well as being subject to overriding sector-specific public concerns. Thus, ratifying plans tends to be a lengthy and complex affair.

ii Environment

Environmental considerations have occupied a considerably larger place in Norwegian legislation over the past few decades, and are particularly visible in the planning and approval stages of property development projects. Environmental warranties have also found their way into most business real estate transactions.

The Norwegian Pollution Act¹⁶ stipulates that the main responsibility for pollution damage rests on anyone that ‘operates, uses or holds’ any real estate, object, plant or business without regard to *culpa*. As a starting point, this would normally be the owner. In cases where the owner and the operator of the property are not the same, the owner may be jointly liable with the operator (as the polluter) (e.g., if such owner is liable according to the Norwegian Neighbour Act).

Pollution liability in Norway is built upon the international polluter pays principle. This means that the polluter shall not only cover all reparative and preventive costs, but also the social costs that such pollution results in for society.

iii Stamp duty/VAT

Registration of a change of ownership to a property by the Norwegian Mapping Authority is subject to 2.5 per cent stamp duty based on the market value of the property. This does not apply to the sale of companies that own the property, as the direct ownership of the property itself does not formally change. Exceptions are also made for newly built properties, where the 2.5 per cent stamp duty applies only to the appropriate ground value until one year after the completion of the building.

The sale of real property or shares is not subject to VAT. This implies that input VAT on building costs is not deductible when the purpose is to transfer the property after completion. However, some exceptions exist where the property is built with the purpose of letting out.

iv Finance and security

Properties may be encumbered with mortgages as well as other types of securities, based on a first come, first served principle with no upper limit. Properties are generally also considered as stable collateral for other financial purposes, and are therefore widely used for financing bank loans and similar.

Even though there is a general prohibition against using the shares or other assets in a target company as security for a loan that enables the acquisition of such target

16 Norwegian Pollution Act of 13 March 1981 No. 6.

company, there is a narrow exemption with regards to using the property as security in SPV transactions.

As with the protection of the title to the property, unregistered loans or other types of agreed securities will not have any effect against third parties that have registered their security in good faith prior to the unregistered security.

Two other common forms of securities are the *urådighetserklæring* and the *sikringspant*. The first, which can be loosely translated as a declaration of non-disposal, is a catch-all encumbrance that prohibits anyone deleting or registering any security, mortgage or lien without the written approval of the right holder. The latter is a normal mortgage, but with the sole function of securing any and all liabilities that may arise during the course of a transaction.

VI LEASES OF BUSINESS PREMISES

Based on the prevailing Norwegian lease standards, the three most ordinary contract types regarding leases of business premises are as follows:

- a* As is: the tenant rents the business premises as they are presented at the time of the contract or takeover, and accepts all non-material defects. The tenant will be responsible for indoor maintenance, whereas the lessor assumes responsibility for the maintenance of the exterior of the building as well as the replacement of technical installations (lifts, air conditioning systems, etc.). The lessor must accept normal wear and tear during the lease period (i.e., the general deterioration of the lease object due to normal usage by the tenant). Thus, the tenant is only responsible for lack of maintenance and any damage caused to the lease object that arises during the lease term. The lessor will maintain the common areas, such maintenance being a part of the joint costs paid by all tenants.
- b* As built/as new: the tenant rents business premises that are new and often built to the particular specifications of the tenant. All defects or deviations from the specification are subject to complaint by the tenant; in all other ways, as above.
- c* Warehouse: as above, but the lessor rents the entire building structure and will thus assume the entire responsibility of the building, including insurance, all maintenance and replacements.

The typical commercial lease term will be for a fixed period of between of five to 10 years; however, certain commercial property is also rented out on a short or mid-term basis (one to three years, and three to seven years, respectively). In many cases, long-term agreements have an option for the tenant to extend the lease, normally for no longer than 10 years (five plus five years), under the same legal terms and conditions but at a renegotiated price (at the market level) for each prolongation term.

Lease agreements may be terminable or non-terminable during the fixed lease period; they may also be agreed to have an undefined term, but typically with a requirement of six to 12 months' prior notice of termination.

Rent is normally agreed as a fixed sum per square metre per year, exclusive of the proportional part of the joint costs of the property and applicable VAT.

The tenant must also pay any and all costs that relate to own usage of power, insurance of its own business, normal indoors maintenance and repairs. In 'as is' and 'as new' leases, the lessor will insure the building and replace all technical installations when maintenance is no longer remunerative. The tenant must normally accept all actions by the lessor that are necessary for the maintenance and renewal during the lease period. If such actions affect the lease materially, the tenant may claim damages or a discount on the lease, the latter normally being capped at the amount of three to six months' lease.

Prior to the commencement of the lease, the tenant must normally deposit into a deposit account, or issue a bank guarantee equal to, three to 12 months' rent as security for any unpaid rent or other claims the lessor may have against the tenant.

The rent is typically adjusted yearly according with the general consumer price index, although sometimes other indexes are used. The parties will often agree that the rent may not be reduced. The tenant may not hold back or offset his or her rent obligations against claims he or she has against the lessor. If such claims are not honoured by the lessor, the tenant must therefore take out separate legal proceedings to have his or her claim covered.

Subletting and transfer rights are normally require the prior written approval of the lessor, subject either to reasonable cause or without reason. However, the tenant may normally transfer the agreement, or sublet within a structure of companies, as long as the guarantee is upheld.

The leasing of real property is exempt without credit for VAT purposes. It is, however, possible to opt for a voluntary registration for VAT purposes for the leasing of real property to taxable businesses. Consequently, it is not possible to opt for a VAT registration when renting to tenants that only carry on business that falls outside the scope of the VAT acts (governmental bodies, health-care and financial institutions, etc.).

A consequence of voluntary registration is that the landlord may deduct input VAT on the building costs, maintenance, etc., and at the same time invoice the rent and other supplies with VAT.

The VAT adjustment scheme applies for input VAT on the building costs (capital expenditure) of real property. The adjustment period is 10 years, implying that the real property must be used in taxable business for this period in order to avoid repayment of deducted VAT.

VII DEVELOPMENTS IN PRACTICE

With some exceptions, the Norwegian property market has had a fairly stable legislative regulation in the past. There are no major proposals (i.e., white papers) for alterations to the legal framework that are expected to change the market in any significant way, even though there has been discussion about altering Norway's farmland legislation to pave the way for green land projects in the wake of the recent change from a social democratic left wing/centre based government to a liberal-conservative right wing government.

For commercial property, the importance of taxation and VAT issues has escalated in the past decade, and these issues are now crucial factors to be taken into consideration in all real estate-related business.

There have been many significant VAT and taxation changes during the past decade, beginning in 2004 with the introduction of the participation exemption method,

which, as discussed above, has resulted in most commercial property being held by SPVs that are the subject of transactions.

Tax-wise, the national budget for 2014 has introduced limitations on deductibility on interest in group loans. These regulations are expected to influence financial models for property acquisitions in the higher price ranges exceeding 100 million Norwegian kroner.

Property lease is not subject to VAT; however, businesses and public enterprises that let buildings or hire plants are permitted to voluntarily register in the VAT register when the premises are used for VAT-liable business. As the deduction of VAT at a rate of 25 per cent is critically important for developers, the introduction of regulations for the adjustment or reversal of input VAT in 2008 have become driving parameters for development and lease projects.

In 2012, the European Court of Human Rights decided that the Norwegian Ground Lease Act was partly in conflict with the European Convention of Human Rights. This has resulted in changes in the Act's regulation of prolonging ground lease contracts. The changes are expected to enter into effect in July 2014 but will have no significant effect on the professional business market.

The technical requirements for constructing private homes and apartments have become stricter and more costly over the past few years due to new energy and environmental requirements. Combined with increased cash requirements prior to taking up house loans, these have generally led to a slower and tougher market for housing constructors. It is believed that the government must ease both the financial and technical requirements in order to meet Norway's upcoming housing demands, although at the moment, no particular government actions are known of in this regard.

VIII OUTLOOK AND CONCLUSIONS

After a downturn in the wake of the 2008 credit crunch, the Norwegian real estate sector has shown gradual, steady improvement and is now considered to be on its way to full recovery.

The Norwegian economy has also shown gradual, moderate improvement since 2010. This, together with a projected 1 per cent growth in employment and strong population growth, suggests an increasing need for growth areas in Norway (typically in central Oslo, Stavanger and Bergen), and a stable, or perhaps slightly declining, market in rural areas.

We have also seen a series of international investors taking an interest in the Norwegian market, suggesting that blue chip properties will be priced at lower yields in the future.

Taking all factors into consideration, we expect the Norwegian real estate market to continue to present interesting investment opportunities. A gradual liberalisation is expected in the construction sector, especially on entry level apartments and similar projects, and thus would appear to present the most interesting business opportunities once the government recognises that the current technical requirements, as well as financial requirements on banks lending to first-time buyers, over time have become too strict.

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Thorvald Nyquist is partner at Deloitte Legal in Norway and is head of the Deloitte real estate industry group. He has over 15 years of extensive experience within corporate and real estate law. Prior to Deloitte, he worked with Thommessen for seven years. In addition to his law degree from the University of Oslo, he holds a master's of business and administration from Berkeley.

Mr Nyquist receives instructions on a regular basis from real estate developers and commercial property owners in transaction and development issues. He also has extensive experience in complex lease disputes, in addition to assisting Deloitte Advokatfirma's tax department on restructuring issues where a solid grasp of real estate legal issues is required.

Mr Nyquist continues to attract a lot of media attention from leading publications within the commercial real estate business, and regularly writes articles for, *inter alia*, Hegnar Online, Estate Media and NæringsEiendom. He is also the editor-in-charge of all contracts and appurtenant documents in the real estate section of Gyldendal Rettsdata.

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