

INTERNATIONAL REAL ESTATE TRANSACTION IN LATVIA 2011-2015: THEORETICAL AND PRACTICAL ASPECTS

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Abstract. The primary aim of this paper is to determine the most common contemporary meaning of the terms most often used to characterise international real estate transactions. The synonyms of the terms "*international*", "*real estate*", "*transactions*" or terms used in research literature with similar meanings were identified during the research. The secondary aim of this paper is to investigate real estate transactions in Latvia giving primary attention to the period 2010–2014, which was significant because during this time, compared to all other countries in the world, Latvia offered the most inexpensive opportunity for a non-citizen to obtain a temporary residence permit simply by purchasing real estate for the minimum price of EUR 71,139. Latvia's case shows how significantly only one factor – the increase of this minimum price requirement to EUR 250,000 in 2014, affected the number of international real estate transactions in Latvia. A number of research methods were employed for the research, including the historical, empirical and comparative analysis of real estate transactions and the terminology used in this field.

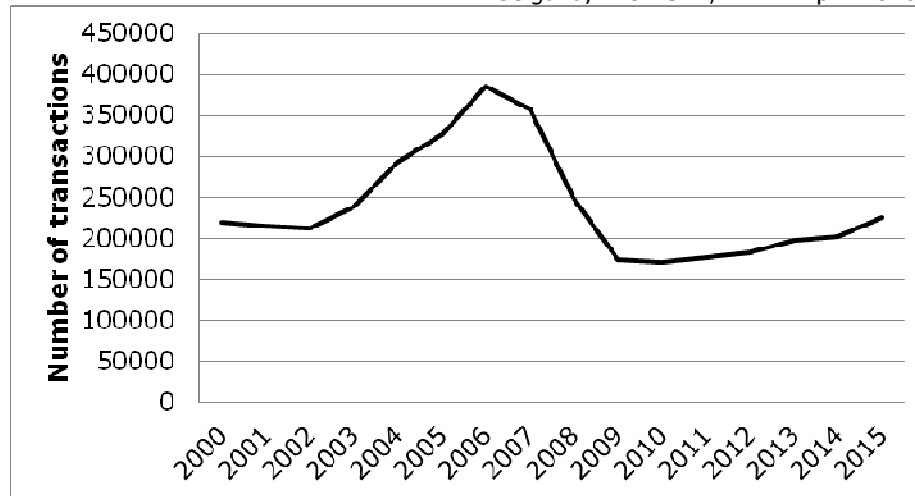
Key words: international real estate transactions, land management, terminology, temporary residence permits.

JEL code: R3, K11, Q15

Introduction

Individuals and legal entities in their lifetime carry out different types of real estate transactions or agreements that are "*intended by the parties to prevent or end a dispute and in which they make reciprocal concessions*" (Black's Law Dictionary, 1999) or unilateral actions, performed by the individuals and by legal entities, which are aimed at the establishment, the amendment or the cessation of civil rights and duties. Some individuals perform transactions on a regular basis, for example, with rent/lease agreements, especially in countries, which have a low home ownership rate (for example, the lowest rates in Europe are in Switzerland with 44 % and Germany with 52.5 % but the highest are in Romania with 96.1 % and Slovakia with 90.3 % (Home ownership rate, 2014)). If the subject is a change in property

rights, transactions are made less frequently. The general view is that in developed nations an individual makes a transaction every ten years on average (Goremykin, 2009); however, precise data are available only if the transactions have been registered. In Latvia's case, all types of transactions – purchase, exchange, mortgage, succession etc. – which have been registered in the Land Register, comprise only a part of the total real estate transactions. The most of rent/lease agreements tend not to be registered (for all registered real estate transactions in Latvia see Figure 1). According to the statistics on the real estate transactions registered in the Land Registry of Latvia, in 2014 the purchase deals made up only 25.28 % of the total number of transactions (Statistics on the Real Estate Transactions Registered in the Land Registry of Latvia).



Source: authors' construction based on the data from Land Registry of Latvia

Fig.1. Number of real estate transactions registered in the Land Registry of Latvia in 2000-2015

This paper focuses on international real estate direct transactions which result in the change of ownership of real estate, i.e. – direct asset deals, with the involvement of a foreign party. First, the terminology and theoretical aspects of international real estate transactions were analysed in the study. Second, direct real estate transactions in Latvia were examined, giving primary attention to the period 2011–2015. When considering the context of the research, the period 2010–2014 was significant because during this time, comparing to other countries in the world, Latvia offered the most inexpensive opportunity for a non-citizen to obtain a temporary residence permit (and thus permission to freely travel around Europe within the countries in the Schengen zone) simply by purchasing real estate for the minimum price of EUR 71 139. The lowest priced real estate that met all the necessary criteria was found solely in the areas outside Riga planning region and outside the nine largest cities of Latvia (Daugavpils, Jekabpils, Jelgava, Jūrmala, Liepāja, Rēzekne, Rīga, Valmiera and Ventspils).

A number of research methods were employed for the research, including the historical, empirical and comparative analysis of the real estate transactions and terminology used in this field. The current legislation of Latvia and

international law were analysed and pertinent literature was reviewed during the research.

Research results and discussion

Terminology used to describe international real estate transactions

Each real estate transaction as a part of real estate management (Kyle and Baird, 1995) is an interdisciplinary or multidimensional (Malloy and Smith, 2013) activity and primarily falls into the competency of the fields of management, law and economics but is not limited only to these. Terminology that is used to describe the transfer of property rights from one party to another is not strictly limited within a particular field but is used in others as well. The term "*real estate transaction (deal)*" in economic theory is primarily used to describe the transfer of real estate ownership or property rights from one party to another but it can also refer to lease agreements or other long term rights (Cotula, 2011). Moreover, the restrictions concerning foreigners can be in place not only regarding land ownership but also – land use (Hodgson et al., 1999), for example, in the agricultural sector (Bell and Savage, 1979-1980). This needs to be distinguished in the research subject (Hailu et al., 2015). Usually, the term "international real estate transaction" is used regarding a land deal

or "land" is used as a synonym for "real property". Most often only "land deals" have restrictions and limitations. In Latvia, there are no restrictions for foreigners regarding deals with real estate that is – "buildings as separate real estate", however, there are restrictions regarding foreigners acquiring real estate that is a "land". However, there are a wide variety of terms used

(see in Figure 2), not all of which are synonyms but are terms that describe only a part in the transaction process. That refers to the case with terms "transfer" and "conveyance", which describe only a part of the transaction process. The term "subdivision", which is used as a "transaction" will be explained later.

International	Real estate	Transaction
Cross Border	Land	Deal
Foreign	Real property	Acquisition
Global	Immovable (things, property)	Purchase
Alien	Immobile	Alienation
Non-citizen,-state	Rights in rem / Real rights	Transfer
Foreigner	Residential / Commercial property	Conveyance
Non-resident	Agricultural land	Grab
Foreign national	Land tenure	Transfer of ownership
Non nationals	Land holding	Sell
Overseas	Landed property	Investment
Transnational	Property rights	Changing hands
Other	Other	Turnover
		Foreignization
		Subdivision
		Other

Source: authors' construction based on the research results

Fig.2. Synonyms of terms "international", "real estate" and "transaction" or terms used in scientific literature with similar meaning

Considering the fact that the term "real estate transaction" is broadly used, it is necessary to clarify its use. The primary classification of real estate transactions refers to asset deals and share deals. An asset deal is a real estate transaction involving a direct transfer of rights of immovable property, which results in the transfer of the real estate from one party to another. A share deal, in contrast to direct property rights of real estate, is acquiring of the property rights to the shares of an entity, which holds the property rights of an item of real estate. An exception exists, e.g., in Scandinavia, where apartment owners are stockholders in the entity in Sweden – Bostadsrättsförening, Finland – Asunto-osakeyhtiö, and similar examples exist in other countries.

The term "foreign investment" can be defined as "transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the

total or partial control of the owner of the assets" (Sornarajah, 2010). Real estate is one form of assets. The term "foreign investment in real estate" can be used to mean:

- an investment in enterprises performing real estate economic activities – 1) "foreign direct investment" (hereafter FDI) – The international standard prescribes that there must be more than 10 % threshold of voting shares, e.g., in Latvia (Figure 4); 2) "foreign indirect (portfolio) investment" with less than 10 % of shares according to the international standard is necessary. In both cases investment may result in indirect real estate transfer of property rights but also may not, if the business enterprise, in which investment is made, carries out real estate activities (Regulation (EC) No 1893/2006), i.e. provides any number of real estate management services;

- the term "*foreign investment in real estate*" can also describe direct real estate transactions, according to international bilateral agreements for the promotion and reciprocal protection of investment. The term "*investment*" "*shall comprise every kind of asset invested in connection with economic activities by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws of the latter and shall include, in particular, though not exclusively: /a/ movable and immovable property as well as any other property rights in rem such as mortgages, liens, pledges, and similar rights...*" (Agreement, 1996).

The term "*subdivision*" is also used as a term for real estate transactions (Stubkjær et al., 2007), which should apply only to a part of the process of the real estate transactions or, more precisely, would be described as "property formation". In order to use the term "*subdivision*", it is necessary in the countries with Civil Law system to define it in the context of the Roman titulus–modus theory. This theory states that requirements for the transfer of ownership are titulus or iusta causa (e.g., purchase agreement but not exclusively) and modus, which in ancient Rome initially was mancipatio, i.e. a ceremonial act, and later – traditio i.e. transfer. During the Middle Ages in some countries it was replaced by registration. In some countries the act of registration is modus, i.e. the prescribed manner to obtain real property rights, thus there the real estate registration has a constitutive effect on property rights. In conjunction with this theory a "subdivision" is neither titulus nor modus, because there is no change of property rights.

Each country and its legal system use the term "*real estate*" differently. Land (except cases where private ownership of land is not permitted for ideological reasons (Hodgson et al., 1999), e.g., China, Vietnam and the former USSR) and

buildings are real estate prototypical (Stubkjær et al., 2007) or paradigmatic (Zaibert and Smith, 2004) or real estate by nature in the case of France, where Civil Code prescribes that a property is immovable, either by its nature or by its destination or by the object to which it applies (Civil Code of France, Art. 517). However, not all buildings in every law system are considered as real estate or land fixtures. They can also be considered as a chattel, e.g. a building, which in one country is deemed a fixture, in another can be deemed chattel. Not every object considered by a layperson as real estate is real property in legal terms and, of course, not everything described as real property in legal terminology is seen as real estate by the public (Stubkjær et al., 2007). The determining factors in defining a building as a land fixture or chattel is the degree of annexation, the purpose of annexation and the prevailing custom in that particular part of the world (Friedman and Lindeman, 2013). Buildings can be temporary and be separate property from the land on which they are located, not a land fixture, as in the case of Superädfikat in Austria. Buildings and the land, upon which they are located, can be real estate belonging to separate owners with the property rights of each registered in separate sections of Land Registry (in Latvia). Moreover, as in the traditional concept of superfic buildings can belong to an owner who is not the landowner (e.g. in Germany – das Erbbaurecht and in Spain – derecho de superfic, Niederlanden – opstal). In many countries, for example, in Germany "*immovable property*" is not defined as a legal term but as property rights to objects are divided into movable things and plots of land (das Grundstück), buildings are component parts of the plot of land.

The main differences in national law determining the definition of the term "*real estate*" are time limited interests in land, which as a whole can be described as ius in re aliena (e.g. emphyteusis, superficies, usufruct,

habitation), easements, buildings (as separate real estate, registered in a different sections of Land Registry), time share property rights, rights in rem, different institutes of apartment property, even – air-borne and sea-going vessels, inland navigation ships and any space objects (Civil Code of Russian Federation, Art. 130) as well as any other objects which are determined to be "immovable" by law. Historically, for various reasons, in some countries mobilizing or de-realty-izing (die Entliegenschaftung) of immovable things or immobilizing or realty-izing of movable things (die Verliegenschaftung) has taken place.

According to the international law, whether or not an object is defined as "real estate", "land" or "immovable property" it is determined by the national law of its location. The Rio declaration on environment and development prescribes that states have the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction. European Law determines that in contractual law a contract relating to a right in rem in immovable property or to a tenancy of immovable property shall be governed by the law of the country where the property is situated (Regulation (EC) No 593/2008). Similarly, in the bilateral international conventions it is clarified, for example, in the "Convention between the Government of the Republic of Latvia and the Government of the Republic of Estonia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income" the term "immovable property" shall have the meaning, which it has under the law of the Contracting State, in which the property is situated.

Countries usually have a wide variety of tests of "foreignness" (Hodgson et al., 1999). Under

international law each State is responsible to define under its own law who is deemed a national and who is not as well as to determine who qualifies as an "alien friend" (Hodgson et al., 1999), with special rights to acquire real estate in a particular country. There are countries, which operate on the principle of reciprocal rights: if you allow us to acquire real estate, we allow you to do as well (e.g., Taiwan and Turkey). In international real estate transactions, parties shall be from a country other than where the real estate is located, which for individuals is usually determined by the nationality or permanent residence or domicile, in rare cases also by ethnicity and by race (Sornarajah, 2010) principle. The nationality of a legal entity is determined by its state of incorporation, management or administrative centre or control (actual owner) principles.

In the political arena, the land deals with foreign parties often raise discussion about national territorial integrity and national security – whether or not foreign ownership would negatively affect national sovereignty or security. Usually, foreigners are restricted from owning land near a country's borders and in other "sensitive" territories. Another important point of argument on the political side regarding foreign ownership is that of allegiance. These are traditional restrictions justified by national security interests. Moreover, in spite of the point of view that economic value of land is increasingly taking a more significant role than its political value (Qin, 2015), the restrictions for foreigners to acquire real estate still exist in the majority of countries. Several nations have no restrictions regarding land ownership by foreigners (e.g. Germany, France, the United Kingdom, Portugal, the Netherlands, Belgium, Luxembourg, Chile, Colombia, Paraguay and Uruguay) (Hodgson et al., 1999).

Considering above mentioned, it is concluded that a language can be a barrier to conceptual understanding and describing each country's real

estate transactions, especially, if the transactions are international. If one law system uses a terminology to describe another system of law's similar activities, there is a basis to the following assertion regarding the legal concept in continental Europe that of all major European languages, English is the one least suitable for talking about (civil or continental) land law, because the common law concepts of land law are completely different from the civil law perspective (Schmid et al., 2005). This encourages careful use of the language in such a way that it is neither a barrier, nor a source for error regarding real estate transactions but rather assists in the understanding of terminology.

Real estate definition in Latvia

The 1937 Civil Code of Latvia went into effect in 1992–1993 after the renewal of Latvia's independence in 1990. The Civil Code of Latvia determines that immovable property in Latvia is land and buildings and other permanent structures are component parts or fixtures of a land. However, in parallel to this, because superfic was not determined, it created a phenomenon, which could be defined as separation of buildings from the land in a way which is not clearly determined by the Latvian law and is regarded in the Latvian practice as an exclusion from the common principles the Civil Law Act is based on (Rozenfelds, 2001). The superfic concept will go into effect in Latvia for non-residential buildings and civil engineering structures only from the January 1, 2017. Therefore, currently the real estate in Latvia can be: 1) land plots or units of land; 2) buildings or structures (with exceptions); and 3) a group of premises (including apartments that can also be undivided shares of a residential building with the rights in rem to use a particular apartment).

International direct real estate transactions in Latvia

In accordance with the theory of *titulus-modus*, the transfer of real estate property rights in Latvia consists of a valid agreement of alienation or other *iusta causa* and registration in the Land Registry. Commonly, all international direct real estate transactions are purchase deals. Restrictions for foreigners to acquire land are set in order to prevent certain foreign parties from other countries from acquiring land. These restrictions apply to real estate transactions of land plots in towns and in rural areas of Latvia (not for buildings as separate property objects). The most significant restrictions to foreigners in rural areas are defined by the Law "*On Land Privatisation in Rural Areas*", which prescribes that transactions, in the result of which an owner of land changes, including the contractual inheriting of land, alienation of pledged land and investing of land in the fixed capital of incorporated companies, shall be regarded as transactions involving land properties.

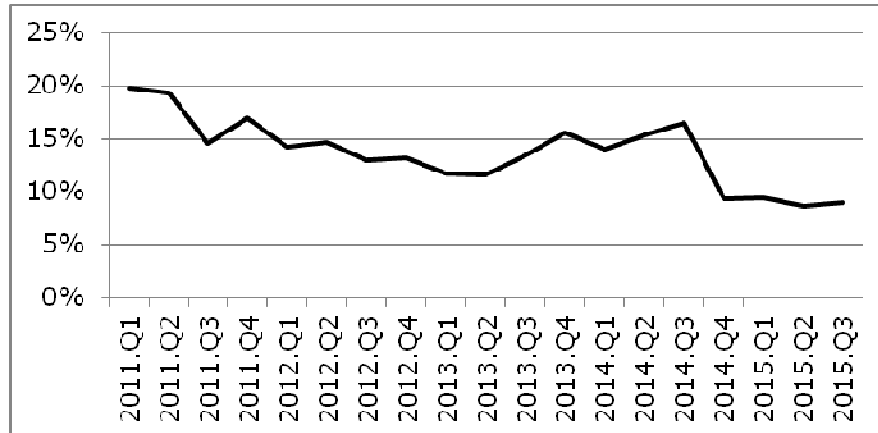
Regardless of the restrictions, which limit foreigners acquiring land plots, the real estate transactions with foreign nationals and legal entities represent a considerable share in Latvia (Figure 3).

There exists stiff competition among countries to bring in foreign investments through property investments or job creation, in exchange for the offer of temporary or permanent residence permits or even citizenship. In this way, the majority of countries attempt to stimulate investments in certain business ventures that create jobs (e.g. Australia, Canada, France, Germany, Japan, New Zealand, South Korea, United States etc.). A pioneer for this kind of real estate purchase transactions was the Caribbean country Federation of Saint Kitts and Nevis which started the so called "*Golden Visa*" business in 1984, one year after gaining independence from the United Kingdom, with an aim to

stimulate national economy by granting citizenship to foreign investors in exchange for a donation of USD 250 000 to the *Sugar Industry Diversification Foundation* or with the purchase of real estate worth at least USD 400 000.

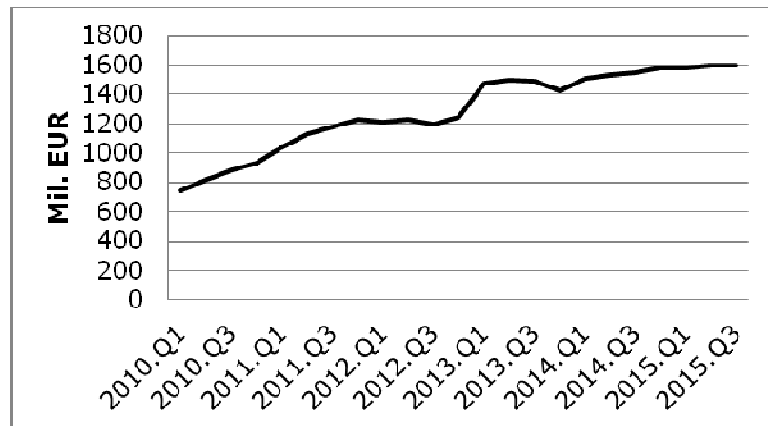
In Latvia, a most significant influence on real estate transactions became the creation of the opportunity for foreigners to obtain a temporary residence permit upon making a real estate

purchase starting with 2010. Latvia, along with many other countries, usually has stipulations that go along with obtaining a temporary or permanent residence or citizenship. Some of these are: a required certificate of non-criminal record, medical insurance, medical examination, absence of any debts to the tax authorities, legality of income etc.



Source: authors' calculations and construction based on data of the State Land Service of Latvia

Fig.3. Percentage of all real estate purchase deals, in which foreigners were involved 2011.Q1-2015.Q3 (Registered in Land Registry of Latvia until 30.12.2015)



Source: authors' construction based on data of the Bank of Latvia

Fig.4. FDI in enterprises performing economic activities of real estate in Latvia, 2010.Q1-2015.Q3, mln EUR

The temporary residence permits programme affects also the FDI as seen in Figure 4, which shows FDI in enterprises that perform economic activities of real estate in Latvia. Since the "Golden Visa" programme was launched in Latvia in 2010, it can be observed that FDI rises significantly and decreases after the minimum price requirement of the real estate, acquired by

foreigners, increased to EUR 250 000 in 2014, Q4.

Conclusions

The main purpose of this research was to analyse terminology used to describe international real estate transactions. The synonyms of the terms "international", "real estate", "transactions" or terms used in research

literature with similar meanings were identified during the research (Figure 2). Because of the large quantity of synonyms used, the introduction section of any real estate transaction research project needs to define the terms "international", "real estate" and "transaction" pertaining to how they are used in particular country. This is of utmost importance especially if the aim of the research is to compare similar economic activities in different countries.

Research shows how immediately and significantly only one factor, i.e. the increase of

Jelgava, LLU ESAF, 21-22 April 2016, pp. 292-299 the minimum purchase price requirement of real estate for the acquiring of foreign residency permits from EUR 71,139 to EUR 250,000 (in 2014, Q4), can affect the number of international real estate transactions in Latvia.

The research analysis of direct international real estate transactions and FDI leads to a conclusion that real estate direct transactions affected by one factor decreased sharply (in 2014, Q4) and in contrast FDI in enterprises performing real estate economic activities merely slowed down (2014, Q4-2015, Q3).

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