

LUXEMBOURG

Law and Practice

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Stibbe (Luxembourg) see p.17



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1. General

1.1 Main Sources of Law

The Luxembourg Civil Code regulates the main aspects of real estate law in Luxembourg. It covers ownership, mortgages and leases.

The following legislation also applies:

- the law of 10 August 1915 on Commercial Companies, as amended;
- the law of 21 May 1999 on the organisation of the territory;
- the law of 10 June 1999 relating to the commo-incommodo procedures regulating the security, environment and technical aspects of construction;
- the law of 13 September 2011 modifying the Law of 10 June 1999 on classified establishments, and its Grand-Ducal Regulation of 10 May 2012 providing new nomenclature of classified establishments, applicable since 1 July 2012;
- the regulation of 5 May 2012 related to the energy performance of residential and functional buildings;
- the law of 19 July 2004 relating to communal planning and urban development;
- the law of 19 July 2005 relating to urban management and development;
- the law of 22 October 2008 on the right of superficies and emphyteosis; and
- the law of 18 July 2018 regarding the environment.

Regarding real estate investments, the main legislation comprises:

- the law of 15 June 2004 relating to investment companies in risk capital (SICAR);
- the law of 5 August 2005 on financial collateral arrangements (the Collateral Law);
- the law of 13 February 2007 relating to specialised investment funds (SIF);
- the law of 12 July 2013 on alternative investment fund managers (AIFM) implementing Directive 2011/61/EU on alternative investment fund managers (AIFMD);
- the law of 17 December 2010 on undertakings for collective investment (UCI); and
- the law of 23 July 2016 on reserved alternative investment funds (RAIF).

1.2 Main Market Trends and Deals

Luxembourg's geographic and demographic characteristics, alongside its political stability and economic growth, contribute to the development of the real estate market and attract a foreign workforce.

In spite of the significant amount of new construction, there is still a high demand for real estate. Luxembourg's regulatory environment and the subsequent arrival of high net worth individuals have resulted in an important rise in prices for houses and apartments.

Statistics show that most nationals own their primary residence, often outside Luxembourg City. Luxembourg's rental market is mostly focused on apartments owned by private investors, with a greater concentration in the country's centre. Due to high rents and reduced offerings in some areas, newcomers and even nationals often decide to live abroad, in one of the neighbouring countries.

The office market is also affected by the country's growing economy, especially in central areas where there is already a shortage of office space. Most new office buildings are pre-let before construction is completed. Office buildings are gradually looking to obtain green certifications and adhere to the latest sustainability standards. Innovative projects are also emerging, with the aim to attract new talents to locations where they can combine working and living.

The number of shopping centres has consequently increased and is now amongst the highest in Europe. Additionally, some foreign investors have taken interest in Luxembourg of late, especially South Korean investors, who positioned themselves strongly with 16.5% of the market in 2019. European investors' presence has slightly decreased compared to 2018, with UK investments accounting for 26.4% of the market. Most transactions are connected to the office market, but retirement homes and student housing are also attracting investors.

As expected, the most significant deals in 2019 were concluded within the office market. The largest transaction was the EUR275 million acquisition by Korea Investment and La Française of the 17-storey D.Square office building, located in Clôche d'Or, from Integrale S.A. and Ethias S.A., which the latter had acquired in 2018 for EUR225 million in the largest transaction in Luxembourg for that year.

1.3 Impact of Disruptive Technologies

An increase of the financing and management of real estate through blockchain is anticipated, as well as the process of the tokenisation of real estate assets. Transferring real estate assets through blockchain would eliminate uncertainties associated with the use of paper while retaining the properties and characteristics of the transferred real estate assets. It would make real estate products as liquid as shares or bonds, and would allow a reduction of operational and administrative costs to a minimum, an integrated management of the distribution of rents to

investors via “smart contracts”, and the automated processing of investors’ onboarding.

The first real estate transaction using blockchain technology was completed in July 2019.

1.4 Proposals for Reform

A draft bill on heritage foundation was launched in 2013 to complete asset planning. This project is still pending, without amendment since 2014.

More recently, a bill on land management and urban development has been under discussion, aiming to implement practical and operational support to that extent.

The current government has announced a reform of the property tax regime in Luxembourg.

2. Sale and Purchase

2.1 Categories of Property Rights

Property rights (for full ownership) are as follows:

- the right to use the asset – *usus*;
- the right to perceive the fruits (rents, etc) – *fructus*; and
- the right to dispose of the asset – *abusus*.

Property rights may be acquired partly or totally through:

- full ownership;
- a lease (rental or commercial, livestock);
- usufruct;
- the rights of emphyteosis (*emphyteose*) or surface (*superficie*);
- co-ownership (*copropriété*); and
- joint ownership (*indivision*).

2.2 Laws Applicable to Transfer of Title

The transfer of real estate assets located in Luxembourg is governed by the laws of Luxembourg, as *lex rei sitae*.

The provisions of the Civil Code mainly rule the transfer of title. Other specific laws or regulations may apply, depending on the type of assets, the type of activity or the quality of the parties.

2.3 Effecting Lawful and Proper Transfer of Title

The transfer of a real estate asset must be recorded in a notarial deed. It is then registered and recorded in the mortgage registry held by the Land Registration and VAT Authorities (*Administration de l’Enregistrement, des Domaines et de la TVA*) to be opposable towards third parties. It is also applicable to all other

remaining in rem rights pertaining to real estate assets, to any mortgage inscriptions or easements (with the exception of legal easements), and to commercial lease agreements with a duration of over nine years.

2.4 Real Estate Due Diligence

Due diligence is usually carried out by making the relevant documentation linked to the real estate available in a virtual data room, which is accessible to the buyers. The findings resulting from the analysis of such documents are summarised in a due diligence report, which may take the form of a full detail report or only a “red flag” summary reporting only the points that may raise an issue for the buyer.

A due diligence report will usually address legal, financial, technical and sustainability/environmental topics.

2.5 Typical Representations and Warranties

Typical representations and warranties under Luxembourg law address the following points:

- disclosure;
- the capacity of the seller and the consequences of the sale;
- property ownership (encumbrances, expropriation, conditions of the property, etc);
- leases;
- insurance;
- permitting; and
- easements.

In cases of misrepresentation, the buyer may take legal action in order to get the sale declared void by a judge.

2.6 Important Areas of Law for Investors

Ownership rights are notably subject to civil code provisions, land use rules (town and country planning), protection of archaeological and/or specially classified sites, mandatory expropriation for reasons of public interest (*expropriation pour cause d’utilité publique*) or pre-emption rights (*droit de préemption*) in favour of the State or municipalities. Ownership rights can also be restricted by easements for public use (*servitude d’utilité publique*). Certain plots of land owned by the State may only be available under temporary occupation rights, rather than full ownership title (see 3 **Real Estate Finance**).

2.7 Soil Pollution or Environmental Contamination

The requirements are integrated in the authorisation to be obtained from the Ministry of Environment (operating permit).

The authorities may impose soil survey or clean-up requirements on the owner, user and/or operator of any land by virtue

of other legal frameworks, such as the legislation on classified installations, waste management or environmental liabilities.

In terms of responsibilities, the Law of 20 April 2009 on environmental responsibility with regard to the prevention and compensation of environmental damage, as modified, provides for the responsibility of the user/operator of the land. The user/operator has to support the costs of prevention or curative measures ordered by the authorities. Exceptions are also provided by the Law in order to avoid the user/operator being held responsible – primarily in the case of the fault of a third party (to be evidenced).

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

At a national level, the modified Law of 19 July 2004 on municipal planning and urban development provides rules by which to control and regulate planning and zoning in Luxembourg, and sets out the division of the country into a general development plan (*plan d'aménagement général* – PAG), corresponding to the administrative division of the country into municipalities (*communes*).

The territories of the municipalities are governed by two main types of zoning plans: the general zoning plan (*plan d'aménagement général* – PAG) and special zoning plans (*plans d'aménagement particulier* – PAP). The municipalities are in charge of issuing the PAG and the various PAPs.

The PAG divides the municipal territory into various zones, stating the following for each zone:

- how the land is to be used (eg, dwellings, economic activity, green zone); and
- the degree of land use (eg, number of houses, green spaces, etc).

Specific zones of the PAG may be divided in PAPs that implement and specify the nature and extent of land use in each zone, or part of a zone of the PAG.

Urban planning law also requires a building permit for a wide range of works, including construction or reconstruction, the modification or extension of existing buildings, and changing the use of an existing building.

Building permits are issued by the mayor of the municipality concerned. A building permit may only be issued if the intended building complies with the applicable PAG and PAPs.

An allotment permit is required in order to divide a plot of land.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation takes place by authority of justice, through a declaration in a grand ducal decree. It may relate to all or part of a building or real property rights. It must be guided by reasons of public utility and it is only possible with fair and prior compensation.

The State and the municipalities benefit from pre-emptive rights, subject to specific conditions.

2.10 Taxes Applicable to a Transaction

In the disposal of a real estate asset located in Luxembourg (ie, an asset deal), a transfer tax of 6% and a transcription tax of 1% are to be paid. If the asset is an office or commercial property located in Luxembourg City, an additional municipal surcharge of 3% is levied (leading to an aggregate rate of 10%).

The transfer taxes are usually payable by the purchaser (unless otherwise agreed upon). The taxable base corresponds to either the purchase price or the fair market value of the property, whichever is higher.

If a Luxembourg real estate asset is contributed to a company against the issuance of shares, reduced transfer taxes apply and amount to 1.1% (or 1.4% for an office or commercial property located in Luxembourg City).

No Luxembourg transfer taxes should apply to a disposal of shares in an opaque company holding a Luxembourg property, since there is no direct transfer of the ownership of the property.

2.11 Legal Restrictions on Foreign Investors

There are no specific legal restrictions on foreign investors.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate in Luxembourg are commonly financed through a combination of equity, quasi-equity and senior debt in the form of a loan, 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.

The debt portion of the financing may take the following forms:

- a mortgage debt for the financing of the acquisition of real estate assets;

- an acquisition debt for the financing of the acquisition of the shares of the entities holding real estate assets; or
- a combination of both for the financing of the acquisition of the shares of entities holding real estate assets and the refinancing of the existing indebtedness of such entities.

3.2 Typical Security Created by Commercial Investors

The financing of acquisitions and development projects is generally secured by securities created over the assets and the shares of the borrower; lenders usually accept non-recourse financing for the acquisition of commercial real estate assets, whereas investor and/or bank guarantees will usually be required in addition to the standard security package for development projects.

Typically, the lenders will require securities that allow them to recover the financed asset directly or indirectly. Such security may take the form of a contractual mortgage (*hypothèque*) over the real estate asset and/or a pledge over the shares of the entity holding such asset.

The security package will also include a security interest over cash flow related to the real estate asset or resulting from the financing transaction, usually in the form of an assignment of rights (insurances, rent), a pledge over receivables (generally related to intragroup financing) and a bank account pledge (over the relevant accounts such as rent account).

Depending on the type of transaction, the creditors may also require security over the borrower's other movable assets.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

Generally, there are no restrictions on granting security to foreign lenders, nor on payments made to foreign lenders under a security document or loan agreement. To remain enforceable against third parties, the mortgage on real estate property must be renewed every ten years.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Real estate assets are often secured by first-ranking mortgages, the registration of which triggers a 0.24% registration duty and a 0.05% inscription fee, with both rates being applied on the total secured debt (usually borne by the purchaser).

The notary fees to record the mortgage inscription in the mortgage registry are calculated on a sliding scale and are also generally borne by the purchaser.

The mere enforcement of a security over a Luxembourg real estate asset should not trigger any registration duty in Luxembourg.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The issuance of a guarantee or the granting of security over its assets by a Luxembourg company must comply with the following rules.

- Financial assistance in Luxembourg refers to the prohibition on public limited liability companies or partnerships limited by shares to, directly or indirectly, advance funds, make loans or grant security for the purpose of a third-party acquisition of its shares. It is arguable whether the financial assistance prohibition also applies to private limited liability companies, but the prohibition can be mitigated by the application of the so-called “white-wash procedure”, which allows the management and shareholders of the applicable company to overrule the financial assistance prohibition.
- Upstream and cross-stream guarantees:
 - (a) the possibility of the issuance of a guarantee to third parties or companies within the same group shall be set out in the articles of association of the Luxembourg company; and
 - (b) the managers/directors of the company must ensure that the issuance of the guarantee is in the company's corporate benefit (*intérêt social*).
- The corporate benefit test is the responsibility of the managers/directors. The company giving the guarantee shall receive some consideration in return (either economical or commercial benefit), but the benefit shall be proportionate to the burden of the guarantee/security granted.
- More generally, all guarantees issued and security granted by a Luxembourg company shall be discussed and approved at a dedicated meeting of the board of managers/directors.

3.6 Formalities When a Borrower Is in Default

The events of default are generally provided under the main credit agreement and, as such, Luxembourg security agreements usually refer to them by cross-reference.

If the main credit agreement contains a specific acceleration procedure clause, it should also be applied to the enforcement of Luxembourg security agreements.

If that is not the case, the creditor informs the debtor of the occurrence of an event default and the enforcement of its security (all or only some of them).

Usually, the enforcement is realised over the shares of the company owning the real estate. The creditor usually creates a specific purpose vehicle, which will appropriate the shares.

Unless there are creditors benefiting from privileged rights, no other creditors may take precedence over the rights of secured creditors.

3.7 Subordinating Existing Debt to Newly Created Debt

Contractual subordination is allowed under Luxembourg law. The existing creditor may agree to subordinate the existing secured debt contractually to newly created debt by entering into an intercreditor agreement or subordination agreement. It will determine the rights of each class of creditors (senior, mezzanine, junior) with respect to, in particular, their rank and subordination, the payment arrangements and the enforcement of security interests.

In theory, contractual subordination survives an insolvency situation of a Luxembourg borrower.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over a real estate property or shares should not be liable for environmental damage, provided it did not cause the damage to the environment itself, nor otherwise controlled the activities of the operator of the real estate property at the origin of any environmental damage.

3.9 Effects of Borrower Becoming Insolvent

A specific regime applies for insolvency proceedings.

The assets subject to the financial collateral arrangement(s) shall not be considered as part of the assets subject to insolvency proceedings (*masse*), enabling the beneficiary to enforce the relevant security irrespective of the opening of an insolvency proceeding and irrespective of other creditors of the *masse*. They cannot be challenged by the court-appointed receiver if they are taken during the suspect period.

Mortgages over real estate property remain in full force and effect even in the case of an insolvency proceeding.

3.10 Consequences of LIBOR Index Expiry

Parties to real estate finance transactions are expected to use new types of agreements under which interests are calculated by reference to risk-free rates (RFRs).

At this stage, the real estate finance documentation of Luxembourg has not much evolved and still relies on standard clauses for interest rate indexes.

In September 2019, the Loan Market Association (LMA) published two exposure draft facilities agreement templates, under which interest is calculated by reference to RFRs. The work is still ongoing.

Luxembourg parties to financial real estate transactions should be ready to prepare the transition to alternative interest rate benchmarks in line with BMR requirements and with British authorities' requirements. The negotiations on a post-Brexit EU-UK trade agreement may influence the use of benchmarks administered by the Bank of England, such as the Sterling Overnight Index Average (SONIA).

4. Planning and Zoning

4.1 Legislative and Government Controls Applicable to Strategic Planning and Zoning

See 2.8 Permitted Uses of Real Estate Under Zoning or Planning Law.

4.2 Legislative and Government Controls Applicable to Design, Appearance and Method of Construction

The construction of new buildings or the refurbishment of an existing building is subject to the municipal building regulations (*Règlement sur les Bâtisses* – Rb), which provide for detailed rules regarding the design, appearance and method of construction.

Each municipality in Luxembourg sets its own municipal building regulation.

4.3 Regulatory Authorities

The State as well as municipalities are responsible for regulating the designated use of individual parcels of real estate.

The modified law of 19 July 2004 applies, as does the given municipality PAG, PAP and/or Rb.

4.4 Obtaining Entitlements to Develop a New Project

Each project is subject to a building permit issued by the municipality (the mayor – *Bourgmestre*).

If the parcel(s) of land is (are) situated in a zone identified in the PAG as being subject to the adoption of a PAP, such PAP will have to be defined and adopted by the municipality council, before the owner can be put in a position to apply for a building permit.

A building permit is then only granted if the project is compliant with:

- the applicable PAG;
- the PAP for a new or existing development, where applicable; and
- the building, public road and site regulations.

Third parties with a direct interest (eg. neighbours) have a right to participate and object to the issuance of the building permit. Once the building permit application is approved by the mayor, a certificate is issued that:

- must be clearly and legibly displayed by the developer at the boundaries of the work site; and
- must state that the public can view the file at the communal authority (for the period allowed for objections, which is three months from the date when the certificate is displayed on the work site).

4.5 Right of Appeal Against an Authority's Decision

Regarding the building permit issuance process, any person may appeal to the Court to have the decision overturned. The appeal must be filed within three months from the display of the certificate by the developer at the boundaries of the parcel of land.

Regarding the PAP adoption process, any person who lodged a complaint with the communal council during the publication period and is not satisfied by the response from the Minister for Home Affairs may appeal to the Court to have the decision overturned.

4.6 Agreements with Local or Government Authorities

Developers and owners remain free to enter into a contract with the relevant authorities (primarily the municipality) in order to anticipate any issue.

4.7 Enforcement of Restrictions on Development and Designated Use

The mayor of the municipality is empowered to stop the works and/or to lodge a criminal complaint and initiate criminal proceedings against the developer/owner.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Luxembourg law provides for a wide variety of company forms capable of acquiring and holding real estate assets.

The most frequently used company types are:

- the private limited liability company;
- the public limited liability company;
- the partnership limited by shares; and
- the simple and special limited partnerships.

The civil company (*société civile*) is also occasionally used to acquire and hold real estate assets, but it cannot be used for repeated speculative real estate operations and is therefore of lesser interest for investors.

Luxembourg also offers a wide range of flexible and efficient investment fund regimes which are of particular interest to real estate asset managers willing to raise capital from investors with a view to acquiring real estate assets:

- UCIs subject to part II of the law of 17 December 2010 on undertakings for collective investment (UCIs Part II):
 - (a) are undertakings for collective investment open to retail investors subject to the ongoing supervision of the Luxembourg Supervisory Authority for the Financial Sector (*Commission de Surveillance du Secteur Financier* – CSSF);
 - (b) may invest in any type of real estate assets and pursue any real estate strategy but are subject to strict diversification requirements; and
 - (c) may be established as a standalone structure or with multiple compartments under a corporate form – investment company with variable or fixed share capital (SICAV or SICAF) in any of the legal forms mentioned above or under a contractual form (common fund – *fonds commun de placement*).
- SIFs:
 - (a) qualify as undertakings for collective investment subject to the ongoing supervision of the CSSF, but are restricted to well-informed investors;
 - (b) may invest in any type of real estate asset and pursue any real estate strategy, and are subject to diversification requirements which are less stringent than those applicable to UCIs Part II; and
 - (c) may be established as a standalone structure or with multiple compartments under a corporate or contractual form.
- SICARs:
 - (a) SICARs are investment companies restricted to well-informed investors, subject to the ongoing supervision of the CSSF;
 - (b) SICARs are not subject to any risk diversification requirements but may only invest in “risk capital” qualifying assets – ie, characterised by the concurrent gathering of two elements, namely a high risk and an

- intention to develop a project (value creation);
 - (c) regarding real estate strategies specifically, if the law does not permit SICARs to hold real estate directly, indirect investment via entities that hold or invest in real estate assets representing risk capital characteristics (private equity real estate) is possible, as is the contribution of capital to real estate companies;
 - (d) the purpose of private equity real estate investments shall, in any case, be to bring about a development (ie, the creation of added value) at the level of the underlying real estate assets, so a SICAR would not be permitted to pursue Core/Core+ strategies; and
 - (e) SICARs may only be established under a corporate form, with either a variable or fixed share capital.
- RAIFs:
 - (a) RAIFs are not subject to the ongoing supervision of the CSSF but have to be either internally managed or managed by a duly authorised external alternative investment fund manager in accordance with Directive 2011/61/EU on alternative investment fund managers so as to offer a certain level of protection to investors through the indirect supervision of the management of the RAIF;
 - (b) the absence of regulatory supervision and pre-approval requirements makes RAIFs more attractive and quicker to market than regulated funds;
 - (c) in terms of main features, the RAIF is a flexible investment vehicle, which may mirror the features of either the SIF (well-informed investors only, any asset class and risk diversification requirement) or the SICAR (well-informed investors only, “risk capital” qualifying assets and no risk diversification); and
 - (d) RAIFs may be established as a standalone structure or with multiple compartments under a corporate or contractual form.

5.2 Main Features of the Constitution of Each Type of Entity

A public limited liability company, a private limited liability company and a partnership limited by shares may only be incorporated by way of special notarial deed. Each of these company types will acquire its legal personality from the date of the relevant notarial deed. The incorporation deed of each such company form will be published in its entirety.

A simple limited partnership and a special limited partnership can be incorporated by way of either a notarial deed or a deed under private seal. While the special limited partnership is deprived of legal personality, the simple limited partnership will acquire its legal personality from the day of execution of the partnership agreement. The incorporation deed of each such

partnership will be published in extracts only. The relevant extract will include the following:

- the precise designation of the unlimited members;
- the name of the entity, its object and the place of its registered office;
- the designation of the managers as well as their signatory powers; and
- the date on which the company starts and the date on which it ends, thus ensuring an appreciable level of confidentiality.

The incorporation process is rather straightforward and can generally be completed within a few days.

With respect to investment fund regimes, investment funds subject to the ongoing supervision of the CSSF (ie, UCIs Part II, SIFs and SICARs) have to be authorised by the CSSF before they are established, and will only be authorised if the CSSF has approved the constitutive document of the fund, the management and the choice of the depositary.

The regulatory approval process usually takes between two and six months, depending on the fund regime and the initiator and fund specifics.

5.3 Minimum Capital Requirement

There is no minimum share capital requirement for the simple limited partnership or the special limited partnership. Public limited liability companies must have a minimum share capital of EUR30,000, or its equivalent in any other currency. The same requirement applies to a partnership limited by shares. The share capital of a private limited liability company must be at least EUR12,000, or its equivalent in any other currency.

Luxembourg investment fund regimes impose different requirements in terms of minimum capitalisation:

- UCIs Part II: the net asset value of a UCI Part II may not be less than EUR1,250,000, and this minimum must be reached within six months following its authorisation; and
- SIFs/RAIFs/SICARs: the subscribed capital of a SIF/RAIF/SICAR increased by the share premium or the value of the amount constituting partnership interests, or the net asset value of a SIF/RAIF under contractual form, may not be less than a certain amount (EUR1,250,000 for SIFs and RAIFs, or EUR1,000,000 for SICARs), which must be reached within 12 months of the authorisation of the SIF or SICAR or establishment of the RAIF.

5.4 Applicable Governance Requirements

Public Limited Liability Company

Under Luxembourg law, public limited liability companies can have either a one-tier or a two-tier board structure.

In a one-tier board structure, the company will be managed by a board of directors comprising at least three members appointed by the general meeting of the shareholders for a term that may not exceed six years. The public limited liability company will be represented towards third parties by its board of directors. However, the articles of association may authorise one or more directors to represent the company, either alone or jointly. The board of directors may create specific committees and is entitled to determine the composition, the powers and the duties thereof. Such committees will act under the responsibility of the board of directors. The articles may further authorise the board of directors to delegate its powers to a management committee or to a managing executive. Such delegation may neither comprise the general policy of the company nor cover all actions reserved to the board pursuant to applicable law.

In a two-tier board structure, the public limited liability company will be managed by a management board, whose powers and duties may be carried out by a sole person if the company has a sole shareholder or if the share capital is less than EUR100,000. Members of the management board will be appointed by the supervisory board or, alternatively, by the general meeting for a term that may not exceed six years. Both physical and legal persons may be appointed as management board members, but a permanent representative will have to be appointed in the latter case. The company will be represented by its management board, but the articles may authorise one or more members of the management board to represent the company either alone or jointly. As in a one-tier board structure, the management board may create committees. The supervisory board will have an unlimited right to inspect all the transactions of the company.

The supervision of the company's affairs will be carried out by one or more supervisory auditor(s) (*commissaires*) appointed by the general meeting of the shareholders for a term that may not exceed six years, unless the accounts are audited by an approved statutory auditor (*réviseur d'entreprises agréé*).

The general meeting of the shareholders enjoys certain specific powers reserved to it by law, including:

- the appointment/removal of the members of the board of directors;
- the appointment of the supervisory auditor(s);
- any amendment to the company's articles of association;
- the approval of the annual accounts and the allocation of the result; and

- the dissolution and subsequent opening of the liquidation of the relevant company.

Partnership Limited by Shares

Partnerships limited by shares are governed by the same governance rules as public limited liability companies, except for the following features:

- the management of the partnership will be carried out by one or more managers who may be unlimited members but do not need to be. Typically, the management will be entrusted to a general partner, being the holder of all unlimited shares in the partnership. In order to mitigate any unlimited liability risks, such general partner will usually be incorporated under the form of a private limited liability company. Even if a limited partner may be a member of the management board, it is strictly prohibited from carrying out any management act towards third parties; and
- the supervision of the company must be entrusted to at least three supervisory auditors (*commissaires aux comptes*) who will form a supervisory board, unless an approved statutory auditor (*réviseur d'entreprises agréé*) has been appointed.

Private Limited Liability Company

Private limited liability companies are more flexible and allow for tailor-made governance regimes. Such possibilities explain why this company form is the most popular investment vehicle for real estate.

The management of a private limited liability company will be carried out by one or more managers, who will be appointed by the general meeting or by the sole shareholder for a limited or unlimited period of time. The managers have the widest powers to realise the corporate object and may take any action necessary in relation thereto, except for those reserved by law or the articles to the general meeting.

The general meeting of the shareholders will enjoy certain reserved powers similar to those of the general meeting of a public limited liability company.

The supervision of the company must only be entrusted to a supervisory board comprising one or more supervisory auditors if the company has more than 60 shareholders and no approved statutory auditor has been appointed.

Simple and Special Limited Partnerships

The governance regime of both partnerships is characterised by an extremely high level of contractual freedom, making it a popular company form for real estate investments.

The management of each partnership will be entrusted to one or several managers, who do not need to be general partners. Limited partners may be members of the management body but cannot take any management action towards third parties without jeopardising their limited liability. In practice, as for the partnership limited by shares, the management will be entrusted to a private limited liability company that will act as general (unlimited) partner.

Matters that necessarily fall within the competence of the general meeting of the partners include:

- amendments to the corporate object of the partnership;
- a change of the nationality of the partnership;
- the conversion or liquidation of the partnership; and
- the approval of the annual accounts.

Such list may be freely supplemented in the partnership agreement.

Specific Governance Rules Applicable to Companies Listed on the Luxembourg Stock Exchange

Such companies must further comply with the specific governance rules enshrined in the X Principles of Corporate Governance of the Luxembourg Stock Exchange (eg, the establishment of a nomination committee and an audit committee).

Specific Requirements Applicable to Alternative Investment Funds (AIF)

Any undertaking for collective investment that raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which does not require an authorisation as an undertaking for collective investments in transferable securities (UCITS) pursuant to Directive 2009/65/EC on UCITS, qualifies as an AIF within the meaning of the AIFMD and as such has to either (i) be managed by an external AIFM designated by the AIF or (ii) be itself authorised as an internally managed AIF.

External AIFMs may either be authorised by or registered with the competent authority of an EU Member State, or be a non-EU AIFM.

Specific Requirements Applicable to Regulated Investment Funds

The directors of a regulated investment fund set up in a corporate form (UCI Part II, SIF or SICAR) must be of sufficiently good repute and be sufficiently experienced, having particular regard to the type of investment fund and its investment policy.

Regulated investment funds set up in the contractual form (UCI Part II or SIF only) shall only be authorised by the CSSF if the

CSSF has approved the application of the management company to manage that common fund.

5.5 Annual Entity Maintenance and Accounting Compliance

Accounting compliance costs will significantly increase if the annual accounts are to be audited by an approved statutory auditor. The appointment of an approved statutory auditor is compulsory under Luxembourg law for public limited liability companies, partnerships limited by shares and private limited liability companies, and also for common partnerships and simple limited partnerships under certain specific circumstances, if at least two of the following thresholds are met:

- balance sheet total: EUR4.4 million;
- net turnover: EUR8.8 million; or
- average number of full-time staff employed during the financial year: 50.

The fees must be assessed on a case-by-case basis.

In addition, the following average costs should be taken into consideration:

- private limited liability company: EUR8,500 covering one local manager, a registered office and general accounting services (essentially annual accounts);
- public limited liability company: EUR9,500 covering two local directors, a registered office and general accounting services (essentially annual accounts);
- partnership limited by shares and general partner under the form of a private limited liability company: EUR18,500 covering one local manager of the entity acting as general partner, a registered office for both entities and general accounting services (essentially annual accounts) for both entities; and
- simple or special limited partnership and general partner under the form of a private limited liability company: EUR15,000 covering one local manager of the entity acting as general partner, a registered office for both entities and general accounting services (essentially annual accounts) for both entities.

For investment fund structures, additional costs linked to the provision of services by third party providers may have to be taken into account, such as depositary fees, administration agent fees, AIFM fees, etc.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Real estate may be subject to long-term in rem rights under (i) a *droit de superficie*, which is a tenancy and building right with renewable terms of a maximum of 99 years each time, and (ii) a *bail emphytéotique*, which is a tenancy right with a duration between 27 and 99 years, which can be renewed.

Actual leases of real estate only confer personal rights of use of the premises to the tenant, and are split into the following three main categories:

- residential lease agreements, mainly governed by the general lease rules of the Civil Code and the law of 21 September 2006, as amended on residential leases;
- commercial lease agreements, mainly governed by the general lease rules of the Civil Code and (to the extent the lease exceeds a terms of one year) by articles 1762-3 and following of the Civil Code, concerning real estate used for commercial, industrial or craftsmanship activities; and
- lease agreements with respect to real estate used for other purposes (eg, office buildings used for administrative purposes or for liberal professions), which are not subject to the specific rules of residential or commercial leases. The leases benefit from the most extensive contractual freedom, and are only subject to the general rules of the Civil Code applying to leases (to the extent not otherwise contractually agreed).

The analysis of the following questions will be limited to commercial lease agreements.

6.2 Types of Commercial Leases

There is only one type of commercial lease, which applies exclusively to real estate used for commercial, industrial or craftsmanship activities.

6.3 Regulation of Rents or Lease Terms

Rents and lease terms for commercial leases are generally freely negotiable, but the tenant (or sub-tenant, if sub-leasing is allowed) may request the renewal of the lease at its term under certain conditions.

6.4 Typical Terms of a Lease

Commercial leases are usually concluded for a duration of nine years, with the possibility for the tenant to terminate the lease after three and six years of occupancy. However, commercial leases can be entered into for any other terms or for an undetermined duration. Leases with a fixed term exceeding nine years must, in principle, be entered into by notarial deed.

Major repairs are at the charge of the landlord, whereas the tenant is liable for the costs of maintenance and “minor” repairs, except if such repairs are caused by dilapidation or force majeure. The parties may derogate from these rules.

As no specific lists of repairs incumbent upon the landlord or the tenant have been established, this has to be determined on a case-by-case basis by the competent courts in cases of dispute.

The frequency of rent payments is freely determined by the parties.

6.5 Rent Variation

Periodic rent adjustments can be set out in commercial lease agreements. A commonly used mechanism is a contractual reference to an index published by the *Service Central de la statistique et des études économiques*. It is important to determine in the lease agreement which index is to be applied, and rent will then be adjusted. Lease agreements usually stipulate that the amount of rent may not decrease in case of a negative development of the relevant index.

6.6 Determination of New Rent

See 6.5 Rent Variation.

Parties can always amend the lease agreement by mutual consent during its term.

At the end of the lease term, under certain circumstances the tenant is entitled to request the renewal of the lease agreement. A new rent amount must be agreed between the parties, which may give rise to disputes between the parties in the absence of specific legislation. To avoid this scenario, parties foresee upfront price adjustment mechanisms in case of renewal or extension of lease agreements.

6.7 Payment of VAT

The rental of real estate property located in Luxembourg is generally VAT exempt.

However, the right to opt for VAT may be exercised under certain conditions. The VAT exemption waiver form is to be submitted for approval by the Luxembourg VAT authorities. The standard 17% rate then becomes applicable on the rent.

6.8 Costs Payable by Tenant at Start of Lease

The tenant may be liable to settle agency fees to the real estate agents. In addition, the tenant will in principle have to make advance payments for the maintenance of common spaces of the building.

6.9 Payment of Maintenance and Repair of Communal Areas

All occupants of a building must participate in the maintenance, repair and other costs related to common areas. The proportion of participation in such costs by a tenant depends exclusively on the size of the space rented as compared to the total size of the building.

6.10 Payment of Utilities and Telecommunications

Generally, each tenant has its own subscription for utilities like water, sewer, garbage, electricity and telecommunication services. Where appropriate, each rental unit will have its own meters/counters for such purpose. Alternatively, certain services may be included in the monthly charges for common spaces.

6.11 Insuring the Real Estate that is Subject to the Lease

The parties are free to decide who bears the direct cost of insurance policies. The tenant may be liable to subscribe appropriate insurance coverage directly for the premises rented, or the building management may subscribe for policies for the entire building. In the case of a general subscription by the building management, the costs are normally reflected in the monthly common charges.

The usual mandatory insurance policies (whether subscribed for by the building management or by the tenants separately) cover fire, water, storm, other natural forces and glass breakage damages.

In any case, tenants are usually required to subscribe for separate coverage with respect to damages to their personal assets and general tort liability for damages caused to visitors on their rented premises.

6.12 Restrictions on Use of Real Estate

The landlord can limit the use of the premises rented out (eg, for office/administrative use only).

Zoning and other legislation may apply and limit the use of premises for commercial, industrial, residential or other use. For certain activities that are qualified as “hazardous”, the tenant will also be required to obtain specific authorisations from the competent authorities.

6.13 Tenant’s Ability to Alter and Improve Real Estate

Any alteration by the tenant to the rented premises is normally subject to the prior approval of the landlord. If alterations are planned from the beginning, they are usually authorised within the framework of the lease agreement. Alterations that would

interfere with the normal use of their premises by other tenants or owners are generally restricted and will require the additional approval of the building management.

For major alterations, building permits from the competent authorities may be required.

Unless otherwise agreed between the landlord and the tenant, any alterations and improvements will be at the cost of the tenant. The landlord normally has the choice of keeping the alterations or improvements at the term of the lease or requesting the tenant to restore the original condition of the premises.

6.14 Specific Regulations

See **6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time.**

6.15 Effect of Tenant’s Insolvency

The insolvency/bankruptcy of a tenant does not automatically result in the immediate termination of a lease agreement. However, lease agreements often contain a possibility for the landlord to terminate the lease agreement without notice if the tenant is declared bankrupt. The landlord and the bankruptcy receiver agree on the termination of the lease and its terms.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

For commercial lease agreements, the common security is a security cash deposit, a first demand bank guarantee or other equivalent guarantee covering an amount limited by statute to six months of rent.

6.17 Right to Occupy After Termination or Expiry of a Lease

Whether or not a tenant has a right to continue to occupy the relevant real estate after the expiry or termination of a commercial lease depends on whether the commercial lease has a fixed term (it ends automatically at its term without requirement to give formal notice) or an undetermined duration (the notice period to be granted is contractually agreed and cannot be of less than six months). Renewal/extension rights may also apply. A commercial lease agreement that ends for any reason is tacitly renewed for an unlimited duration, to the extent no notice of termination has been given.

In a fixed term commercial lease, it is recommendable to send a formal notice of termination at least six months before the agreed term of the lease, with a request for the tenant to vacate the premises at the agreed term and to avoid an automatic tacit renewal.

However, the landlord only has the right to terminate a lease for unlimited duration or to refuse the renewal of a fixed term lease (if it was timely requested by the tenant) (i) to the extent the landlord or his descendants of the first degree intend to make personal use of the premises, (ii) to the extent the premises will no longer be rented for the same activities, or (iii) in case of the reconstruction or transformation of the rented building.

If the tenant has occupied the rented premises for at least nine years, the landlord can refuse a renewal of the term lease or terminate an undetermined duration lease without giving reasons, but only if the landlord or a third party agrees to pay an eviction indemnity to the tenant before the end of the lease.

6.18 Right to Assign Leasehold Interest

A contractual clause in a commercial lease prohibiting the assignment of the lease or sublease of the leased premises is null and void if the assignment of the lease or the subleasing is made together with the assignment of the commercial activity (*fonds de commerce*) and an identical commercial activity will remain established on the premises. A prohibition of the assignment of the lease or subleasing by the landlord should remain possible to the extent it is not made in conjunction with the assignment of the underlying business.

Any assignment of the lease or any sublease must be notified to the landlord, who has 30 days to refuse its consent for valid reasons. The tenant has the ability to object before the competent court, within eight days of the refusal.

The tenant remains bound, as joint and several surety, for the performance of the obligations under the assigned or subleased lease agreement.

6.19 Right to Terminate Lease

The landlord may request the competent court to terminate the commercial lease with immediate effect and before its term if the tenant does not respect the obligations contained in the lease agreement. The lease agreement can also foresee a clause entitling the landlord to terminate the lease with immediate effect for violation by the tenant of substantial obligations under the lease agreement. If the tenant refuses to vacate the premises, the landlord can request a confirmation of termination by the competent court to evict the tenant.

6.20 Registration Requirements

There is no requirement to register a lease agreement or perform any other particular execution formality. Registration of the lease agreement can be made on a voluntary basis with the Luxembourg VAT authorities.

6.21 Forced Eviction

See 6.19 Right to Terminate Lease.

The landlord can request the competent court to confirm the immediate termination of the lease and to order the eviction of the tenant. The court may grant a reasonable deadline for the tenant to vacate the premises. Court proceedings with respect to lease agreements usually take approximately six months.

6.22 Termination by Third Party

If the Luxembourg government initiates an expropriation procedure of the premises occupied by a tenant, for public reasons, the tenant will be called by the landlord to participate in the expropriation proceedings and will normally be indemnified by the government if the lease has to be terminated following the expropriation procedure.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are three main methods used to price construction projects, as follows:

- the fixed price contract is most appropriate where simplicity of management is a consideration due to the size of the project or the lack of sophistication or time availability of the owner's internal management team;
- the cost-plus contract allows the contractor to be paid the full price for all agreed-upon construction-related costs, overheads, and a fee representing the contractor's profit; and
- the unit price contract is often used for repetitive projects as it sets a price for each unit of work or task to be completed.

7.2 Assigning Responsibility for the Design and Construction of a Project

The architect is liable for the design in the event of a plan defect, if the plans have been rigorously followed by the constructor (contractor) and the owner (client). The architect is bound by an obligation of result.

The responsibility of the constructor/contractor can be retained in solidum with that of the architect if a defect that arises during the works.

Finally, the consulting engineer may also be held jointly and severally liable with the architect because their interventions are intermingled.

All participants can be held responsible for a breach of the client's advice and intelligence duties.

7.3 Management of Construction Risk

Risk factors can be split into two groups:

- internal risks, which fall within the control of clients, consultants and contractors; and
- external risks, which include risk elements that are not in the control of key stakeholders.

Constructions are regulated by Luxembourg common law provided by the Civil Code.

7.4 Management of Schedule-Related Risk

All possibilities offered by the Civil Code can operate. In particular, forfeiture clauses allow monetary compensation at key stages of the construction. Parties usually use such indemnification clauses.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The main securities under a construction contract consist of the following:

- cash retentions, which involves withholding a small amount from the contractor's claim (typically 10% of the claim), until a certain value of security has accumulated (typically 5% of the contract sum);
- using a separate bank account to give the contractor greater comfort that it will eventually receive the security amount, once its obligations have been discharged;
- a guarantee given by a bank to pay an amount on demand to the named beneficiary;
- insurance bonds that are similar to bank guarantees, in that they are issued by a third party financial institution (usually an insurance company), and are payable on demand to the named beneficiary; and
- a letter of comfort, which consists of an assurance given by a third party, such as a bank, accountant or related body corporate, about the financial standing of a particular entity.

7.6 Liens or Encumbrances in the Event of Non-payment

Mortgages are often used in construction (see 2.3 **Effecting Lawful and Proper Transfer of Title**).

7.7 Requirements Before Use or Inhabitation

Ownership rights relating to real property are entered into the Administration Registry and the Mortgage Registry, which prevents a third party purchasing the same piece of property in good faith.

8. Tax

8.1 VAT

As a principle, the purchase of an existing building is VAT exempt in Luxembourg. However, as for the lease and under certain conditions, this purchase can be subject to VAT by filing a VAT option form.

In the case of a building to be constructed, the construction work will always be subject to VAT at a rate of 17% (save for personal use, under certain conditions and limits, in which case a 3% reduced rate may be applied).

8.2 Mitigation of Tax Liability

The significance of transfer taxes on real estate assets (7% to 10%, depending on the location and nature of the property) led to the vast majority of large real estate transactions assuming the format of share deals. Since the registered owner of the property remains unchanged, no transfer taxes are due. Besides, the underlying capital gains on the property itself will not be realised and thus will not be taxed. The latent tax burden is transferred to the new shareholder and will only be realised when the property is sold in an asset deal. Therefore, the selling price is frequently discounted by a provision for latent capital gains.

Most of the investment vehicles can be structured to ensure tax efficiency.

8.3 Municipal Taxes

Each municipality in Luxembourg is authorised to levy a property tax on any immovable property situated within the limits of the municipality, whether built on or not. The land tax ranges between 0.7% and 1% of the unitary value of real property (determined based on the value of the property or of a similar property in 1941).

8.4 Income Tax Withholding for Foreign Investors Rental Income

Non-resident companies or individuals are taxable on their Luxembourg-sourced rental income similarly to Luxembourg resident taxpayers, although subject to any applicable provisions of a tax treaty. Double tax treaties concluded by Luxembourg are based on article 6 of the OECD Model Convention as far as the taxation of rental income is concerned. According to this article, rental income is taxable in the state where the immovable property is located.

Non-resident companies deriving real estate income (ie, rents) from Luxembourg situs properties will be subject to Luxembourg taxation applicable to resident companies.

For non-resident individuals directly owning real estate assets located in Luxembourg, the rental income will be subject to personal income tax in Luxembourg, in accordance with progressive rates.

Non-residents may be entitled, under certain conditions, to deduct general expenses related to the obtainment of real estate income and also to depreciate the value of the assets.

Capital Gains Upon the Sale of a Luxembourg Property

The basis for assessing real estate income tax is usually the difference between the purchase price and the selling price of the real estate property.

The capital gains realised upon the alienation of an immovable property are generally taxable in the country of location of such property (ie, Luxembourg). The State of residence of the alienator typically provides relief for the taxes paid in Luxembourg.

Accordingly, capital gains arising from the sale of a Luxembourg property by a non-resident company are subject to the standard Luxembourg corporate income tax rates.

For non-resident individuals, capital gains are not subject to a separate tax but instead to the standard rates of income tax (or reduced rates under certain conditions).

8.5 Tax Benefits

The ownership of real estate by a Luxembourg opaque company allows the recognition of tax-deductible depreciations according to the asset's expected useful life.

Business expenses such as management fees are deductible under certain conditions.

At arm's length borrowing costs can also be deducted annually, up to EUR3 million or 30% EBITDA (save for exceptions), whichever is higher.

Furthermore, the Luxembourg tax law enables (under certain conditions) a Luxembourg company to defer a capital gain realised upon the disposal of a real estate asset if an amount corresponding to the sale proceeds realised is reinvested into another fixed asset.

Stibbe (Luxembourg) is an internationally oriented law firm. Stibbe can count on more than 375 lawyers handling complex legal challenges for clients, both locally and cross-border, from its main offices in Amsterdam, Brussels and Luxembourg, and branch offices in Dubai, London and New York. The Luxembourg-based Real Estate team handles a broad spectrum of issues, such as zoning and planning, building and construction, leases, corporate structuring, tax, real estate funds and financing. Its expertise also covers all acquisition, construction and development transactions, advising on drafting any type of

contracts, financing, security, international disputes, assisting in technical expert proceedings, and industrial accidents and fires. Clients include property developers, financial institutions and institutional investors, such as Almacantar, Rothesay Life, Morgan Stanley Bank, Deutsche Bank, Caixabank and KKR. The firm would like to thank Johan Léonard (partner in the tax practice), Audrey Jarretton (counsel in the banking & finance practice) and François Bernard (senior associate in the corporate/M&A practice) for contributing to this guide.

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