

Types of Agreements for Investment in Commercial Real Estate Under Construction

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It is now common in Russia for developers to raise investor funds to finance the construction of commercial real estate. In contrast to the housing market, the legal regulation of the commercial real estate market — i.e. the Civil Code, see especially Federal Laws No. 214-FZ of Dec. 30, 2004 and No. 39-FZ of Feb. 25, 1999 — is quite liberal and its participants are able to choose from a range of legal structures.

Here we briefly describe the most common structures and point out their main advantages and disadvantages.

Investment Agreement

Although the legislation does not precisely define the investment agreement, in practice an investment agreement is usually understood to be an agreement between the developer and the investor under which the investor provides the developer with funds and the developer organizes construction and delivers the constructed property to the investor.

The main advantages of this structure are:

- legal flexibility;
- no onerous demands on the developer (there is no requirement to provide security, and there are no statutory penalties);
- no need to observe strict formalities (e.g. state registration of the agreement, publication of a project declaration).

Disadvantages of this structure:

- since there is no detailed regulation of investment agreements, it is unclear how a court may characterize the relationship;
- it may be difficult to register the investor's title because investment agreements are not transactions the state registrars usually deal with.

Preliminary Sale-Purchase Agreement with Borrowed Financing

When using this structure, the parties enter into a preliminary sale-purchase agreement for the property under construction and also a loan agreement, under which the investor finances the construction. Upon completion of construction, the parties offset their counterclaims.

Disadvantages of this structure:

- the preliminary sale-purchase agreement may be declared unconcluded because at the time of its signing the property cannot be identified precisely;
- upon completion of construction, the developer has to first register title to the constructed property in its own name, and only then sell it to the investor.

Advantages of this structure include:

- having a separate loan obligation is to the parties' advantage because even if the preliminary agreement is declared unconcluded, the loan obligation will remain valid and enforceable.

Sale-Purchase Agreement for 'Future Real Estate'

This method is based on Article 455(2) of the Civil Code, pursuant to which goods to be created by the seller in the future may be the subject of a sale-purchase agreement.

The possible use of this structure with respect to "future" real estate has long been under discussion. The main argument against using this structure is the impossibility of precisely identifying the subject of the sale-purchase agreement.

However, it is worth noting that the Supreme Arbitration Court is currently considering a draft Plenum Resolution that, if passed, will effectively legalize this structure and, apparently, will make it common.

Nevertheless, this model will have certain disadvantages, even if the Plenum Resolution is adopted, namely the need for the developer to first register its title to the constructed properties and only then to transfer the title to the purchaser.

Shared Construction Participation Agreement

The parties may also choose to enter into a shared construction participation agreement (the "SCP Agreement") under Federal Law No. 214-FZ.

The advantages of this structure are that:

- the legislation contains detailed regulation of the form and content SCP Agreements

and, as a result, there is no risk of the relationship being re-characterized;

- this structure is particularly advantageous for the investor, as Federal Law No. 214-FZ is generally oriented toward protecting its interests.

Disadvantages of the SCP Agreement:

- funds cannot be raised under the SCP Agreement until the construction permit is obtained;
- observance of strict formalities (state registration of agreements, publication of a project declaration);
- it is impossible to sell industrial property under a SCP Agreement; see Federal Law No. 214-FZ of Dec. 30, 2004. Article 2(1).

Considering the above, we believe that the developer and the investor of commercial real estate under construction have quite a large arsenal of Russian legal means for structuring their investment relationship. Of course, each of the structures described above has both advantages and disadvantages, but we are certain that with careful legal analysis of the specific investment project the parties will be able to develop an appropriate contractual model.

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