

Chambers

GLOBAL PRACTICE GUIDES

Definitive global law guides offering
comparative analysis from top ranked lawyers

Real Estate

Israel - Law and Practice
Yigal Arnon & Co

chambersandpartners.com

2018

ISRAEL

LAW AND PRACTICE:

p.3

Contributed by Yigal Arnon & Co

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Yigal Arnon & Co

CONTENTS

1. General	p.5		
1.1 Main Sources of Law	p.5		
1.2 Main Market Trends and Deals	p.5		
1.3 Proposals for Reform	p.5		
2. Sale and Purchase	p.5		
2.1 Categories of Property Rights	p.5		
2.2 Laws Applicable to Transfer of Title	p.5		
2.3 Effecting Lawful and Proper Transfer of Title	p.6		
2.4 Real Estate Due Diligence	p.6		
2.5 Typical Representations and Warranties	p.6		
2.6 Important Areas of Law for Investors	p.7		
2.7 Soil Pollution or Environmental Contamination	p.7		
2.8 Permitted Uses of Real Estate Under Zoning or Planning Law	p.7		
2.9 Condemnation, Expropriation or Compulsory Purchase	p.7		
2.10 Taxes Applicable to a Transaction	p.7		
2.11 Legal Restrictions on Foreign Investors	p.8		
3. Real Estate Finance	p.8		
3.1 Financing Acquisitions of Commercial Real Estate	p.8		
3.2 Typical Security Created by Commercial Investors	p.8		
3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders	p.8		
3.4 Taxes or Fees Relating to the Granting and Enforcement of Security	p.8		
3.5 Legal Requirements Before an Entity Can Give Valid Security	p.8		
3.6 Formalities When a Borrower Is in Default	p.8		
3.7 Subordinating Existing Debt to Newly Created Debt	p.9		
3.8 Lenders' Liability Under Environmental Laws	p.9		
3.9 Effects of Borrower Becoming Insolvent	p.9		
4. Planning and Zoning	p.9		
4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning	p.9		
		4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction	p.9
		4.3 Regulatory Authorities	p.9
		4.4 Obtaining Entitlements to Develop a New Project	p.9
		4.5 Right of Appeal Against an Authority's Decision	p.9
		4.6 Agreements with Local or Governmental Authorities	p.10
		4.7 Enforcement of Restrictions on Development and Designated Use	p.10
		5. Investment Vehicles	p.10
		5.1 Types of Entities Available to Investors to Hold Real Estate Assets	p.10
		5.2 Main Features of the Constitution of Each Type of Entity	p.10
		5.3 Minimum Capital Requirement	p.10
		5.4 Applicable Governance Requirements	p.10
		5.5 Annual Entity Maintenance and Accounting Compliance	p.10
		6. Commercial Leases	p.10
		6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time	p.10
		6.2 Types of Commercial Leases	p.11
		6.3 Regulation of Rents or Lease Terms	p.11
		6.4 Typical Terms of a Lease	p.11
		6.5 Rent Variation	p.11
		6.6 Determination of New Rent	p.11
		6.7 Payment of VAT	p.11
		6.8 Costs Payable by Tenant at Start of Lease	p.11
		6.9 Payment of Maintenance and Repair	p.11
		6.10 Payment of Utilities and Telecommunications	p.11
		6.11 Insuring the Real Estate That is Subject to the Lease	p.11
		6.12 Restrictions on Use of Real Estate	p.11
		6.13 Tenant's Ability to Alter and Improve Real Estate	p.11
		6.14 Specific Regulations	p.11

ISRAEL LAW AND PRACTICE

Contributed by Yigal Arnon & Co **Author:** Hagit Bavly

6.15	Effect of Tenant's Insolvency	p.12
6.16	Forms of Security to Protect Against Failure of Tenant to Meet Obligations	p.12
6.17	Right to Occupy After Termination or Expiry of a Lease	p.12
6.18	Right to Terminate Lease	p.12
6.19	Forced Eviction	p.12
6.20	Termination by Third Party	p.12
7.	Construction	p.12
7.1	Common Structures Used to Price Construction Projects	p.12
7.2	Assigning Responsibility for the Design and Construction of a Project	p.12
7.3	Management of Construction Risk	p.12
7.4	Management of Schedule-Related Risk	p.13
7.5	Additional Forms of Security to Guarantee a Contractor's Performance	p.13
7.6	Liens or Encumbrances in the Event of Non-Payment	p.13
7.7	Requirements Before Use or Inhabitation	p.13
8.	Tax	p.13
8.1	VAT	p.13
8.2	Mitigation of Tax Liability	p.13
8.3	Municipal Taxes	p.13
8.4	Income Tax Withholding for Foreign Investors	p.13
8.5	Tax Benefits	p.14

Yigal Arnon & Co has 60 years of real estate experience, with more than 40 lawyers in the largest, most professional, experienced and reputable real estate department in Israel, operating in our firm's offices in Tel Aviv and Jerusalem. The firm has unique and unparalleled expertise gained in commercial, residential, industrial, infrastructure and mixed-use real estate projects. The firm repre-

sents all classes of parties in real estate projects: companies, contractors, sellers and buyers, financial institutions, tenants and owners. Our clients include major Israeli and international real estate companies, investment companies, construction companies, holding companies, domestic and international banks, real estate developers and individual entrepreneurs.

Author



Hagit Bavly is a senior partner in the firm, and co-head of the real estate department. Her practice focuses on real estate, commercial law and finance. Hagit has significant experience in a wide variety of commercial transactions, in particular in the field of real estate, including purchase and sale agreements, construction agreements, joint ventures, partnership agreements, acquisition of real estate companies, IPO of real estate companies, bond issuances for real estate projects, financing agreements for projects and for companies (representing lenders and borrowers), and debt arrangements, and a wide experience in

planning, including assisting planning procedures, drafting rules for city plans, representing clients in all planning committees and in court with regard to planning procedures. Hagit provides legal advice for complex and large-scale transactions and projects, along all stages of the process, acquisition, planning, construction, and marketing. Hagit graduated with a law degree from the Hebrew University in Jerusalem in 1982. In addition, she received a B.Des from the Bezalel Academy of Art & Design in 1986 and an M.B.A from Tel Aviv University in 1995. Hagit was admitted to the Israel Bar in 1984. She joined the firm in 1987 and became a partner in 1995. She has contributed to several legal publications.

1. General

1.1 Main Sources of Law

The main sources of real estate law are the following statutes: the Land Law 5729-1969 (the "Land Law"), the Planning and Building Law 5725-1965, the Contracts Law (General Part) 4733-1973, the Lease and Borrowing Law 5731-1971, the Sale Law 5728-1968, and the Land Tax Law (Appreciation and Purchase) 5723-1963.

1.2 Main Market Trends and Deals

The Israeli real estate market focused in the last 12 months on residential construction, particularly the construction of low-cost housing units. The construction of office spaces continues, but there has been a downturn in the construction of commercial projects.

1.3 Proposals for Reform

The government is making a concerted effort to simplify the planning and permit processes, in order to enable the addition of residential units to the market in a short period of time, and lower the prices of residential units all over Israel, and mainly in the centre of the country. Encouraging the construction of residential projects for rent can help the market.

2. Sale and Purchase

2.1 Categories of Property Rights

Israeli law recognises five types of property rights: ownership, leasehold, mortgage, right of way and easement.

A very important element of Israel real estate law is that an obligation to perform a real estate transaction has to be in writing, excluding the lease that does not exceed ten years.

2.2 Laws Applicable to Transfer of Title

The Land Law stipulates the principles for executing a real estate transaction for all types of property – residential, commercial, offices, etc.

Other statutes govern specific areas and stipulate further provisions, which are usually binding on the seller or the landlord, and protect the buyer or the tenants. Examples include the sale laws, which apply primarily to the sale of residential units, and new regulations (from 2016) that apply to the sale of land that is not designated for construction.

2017 saw the lowest number of real estate transactions in Israel since 2011.

2.3 Effecting Lawful and Proper Transfer of Title

Article 7(a) of the Land Law prescribes: “A transaction in immovable property requires registration. The transaction is completed by registration, and the time at which the Registrar approves the transaction for registration shall be regarded the time of registration.” In other words, a real estate transaction is completed only by registration in the applicable Land Registry. Registration is computerised and accessible via the Internet, both for viewing and for registration of sale transactions and other transactions, such as a “cautionary note” regarding an undertaking to perform a real estate transaction.

Israel does not have registration or title insurance, as exists in the United States and other jurisdictions. Perhaps no such mechanism was developed because there is no need: in Israel, registration is conclusive and may be relied upon.

One of the elements that affects and delays registration is that tax clearances need to be submitted for registration of the transaction. In the last few years, changes have been made in order to facilitate tax payment and the obtaining of clearances, mainly through automatic clearance against payment by the buyer of fixed advances on account of tax payments that apply to the seller.

However, a substantial portion of the land in Israel is owned by the government or by related entities and managed by the Israel Land Authority (the “ILA”), which is a governmental unit. Much of the land that is managed by ILA has not yet undergone parcel planning to enable its division into specific parcels.

Article 13 of the Land Law stipulates that “a transaction in immovable property extends to the land ... and a transaction in respect of a specific part of the property is invalid.” Therefore, title cannot be registered with regard to land that is not registered as a separate parcel or as a separate unit in a “co-operative house” in the land registry. It should be noted that a “co-operative house” is the common way of registering the ownership with respect to a building or a project that has two or more units, residential or other, and that a “co-operative house” is different from the US condominium. The significance of all this is that there is still a lot of land that cannot yet be registered in the names of its different owners in the Land Registry, and is therefore temporarily registered with the ILA that runs such “parallel” registration.

2.4 Real Estate Due Diligence

Before a real estate transaction takes place, a due diligence review is conducted, with the scope varying according to the type, complexity and value of the property, and other parameters. The review may include the following:

- checking the registration and any restrictions that may exist with regard to the registered rights, such as mortgage, lien or expropriation;
- planning restrictions – what may be built on the property, whether a valid permit was issued for the existing building, whether taxes or levies will be imposed in connection with future construction;
- physical inspection – of the land, of construction on the land, of infrastructure, etc;
- third-party rights such as tenants, or obligations toward planners or contractors; and
- outstanding taxes and levies on the property, including those that will be imposed on the seller and which will be required in order to register the transaction.

Depending on the value and complexity of the property, various professionals may be retained for the due diligence process – lawyers, accountants, insurance consultants, tax experts, engineers, assessors, etc.

2.5 Typical Representations and Warranties

The seller of real estate must make a representation about the property, about any restriction imposed on their rights to the property and with regard to its sale and transfer, and must disclose to the buyer anything he or she knows about the property, including defects. This does not limit the buyer’s duty to perform a due diligence review.

The seller must provide representations about matters that cannot be examined, primarily agreements that have been entered into with regard to the property: lease agreements, agreements with planners and contractors, sale agreements with third parties, etc.

A seller who fails to satisfy this disclosure obligation can be sued for damages suffered by the buyer because of entering into the agreement, and in some cases the contract may even be terminated.

There are also specific obligations for a developer who builds and sells real property, pertaining primarily (but not exclusively) to the sale of residential units. Such a developer is subject to enhanced duties, both with regard to the presentation of the property and with regard to details and provisions that must be included in the sale agreement and its appendices, such as a duty to complete the registration of the property in the land registry in a specific period of time, and to guarantee the buyer’s payments until construction has been completed, and a “cautionary note” or some other collateral has been provided to secure the buyer’s right to be registered as the owner of rights in the property.

After executing a sale agreement, if the buyer discovers information that the seller knew or should have known and which, had the buyer known prior to signing, would have de-

tered him or her from entering into the agreement (except for a mistake about the profitability of the deal), the buyer may have the right to cancel the agreement.

2.6 Important Areas of Law for Investors

Before entering into a transaction for real estate property, the buyer should inspect the items detailed in **2.4 Real Estate Due Diligence**, above. He or she should also consider the legal status of the property and the rights to the property, the planning and permit status of the property and its surroundings, existing and future tax exposures, and the legal condition – ie, any obligations in connection with the property that exist toward third parties and that might affect their ability to use or develop the property. If the property is part of a “co-operative house”, the buyer should inspect the “co-operative house” documents; if the rights to the property are a long-term lease, he or she should review the terms and restrictions of the lease, etc.

2.7 Soil Pollution or Environmental Contamination

Environmental legislation has advanced in Israel over the last years. The proposed Order for Prevention of Soil Contamination and Rehabilitation of Contaminated Land is still pending. Among its provisions, the Order proposes to prohibit soil contamination and the transfer of contaminants into the soil, and imposes liability on the contaminator. The Order further imposes a duty on the landowner to inform any prospective buyer of any contamination on the land.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

General information about zoning and building rights with respect to real estate property can be extracted from the websites of the planning authorities. One can obtain official information by filing an application and paying an application fee (negligible amount). In some cases, the applicant should also submit a measurement survey of the property.

A landowner seeking to rezone his property or add building rights can initiate a planning process, provided that the proposed plan is consistent with binding plans that are higher up in the planning hierarchy, and subject, of course, to the planning policy of the applicable planning authorities. In the last few years, general city plans have been approved for many of the larger cities, stipulating planning principles such as permitted uses, building height limits and density, the location of public buildings and public areas, road systems, etc; any plans that is initiated must comply with these principles.

2.9 Condemnation, Expropriation or Compulsory Purchase

Various laws allow property to be expropriated for public use, such as roads, parks, recreation areas, nature reserves, parking areas, etc.

Before initiating such procedure, the authority must post notice of its intended expropriation in the vicinity of the property, and deliver this notice to the owner in person, to allow him to appeal against it. Compensation will be paid if more than 40% of the property (in the aggregate, over the years) has been taken.

If the land is expropriated but not used for the purpose for which it was taken, or if the need for such public use has ended, the original owner can claim back his land, or its monetary equivalent.

2.10 Taxes Applicable to a Transaction

Pursuant to the Land Tax Law (Appreciation and Purchase) 5723-1963 (the “Land Tax Law”), the buyer must pay purchase tax and the seller must pay land appreciation tax in any real estate transaction.

Generally, purchase tax is 6%; there are progressive rates for residential properties that may exceed this figure. Land appreciation tax (which is capital gains tax) is equal to 25% of the seller’s capital gain on the transacted property. However, if the seller’s business is the development and sale of real estate property, they shall pay income tax rather than land appreciation tax.

There are specific exemptions with regard to land appreciation tax on residential apartments. The most common one is an exemption on the sale of an apartment if the seller has no other residential apartment. Such exemption is available only to Israeli residents.

Purchase tax rates on the purchase of residential apartments in Israel by foreign residents are also different to the rates that apply to local residents.

In addition, if the seller makes a profit on the sale that results from a change in the city plan that governs his property, the seller has to pay a land betterment levy to the local authority within whose jurisdiction the property is located, this in addition to land appreciation tax. Such levy equals 50% of the gain attributed to the property due to the approval of the city plan.

A gift between certain immediate relatives can be exempted from land appreciation tax, and be subject to reduced purchase tax rates.

Note that there is no inheritance or estate tax in Israel, so the transfer of real property by will or succession is not taxable.

Land appreciation tax and purchase tax pursuant to the Land Tax Law also apply in the event of transfer of shares in a “real estate entity” – ie, an entity that owns only real estate property.

2.11 Legal Restrictions on Foreign Investors

There is no restriction on the transfer of privately owned real estate to foreigners. Land administered by the ILA (see 2.3 **Effecting Lawful and Proper Transfer of Title**, above) can be transferred to foreigners subject to certain limitations, and to the ILA's approval.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

In most cases, transactions in commercial real estate are financed by Israeli banks or Israeli insurance companies. Parties that cannot obtain such financing approach private financiers; the terms of these loans will usually be less convenient for the borrower.

Large projects can raise money by issuing debentures or shares.

3.2 Typical Security Created by Commercial Investors

The collateral available to the financing entity is first and foremost the property itself. Sometimes, the borrower is required to provide additional collateral. In the last few years, there have been hardly any non-recourse loans; in other words, the lender has recourse against the borrower, including with regard to other assets that were not submitted as collateral.

The property itself is pledged through registration of a mortgage at the Land Registry; if the property is administered by the ILA and has not yet been registered in the Registry in the name of the borrower, the collateral can be in the form of an obligation of ILA to register a mortgage.

All income accruing on the property is also pledged as collateral, including by way of irrevocable instructions to tenants to pay their rent to a designated bank account that is pledged in favour of the lender. Any insurance benefits to which the borrower may be entitled are also pledged as collateral.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There is no legal restriction on lending money to foreign residents for the purpose of buying real property in Israel but, naturally, lenders will stipulate stricter terms on loans to foreign residents, either because they are less familiar with the borrower's business or because of the uncertainty with regard to verifying the borrower's capability to enter the loan agreement, and with regard to foreclosing on the borrower's collateral in case of default.

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

Registration of pledges is subject to the payment of a small fee to the Land Registry. The fee is fixed and is not a function of the value of the property, and is therefore negligible.

The cost of notarising a document is also fixed and negligible.

Lenders charge for the preparation of their documents, and for the costs of the consultants they use for the transaction. These amounts could be significant.

Financing agreements always stipulate that the cost of foreclosing on the collateral in case of default will be borne and paid by the borrower. Such costs may be significant, especially because of the fees of the consultants engaged for the purpose of liquidating the property.

Upon foreclosure, property is liquidated by selling it and collecting the debt from the proceeds. On the sale of a property in such a case, the borrower shall have to pay land appreciation tax pursuant to the provisions of the Land Tax Law, as described above.

3.5 Legal Requirements Before an Entity Can Give Valid Security

When resolving to pledge the company's property, directors must weigh up the best interests of the company and its shareholders, and verify that the pledge and financing transaction do not cause a reduction in capital.

3.6 Formalities When a Borrower Is in Default

A borrower seeking to foreclose on a mortgage or pledge created over a residential apartment must comply with Article 81B1 of the Execution Law 5721-1967, which stipulates that, in case of a loan that is repaid by installments, where the borrower defaults on at least one instalment, the lender may file a petition to foreclose only six months after the date of default, and only with regard to the amount in arrears and not with regard to the entire loan amount. If it was not stipulated that the loan would be repaid in instalments, the lender may, upon default, file a petition for full recovery of the loan as of the actual date of default.

The lender will rank higher than other creditors only if they procured the appropriate registration for their rights. The best protection is granted by registering a mortgage in the Land Registry, or - if the borrower's rights are not yet registered in the Land Registry - by a pledge with the Registrar of Companies in the case of a company and in the Registry of Pledges in the case of an individual.

3.7 Subordinating Existing Debt to Newly Created Debt

If there are two or more pledges of the same kind, the one that was registered first will prevail. A fixed charge will prevail over a floating charge. Obviously, the ranking can be changed by agreement between the owner and the lenders.

3.8 Lenders' Liability Under Environmental Laws

The lender does not hold possession or rights in the property. Foreclosure is usually effected by selling the property to a third party, not by transferring it to the lender. The lender is therefore not deemed the possessor and is not liable for compliance with environmental laws with respect to the property.

3.9 Effects of Borrower Becoming Insolvent

In the event of the lender's insolvency, the lender's rights and obligations are transferred to their creditors. In other words, the right to foreclosure pursuant to the charges shall not expire, and will be transferred to the lender's receiver, trustee or special manager.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

The Planning and Building Law 5725-1965 (and the regulations promulgated thereunder) defines the planning bodies – Regional Committees, Local Committees and National bodies such as the National Planning and Building Council, the Committee for Protection of the Coastline Environment and others. It also defines the hierarchy among them, and the plans that each is authorised to approve. Each of the planning and building committees is subject to another one higher up in the hierarchy, although they also have independent discretion with respect to certain matters. Building plans must always comply with those of higher hierarchy, including regional and national outline plans. Certain subjects are regulated on the national level, such as coastline preservation, gas stations and railways.

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

Local committees may stipulate instructions for their jurisdiction, relating, for example, to the aesthetic design of the building, its entrance elevations and its integration into the environment. Some cities, such as Tel Aviv, adopt specific plans for the restoration of heritage buildings, which define which buildings must be restored, and categorise them according to the level of restoration required. The most protected level requires restoration of all elements and prohibits addition of any new construction.

4.3 Regulatory Authorities

There are three levels of planning authorities:

- the National Council, which is in charge of planning and stipulating statewide instructions and policy;
- the Regional Committees, which are in charge of promoting and implementing the instructions of the National Council in their respective regions; and
- the Local Committees, which promote and approve plans on the local level, designate uses, define the land-to-building ratio, stipulate building restrictions, etc.

As mentioned, there are also statewide terms and conditions, such as building and uses on the coastline or near gas stations.

One planning subject that has been on the planning agenda in the last few years is the building of intracity and intercity public transportation facilities. This also affects construction in the city centres and the regulations for the construction of parking spaces, as some of the effort in this respect is directed towards reducing parking space allocations and stipulating maximum parking space allocations, to make it harder to use private cars and to encourage use of public transportation.

4.4 Obtaining Entitlements to Develop a New Project

All "construction work", which has a very broad definition under Israeli law, requires a building permit from the applicable Local Planning and Building Committee. A building permit must comply with all plans that govern the relevant land in terms of the land-to-building ratio, location within the lot boundaries, height, designated use, etc. An owner of real estate property who wants to build a building that will not comply with the current plans can apply for a specific city plan. If such a specific plan conflicts with other plans of higher hierarchy, it may also have to be approved by the Regional Planning and Building Committee if it conflicts with Regional plans, or by the National Planning and Building Council if it conflicts with nationwide plans, etc.

Anyone who sees himself adversely affected if a proposed plan is approved may file an objection to the proposed plan. The planning bodies will examine the proposed plan and the objections, and will also take planning policy into account. It is not possible to object to an application for a building permit that complies with the governing building plans.

4.5 Right of Appeal Against an Authority's Decision

Decisions of the Planning Committees to approve or reject a plan or an application for a concession relief or exceptional use [use that does not comply with the zoning] can be appealed to the Appellate Board or the Administrative Courts.

Decisions of the Administrative Courts can be appealed to the High Court of Justice, subject to receiving leave to appeal.

4.6 Agreements with Local or Governmental Authorities

In some cases, in order for a permit for new construction to be granted, certain development works in the vicinity of the property are necessary, regarding traffic, utilities, etc, to make sure that the new construction is adequately connected to the traffic and utility grids, and that their capacity is sufficient to handle the load added by the new construction. The Local Authority charges a development levy from the applicant for this purpose, which is usually a “one time” charge (not a repeated charge), calculated according to the size of the lot and the intended scope of the new construction. As a condition for a building or occupancy permit, the Local Authority sometimes requires the developer to perform such works himself or to engage with contractors appointed by the Local Authority for this purpose. In most cases, the engagement is with a municipal development company or a contractor appointed by the same.

4.7 Enforcement of Restrictions on Development and Designated Use

The Planning and Building Law is a penal code, and is enforced by the law enforcement agencies, including municipal inspectors. A person or entity who violates the Planning and Building Law, builds without a permit or in violation of a permit, or uses any property in violation of a permit will be indicted, and enforcement actions will be taken. An independent unit has been set up as part of the effort to enforce planning and building laws, called the National Unit for Enforcement of Planning and Building Laws.

5. Investment Vehicles

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

Investors can hold real estate in any way they choose, either in their capacity as individuals or through corporate entities, due to tax planning and in order to use the limited liability protection that a company affords.

5.2 Main Features of the Constitution of Each Type of Entity

A company has a separate legal identity to that of its shareholder. A limited liability company protects its shareholders, such that, subject to special circumstances, a shareholder of a limited liability company shall have no exposure if any lawful activity of the company should fail. A limited partnership also has a separate legal identity to that of its limited partners. Limited partners that are not involved in the

management of the partnership have similar protection as shareholders in a limited liability company.

5.3 Minimum Capital Requirement

The minimum equity required to incorporate a company is ILS1 (less than USD1). There is no minimum equity required to form a partnership.

5.4 Applicable Governance Requirements

There are no specific requirements for investment in real estate but there are obligations as to representations that have to be made by the lenders, and with regard to the liability of individual borrowers and guarantors. There are specific limitations on lenders with respect to providing loans to individuals for the purpose of financing the purchase of residential units.

5.5 Annual Entity Maintenance and Accounting Compliance

Companies and partnerships must file annual statements with the Companies Registrar and the tax authorities, and pay a fixed annual fee to the Companies Registrar. The annual cost of all of the above starts from ILS6,000-10,000 (approximately USD2,000-2,500), depending on the scope of activity and the level of complexity.

6. Commercial Leases

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

The Leasehold and Borrowing Law 5731 -1971 (the “**Leasehold Law**”) stipulates the following definition: “A leasehold is a right granted, against a consideration... to hold possession and use property for a limited time.” The Land Law, which lists leasehold rights as one of the five property rights, offers a similar definition. Making real property available to others for exclusive use, for a limited time, and against a consideration can only be done through a leasehold. Terms such as “use” or “permission” which are not defined by law are sometimes used in this respect; they are substantially leaseholds.

There is an obligation to report a leasehold agreement to the tax authorities and register it in the Land Registry, depending on the term of the leasehold (ten years for registration, 25 years for reporting to the land tax authorities and paying taxes). A long-term lease of more than five years is called “*hahira*” in Hebrew. If the term exceeds 25 years, it is called “*hahira-ledorot*” (literally: long-term lease for generations).

A status of protected tenancy exists in Israel, protecting tenants who were tenants when the Protected Tenancy Law entered into effect and anyone who rented real property and paid a substantial amount up front in order to obtain this sta-

tus. However, hardly any new protected-lease agreements are entered into anymore. There is no longer protected tenancy for commercial property, and it is gradually disappearing from the residential-lease market as well.

6.2 Types of Commercial Leases

There are various mechanisms to effect commercial lease agreements, including advance payment, monthly / quarterly payment, rent calculated on revenue, etc. All this does not affect the substantive nature of the engagement as leasehold.

6.3 Regulation of Rents or Lease Terms

The Leasehold Law was amended in 2017 and “fair rental” provisions were added, protecting only residential tenants. The law does not limit the amount of rent or its increase, but clearly defines obligations governing lessors of residential properties, including mandatory contractual disclosures, and stipulates the kind of payments that the landlord should pay and may not pass on to the tenant.

As mentioned, there are still some protected tenancies, and the rent for these is limited, but they are gradually disappearing from the market.

6.4 Typical Terms of a Lease

The lease term is usually broken up into an initial period of about three to five years, plus one or more options that the tenant may exercise. The initial lease term and the option periods will not usually exceed ten years in total.

Standard practice is that the tenant is responsible for ongoing maintenance, and the repair of any damage except for reasonable wear and tear. Commercial properties are often let in “structural envelope” condition, and the tenant completes the finishing at his own cost and expense. In such cases, the tenant is liable to make any necessary repairs to the works he or she has performed. Triple net lease is not commonly practised in Israel.

Rent is usually paid every quarter, in advance.

6.5 Rent Variation

In most cases, rent is linked to the consumer price index.

6.6 Determination of New Rent

In each option period, rent usually goes up by 3-5%.

6.7 Payment of VAT

VAT is due for rent on commercial properties.

6.8 Costs Payable by Tenant at Start of Lease

In addition to the payment of rent, management fees and other current payments throughout the term of the lease, tenants of commercial properties are required to submit securities to the lessor prior to the commencement of the

lease term, to purchase insurance and, in some cases, to participate in the lessor’s legal fees in connection with the lease agreement.

6.9 Payment of Maintenance and Repair

Common areas in commercial properties, such as lobbies and parking areas, are usually managed by the lessor, directly or through a third-party management company. The cost is usually broken down among all tenants, according to a predefined formula – per square metre or against a fixed fee.

6.10 Payment of Utilities and Telecommunications

The same applies to utilities and telecommunication infrastructure that serves several tenants – the costs can be divided among the users, per square metre or against a fixed fee.

6.11 Insuring the Real Estate That is Subject to the Lease

In multi-tenant commercial properties, the lessor usually takes care of the insurance of the building, and includes the tenants as additional insured. In some cases, the tenant is billed separately for this cost. In properties that are let to a single tenant, building insurance obligation can be passed on to the tenant. Coverage is standard; disputes sometimes arise in connection with the duty to insure against earthquakes or other natural disasters. The Israeli government provides mandatory insurance against war and terrorism.

6.12 Restrictions on Use of Real Estate

In the lease agreement, lessors may stipulate various provisions regarding the use, such as the purpose (subject, however, to antitrust law in the case of shopping malls and similar properties), operating hours, behaviour on the property, maintenance, etc. Tenants’ use of the property is also subject to regulatory provisions, such as the Business Permits Law, which regulates operating hours, the duty to obtain a business permit, compliance with permitted use in accordance with the city plan and building permit, etc.

6.13 Tenant’s Ability to Alter and Improve Real Estate

In commercial properties, standard practice is that the lessor prohibits the tenant from performing any works or changes to the property, and that if any such works or changes are performed, the lessor can choose, at the end of the term, either to keep the changes or to have the tenant remove them, all of these with no charge to the lessor.

6.14 Specific Regulations

As mentioned, the Leasehold Law was amended in 2017 and “fair rental” provisions were added, which apply to residential leaseholds only. The purpose of this amendment is to protect residential tenants, primarily through imposing certain disclosure duties and liabilities on the lessor. However, rent is not limited in any way. It is too early to say whether

these amendments have improved the situation of residential tenants in the market.

6.15 Effect of Tenant's Insolvency

Commercial lease agreements sometimes stipulate that if the tenant enters into bankruptcy or is pronounced insolvent, the lessor shall be entitled to terminate the agreement and evict the tenant. Courts do not enforce this provision as long as the tenant complies with the agreement. The courts sometimes allow the receiver or other officer appointed to the insolvent tenant to transfer the lease to a third party that acquires the tenant's business operation.

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

The best security for lessors is, of course, a bank guarantee. Industry standard is a bank guarantee equal to 3-6 months' worth of rent, plus management fees. Other securities include deposits, promissory notes and personal guarantees.

6.17 Right to Occupy After Termination or Expiry of a Lease

The tenant has no right to stay on the property after the end of the lease. However, if he does, the lessor is not allowed to take any "self-help" action: he must petition the court through an expedited process, seeking an eviction order. This is one of the reasons why property owners insist on substantial securities, as described above. Another effective measure is to stipulate liquidated damages. If the property is not vacated after the end of the lease.

6.18 Right to Terminate Lease

Lease agreements usually include the terms upon which the lessor may terminate the lease, primarily defaulting on the rent or violating the purpose of the lease. The Leasehold Law protects the tenant where the property cannot be used for the purpose of the lease, allowing him not to pay rent for the period during which use of the property was precluded. However, if the tenant exercises this right, the lessor may, after a reasonable time, terminate the lease.

6.19 Forced Eviction

In the event that the lessor terminates the agreement due to breach by the tenant, the lessor may require the tenant to vacate the property; if the tenant does not do so, the lessor may petition the court through an expedited process for an eviction order. This can take several months, and even longer if the tenant offers substitutional defence arguments and refutes the alleged breach.

6.20 Termination by Third Party

Termination of a lease by a third party is very rare. This can happen if a building is declared dangerous, or if the property or any part of it are expropriated, as happened in recent

years in Jerusalem and Tel Aviv in the case of properties that border the light rail route.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The consideration in construction contracts is usually a pre-agreed fixed sum, allocating the risk to the contractor, or is calculated by measuring the quantities of work actually performed, which means that the developer cannot know in advance how much the project will cost.

The developer can also decide whether to use a single construction contractor or to engage several different contractors for the structural frame, systems, fit out work, etc.

7.2 Assigning Responsibility for the Design and Construction of a Project

Developers usually commission planning and design separately from construction. The developer engages planners and consultants (up to 15-20 in a complex project), and a project manager that handles management and supervision; later on, the developer also engages one or more contractors.

These alternatives vary in the certainty of the cost, planning flexibility and the ability to continue planning after the process has been launched, and in the legal and contractual liability. A landlord that does not engage a turnkey contractor but uses several different contractors will be liable for the construction, including with regard to building safety, even if he retains a project manager and inspector.

7.3 Management of Construction Risk

Developers can stipulate that the contractor will bear the entire liability – for construction dates and costs, third party liability, etc. Criminal liability for which the owner is liable by law cannot be transferred to the contractor. The courts have drawn a distinction for this matter between turnkey contractors, who are considered liable for everything that happens on the site, and a developer that builds with several contractors; the latter cannot disclaim liability.

A developer cannot disclaim liability toward purchasers of part or all the project. The developer will be liable directly towards purchasers, regardless of whether he has back-to-back liability against his contractor.

Construction contracts usually impose broad liability on the contractor, who assumes contractual liability and warrants to purchase insurance and indemnify the developer.

7.4 Management of Schedule-Related Risk

It is standard practice for a construction contractor to be held liable for the project's timetables. Liquidated damages for delays are also common practice.

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

Contractors usually submit bank guarantees: first, a performance guarantee, the main purpose of which is to guarantee the contractual timetable, and later on a warranty guarantee for the quality of the construction. The performance guarantee is usually equal to 5-10% of the contractual fee, while the warranty guarantee is usually half of the performance guarantee, and is sometimes reduced after the first year.

7.6 Liens or Encumbrances in the Event of Non-Payment

In most cases, construction contracts prohibit the designer and contractor from pledging their contractual rights toward the developer. Subject to the developer's consent, contractors sometimes pledge the right to receive their fee.

7.7 Requirements Before Use or Inhabitation

Once construction is completed, the building permit issuer must obtain a completion certificate before the new building can be used. Several certificates should be obtained as a prerequisite: a certificate confirming that the building is compliant with the building permit, confirmation from an inspection institution regarding the quality of construction, confirmation the the building complies with safety requirements, a certificate confirming that the building complies with the rules regarding access for persons with disabilities, etc. Use of a building without a completion certificate is a violation of the criminal code, both by the owner and by the user.

Yigal Arnon & Co

1 Azrieli Center
Tel Aviv 6702101
Israel

Tel: +972 3 6087821
Fax: +972 3 6087727
Email: hagit@arnon.co.il
Web: www.arnon.co.il



YIGAL ARNON & CO.
LAW FIRM

8. Tax

8.1 VAT

VAT is payable on any transaction in which the seller or purchaser are registered with the VAT Authority as a "business entity" for VAT purposes. The sale and purchase of corporate real estate will always be subject to VAT. If the seller is a "business entity", he or she is liable for remitting VAT, and the purchaser will receive an invoice and can set off the VAT against VAT in other transactions, such as payments made to suppliers. If the seller is an individual who is not a "business entity", the purchaser shall pay VAT through a self-billing invoice, which can also be set off. VAT in Israel is 17%. Transactions in Eilat in the south of Israel are exempt from VAT.

8.2 Mitigation of Tax Liability

Purchasers have tried in the past to allocate some of the consideration in real estate transactions to assets other than the real property, such as equipment, leasehold rights, etc, in order to reduce their purchase tax obligation. The Supreme Court ruled against this, and it would now be difficult to use arguments of this kind to reduce the value of the transaction. Purchasers sometimes claim that some of the amount was for reputation. For this to carry, they must prove that the reputation is independent from the real property, and must establish its value.

8.3 Municipal Taxes

City tax is fixed by the local authority, by a "city tax order", which is updated from time to time, subject to a cap stipulated by the government. The amount varies among properties, depending, among other things, on the use category and sub-category, such as office, banking, movie theatres, stores, etc. Exemptions from city tax on usable (as compared to unusable) property are rare, and depend primarily on the user; for example, disabled persons are eligible for discounts on business uses, and senior citizens are eligible for discounts on residential uses.

8.4 Income Tax Withholding for Foreign Investors

Payments to foreigners are subject to withholding tax – 25% for individuals, and the applicable corporate rate for corporations (23% in 2018). All such payments are subject to any applicable tax treaty with the investor's country of residence, and depend on the classification of the income.

Rent is taxable according to the classification of the proceeds: corporations will pay corporate income. while individuals will pay their income tax bracket (this could reach 47%, plus 3% "additional" tax). Tax on rent is paid by the lessor, or by the tenant through tax withholding, depending on whether the lessor has an exemption and whether the tenant is subject to tax withholding duty.

Tax breaks exist only for income on residential rent, up to a specific annual amount.

The sale of real property is taxable at 25% on the profit. Taxable profit can be reduced by offsetting expenses against the income; in addition to the cost of purchase, the seller can deduct improvements such as renovations, betterment levy, real interest on loans taken to finance the original purchase, and ancillary expenses to the purchase and sale of the property, such as broker and attorney fees.

8.5 Tax Benefits

Companies and “business entities” that generate business income on real property can make ongoing deductions on their expenses on the property, and may deduct depreciation on the cost of purchase and improvements they had invested. Any deductions made on a current basis, as mentioned, will not be recognised as an expense upon the sale of the property.