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CONTENTS

| | | |
|----------------------------|---|-----|
| Preface | John Condliffe, <i>Hogan Lovells International LLP</i> | |
| Belgium | Alexandre Emond & Jeroen Versnick, <i>Liedekerke Wolters Waelbroeck Kirkpatrick</i> | 1 |
| Brazil | Camila Mendes Vianna Cardoso, Alexandre Sales Cabral Arlota & Tereza Cristina de Almeida Marins Gorito, <i>Kincaid Mendes Vianna Advogados</i> | 11 |
| Colombia | Francisco Uribe, Isabel Rojas & Juanita Bermúdez, <i>Brigard & Urrutia Abogados S.A.S.</i> | 20 |
| Denmark | Hans-Peter Jørgensen & Jesper Avnborg Lentz, <i>Gorrissen Federspiel</i> | 30 |
| England & Wales | John Condliffe, Anthony Newton & Jamie Hyams, <i>Hogan Lovells International LLP</i> | 40 |
| Finland | Antti Laaksonen, Panu Penttilä & Sakari Lähteenmäki, <i>Project Law Attorneys Ltd</i> | 50 |
| France | Catherine Saint Geniest, Paul-Henri de Cabissole & Laura Viale, <i>JeanetAssociés A.A.R.P.I.</i> | 58 |
| Germany | Dirk Mackeprang & Hendrik Sandmann, <i>FPS Partnerschaftsgesellschaft von Rechtsanwälten mbB</i> | 65 |
| Greece | Panagiotis Drakopoulos & Maria Eliza Kyparissi, <i>Drakopoulos Law Firm</i> | 76 |
| Ireland | Jim Murphy, Richard Leonard & Jennifer Halpin, <i>McCann FitzGerald</i> | 81 |
| Italy | Luigi Croce & Christian Mocellin, <i>NCTM Studio Legale Associato</i> | 90 |
| Japan | Junko Ogushi, Russell K. Kawahara & Shuji Koyama, <i>Atsumi & Sakai</i> | 100 |
| Luxembourg | Léon Gloden & Max Becker, <i>Elvinger, Hoss & Prussen</i> | 107 |
| Netherlands | Leon Hoppenbrouwers & Niels Molenaar, <i>Allen & Overy LLP</i> | 117 |
| Norway | Thomas R. Håkonsen & Maren Müller, <i>Advokatfirmaet Schjødt AS</i> | 127 |
| Paraguay | Ana Añazco, Juan Carlos Boggino & Paolo Doria, <i>Peroni Sosa Tellechea Burt & Narvaja</i> | 136 |
| Romania | Florian Nițu & Ela Marin, <i>SCA Popovici Nițu & Asociații</i> | 143 |
| Russia | Alyona Kucher, Natalia Putilina & Dmitry Stakheev, <i>Debevoise & Plimpton LLP</i> | 154 |
| Spain | Andrés Monereo, Michael Fries & Mónica Regaño, <i>Monereo Meyer Marinel-lo Abogados</i> | 166 |
| Switzerland | Wolfgang Müller, Walter Häberling & Christian Eichenberger, <i>Meyerlustenberger Lachenal</i> | 176 |

Japan

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Introduction

In Japan, most leases are governed by the Act on Land and Building Leases (Act No. 90 of October 4, 1991) (the “ALBL”) as amended by the Law to Facilitate the Supply of High-Quality Housing for Rent of 1999, which became effective in April 2000 (the “1999 Law”, and the ALBL as amended by the 1999 Law, the “Act”) and the Civil Code. Prior to the enactment of the 1999 Law, the laws governing leases, and the court interpretation of leases, were reflective of the relative shortage of housing in Japan and generally sympathetic to tenants (e.g., making it difficult for a landlord to terminate a lease). The 1999 Law re-balanced the scales somewhat and made it possible for building owners to have more certainty about the term of leases (as discussed further below).

The Act applies to land leases for land on which a separately owned building is situated and to building leases, including space leases for space within buildings (both commercial and residential). The Civil Code applies to leases not governed by the Act (such as temporary structures, agricultural leases, open land, etc.) and covers matters not covered by the Act (such as formation, breach of lease, etc.). Leases created prior to 1991 continue to be governed by the predecessor to the ALBL, the Land Lease Act and the Building Lease Act. However, the discussion in this chapter will primarily discuss the state of the law as reflected in the Act and, to a lesser extent, the Civil Code.

In Japan, buildings and land are separate estates. Unless otherwise noted, in this chapter, we shall use the term “landlord” to refer to a building owner.

Key leasing provisions

Length of term

The length of term of a lease will depend on whether the lease is for land or for building, and whether the lease is an ordinary lease (sometimes referred to as a “standard” or “traditional” lease) or a fixed term lease. If an ordinary building lease has a stated term¹, theoretically, neither party can terminate the lease prior to the stated termination date unless either party has reserved such right to terminate prior to the stated termination date (in which case, statutory rules will govern). On the other hand, if an ordinary building lease does not have a stated term or is deemed to not have a stated term, the tenant would be able to terminate upon giving notice to the landlord three months in advance, while a landlord may be able to terminate the lease by giving the tenant notice six months in advance, but the landlord must have “justifiable reasons”, as discussed below.

Moreover, even if an ordinary lease has a stated term, unless the tenant gives notice of its desire to not renew the lease, the lease will automatically renew on the same conditions,

except that the lease shall be regarded as not having a stated term. Prior to 1999, it was difficult for a landlord to terminate a building lease upon the expiration of the stated term (or earlier than the stated term) because regardless of the stated term of a lease, unless the tenant elected not to renew the lease or unless the landlord had a “justifiable reason” (*seito jiyu*, a factual determination based on factors discussed below) to reject the tenant’s request to renew the lease, the term would be renewed (or the landlord’s desire to terminate would not be recognised).

The 1999 Law created a new type of lease, the so-called “fixed term building lease”, which was made available for building leases. In contrast to the ordinary building lease, a fixed term building lease, as defined in Article 38 of the Act, definitively terminates without renewal upon expiry of the term specified in such lease agreement, so long as certain requirements are fulfilled. Neither party may terminate a fixed term building lease prior to the expiry of the stated term (except that a fixed term lease for residential purposes of a leased space of less than 200 square metres may be terminated by the tenant on notice given one month in advance, if it is necessary to terminate for unavoidable circumstances, such as job transfer, receiving of medical care or need to provide care to a relative). However, if upon the expiry of the term, both parties agree to continue using the subject space or building, a new agreement may be executed and the subject space or building may continue to be used. If the term of the fixed term building lease agreement is one year or longer, the landlord is required to notify the tenant of the termination of the agreement during the period one year to six months prior to expiry. However, even if the landlord fails to give such notice, the landlord can at any time before the scheduled termination date notify the tenant of the termination of the lease. In such case, the contractual relationship will definitively terminate after the passage of six months from the date on which such notice is given.

The following is a summary of the length of term of various types of leases:

- (i) *Ordinary Land Lease for Building*.^{2 3} An ordinary land lease will have an initial term of at least 30 years, unless a longer term is specified in the agreement. Such leases will renew for a renewal term of 20 years, and thereafter for renewal terms of 10 years or such longer period as the parties agree upon. Prior to the expiration of each scheduled term, the tenant will have the right to elect whether or not to renew the lease. The landlord⁴ may not object except for “justifiable reasons”. To determine whether a landlord has “justifiable reasons”, the following factors will be considered: (a) the landlord’s need to use the land for its own purposes; (b) the prior history of the lease; (c) the present use of the land and the condition of the building situated on the land; and (d) any economic consideration that the landlord is willing to pay to the tenant to surrender the land. At the expiration of the term of the lease, the tenant has the right to require the landlord to purchase the building situated on the land at current market value.
- (ii) *Fixed Term Land Lease*. There are four types of fixed term land leases: (a) ordinary fixed term land leases which must have a term of 50 years or more; (b) fixed term lease for business use which will have a term of at least 30 years but less than 50 years; (c) fixed term lease for business use which will have a term of at least 10 years but less than 30 years⁵; and (d) fixed term land lease with special provision for transfer of building must have a term of at least 30 years⁶.
- (iii) *Ordinary Building Lease*. The parties are free to agree to the length of the term of the lease, as long as the agreed upon term is at least one year or longer. Unless either party gives notice at least six months and not more than one year in advance of the expiry of the lease term of its desire not to renew or not to renew unless the terms are changed, the lease will be automatically renewed on the same terms and conditions,

except that the lease will thereafter be deemed to be a lease without a stated term (in which case, the tenant can terminate upon notice given three months in advance, and the landlord may be able to terminate upon notice given six months in advance)⁷. However, as mentioned above, a landlord cannot give notice of non-renewal unless there is justifiable reason.

- (iv) *Fixed Term Building Lease*. This type of lease may have a lease term of any length as agreed by the parties, and the term will not be automatically renewed. Prior to executing the lease, the landlord is required to explain to the tenant in writing (separate from the lease agreement) that the lease term will not be renewed and provide sufficient explanation of the lease term to the tenant. In addition, in the case where the lease term is one year or more, at least six months and no more than one year prior to the expiration of the lease term, the landlord is required to give a reminder to the tenant of the expiration of the lease.

Rent (frequency, basis of calculation)

Rent is typically paid on a monthly basis. Often a lease will provide that in addition to rent, the tenant is required to pay a portion of the common area expenses (*kyoekihi*). The rent and these common area expenses are often set forth in the original lease agreement. The amount of rent may be adjusted (see “Rent review” below). The common area expenses are supposed to reflect operating expenses of the common areas of a building.

Remedies for non-payment of rent and breach of other covenants (including forfeiture)

A failure to pay rent or material breach of another covenant of the lease such as the permitted use would typically constitute an event of default (many leases provide for a brief cure period). Generally speaking, assignment and subletting are considered material breaches which are not curable. If the event of default not being cured within the cure period, if any, and if the nature of the default is such as to destroy the relationship of mutual trust between the landlord and the tenant, a landlord will be entitled to terminate the lease and obtain a court judgment evicting the tenant if the tenant does not voluntarily surrender the premises.

Rent review

Under Article 32 of the Act⁸, either party of a building lease has the right to request an adjustment of rent if the amount of rent has become unreasonable as a result of an increase or decrease of taxes and other burdens on the land or the building, a rise or decline in price of the land or building, or fluctuation of any other economic circumstances, or in comparison to the rent of neighbouring properties similar in nature. If the parties cannot agree upon the adjustment of the rent, the party desirous of the rent adjustment can commence litigation, preceded by mandatory mediation (*chotei*). In the case of a request for an increase of rent, pending the determination of rent, the tenant can continue to pay rent in the amount it believes to be reasonable, but at least equal to the current rent. After the determination of the new rent has been made, if the tenant has underpaid rent compared with what would have been appropriate, the tenant will be obligated to pay to the landlord an amount of the shortage plus interest calculated at the rate of 10% per annum. In the case of a request for a decrease of rent, pending the determination of rent, the landlord will have the right to require the tenant to pay rent in the amount the landlord believes to be reasonable, but at most equal to the current rent. After the determination of the new rent has been made, if the tenant has overpaid rent compared with what would have been appropriate, the landlord will be obligated to refund the overpaid amount plus interest calculated at the rate of 10% per annum.

Any provision of an ordinary building lease that purports to exclude the right to request a decrease of rent under Article 32 of the Act would be null and void; however, if a landlord

has agreed not to raise the rent under an ordinary building lease, such agreement will be valid. On the other hand, in the case of a fixed term building lease agreement, the right to request a decrease in rent or an increase in rent can be excluded by way of special agreement (which fixes the rent or establishes an objective standard by which to adjust the rent), in accordance with Article 38 of the Act.

We note that in Japan there is a system by which, instead of making a payment to a creditor, a debtor can elect to deposit its payments with the local Legal Affairs Bureau (*kyotaku*). In the process of rent adjustment, the *kyotaku* can be used if the landlord refuses to receive rent payment or cannot receive the same.

Break rights

Please see the discussion in the section, “Length of term”, above.

Maintenance and repair

Unless the lease agreement provides otherwise, landlords are responsible for making all maintenance and repairs to the leased premises. Most leases do not change this allocation of responsibility for residential properties. However, leases for commercial use may provide maintenance and repairs as tenants’ obligations.

Alterations

Commercial space lease is often provided by landlords to tenants in a shell or core condition where the tenant is responsible for the cost of building out the space. However, depending on market conditions and/or the negotiations between the parties, some landlords may provide a build-out allowance or make other concessions in favour of tenants.

Reinstatement

At the time of surrender of the premises, the tenant will be required to restore the premises to the original condition as of the time of commencement of the lease (*genjo kaifuku*), subject to ordinary wear and tear. This applies to both commercial and residential leases. There have been many disputes as to how to allocate the cost of restoring the premises (including what constitutes ordinary wear and tear), especially in the residential lease context. As a result, the national and some local governments have produced guidelines on how such costs should be allocated where the lease agreement is not clear.

Assignment and subletting

Typically, leases prohibit the assignment of a lease or subletting without the consent of the landlord. When a building is owned in trust, the trustee (usually a trust bank) will generally require that the entire building be master-leased to a master lessee who in turn will sublet space in the building to subtenants. When overseas investors acquire real estate in Japan, they will often use a master lease structure even if the property is not entrusted. This is because if a tenant were to make a rent payment directly to an overseas owner, the tenant would be burdened with the trouble of withholding tax from each monthly rent payment. On the other hand, if there is a domestic entity which is acting as master lessee of the entire building, the subtenants (the actual occupants of space) will not need to be concerned with the withholding tax procedures when making their respective rent payments. Instead, the master lessee will handle all such withholding tax procedures in connection with payments to the overseas property owner.

Sale by landlord

If a landlord sells its land or building, the successor landlord automatically succeeds to the position of landlord under any existing leases, including the obligation to refund

security deposits to the tenants (please see “Security provided to landlords (parent company guarantees, bank guarantees, rent deposits)”, below). In other words, it would not be necessary to obtain consents from the existing tenants to the change in landlord.

As mentioned above, it is not unusual for a master lease structure to be used. If there is an existing master lease, the successor landlord automatically succeeds to the position of master landlord under the master lease without the consent of the master lessee, and the existing subtenants automatically continue to be subtenants under their subleases. However, frequently in connection with the sale of the property, even if the master lessee is not changed, the person holding the security deposits and having the obligation to refund security deposits for the subleases will change. In such case, it will be necessary to obtain the consents of the subtenants in order to release the existing obligor from such obligation. In addition, it is often the case that the existing master lessee is affiliated with the former landlord of the property. In such case, the new landlord will usually need to change the master lessee and it will be necessary to obtain the consents of the subtenants to the changes associated with this.

Permitted use

Tenants are permitted to use the leased premises in the manner specified in the lease agreement. Other uses of the leased premises may constitute a breach of the lease, giving rise to a right of the landlord to terminate.

Insurance, including insurance during fit out by an occupier

Typically, leases do not specify insurance requirements. However, landlords will generally maintain property and casualty insurance on the property (other than for the personal property of the tenant), liability and rental income insurance.

Security of tenure, renewal rights, extensions of contractual term

In the case of land leases, at the commencement of the lease, the tenant will pay a non-refundable concession fee (*kenrikin*) to the land owner to secure its right to the leasehold. Depending on the size and location of the land, the amount of concession fee may easily amount to millions of dollars. After payment of the concession fee, it will be difficult for the land owner to terminate or interfere with the tenant’s rights to the land, and the tenant may feel confident in proceeding to construct its building on the land. When the term of a land lease is extended, the tenant will be required to pay the land owner an extension fee (*koshinryo*).

In some, but not all, building leases, when the tenant extends the term of the lease, it will be required to pay the landlord an extension fee.

Please see section “Length of term”, p100, for further discussion.

Security provided to landlords (parent company guarantees, bank guarantees, rent deposits)

It is common for a landlord to require a tenant to pay a security deposit (*shikikin*) prior to taking occupancy of leased premises to secure the tenant’s obligations under the lease. In the Tokyo area, the security deposit for residential leases is typically in an amount equivalent to one to two months’ rent, while for commercial leases, amounts of six months to one year are not unusual. The security deposit is refundable upon surrender of the premises in good condition. If, when the premises are surrendered, they have not been restored to the same condition as when originally delivered, the landlord will apply the security deposit to pay the cost of such restoration and only return to the tenant the balance, if any, of the security deposit. Residential landlords commonly require a tenant to have a guarantor – usually a rent guarantee company that, for a fee, guarantees payment of the rent by the tenant.

There is no obligation for a landlord to keep security deposits segregated. The obligation to return the security deposits is an unsecured obligation of the landlord or, upon sale of the premises, its successor.

In addition to security deposits, some landlords require key money (*reikin*) in an amount equivalent to one or two months' rent. This amount is non-refundable.

Taxes and other occupational costs

In principle, except in the case of rental payments for land (other than certain types of parking lots etc.) and for residential properties, rental payments are subject to consumption tax.

* * *

Endnotes

1. An ordinary building lease that has a stated term of less than one year will be deemed not to have a stated term.
2. Leases created prior to the enforcement date of the ALBL (August 1, 1992) and thus governed by the Land Lease Act follow a different mechanism of renewal from those governed by the Act and discussed herein.
3. Land lease not for building, such as for land to be used for solar power-generating panels, are governed by the Civil Code which will limit the term of the lease to 20 years or less.
4. "Landlord" in (i) and (ii) means a land owner.
5. While land leases of type (a) and (b) require special provisions to eliminate the application of the statutory renewal mechanism, land leases of type (c) automatically exclude such application.
6. In the case of (d), the landlord is required to buy the building on or after 30 years have passed since the creation of the land lease. However, in the case of (a) and (b), the tenant's right to require the landlord to buy the building at the end of the term can be eliminated, and in the case of (c), such right is automatically eliminated.
7. A special agreement contrary to this sentence which is not disadvantageous to the tenant will be valid.
8. For a land lease, see Article 11 of the Act.



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