

Long-Term Lease of Land in State Ownership and Project Development – Practical Experiences



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The use or disposal of leased land in state property during and after the lease term is controversial. The authors share some experiences in this area.

Introduction

State-owned property or property owned by a municipality may be leased for up to 90 years, subject to approval by the Parliament of Montenegro. The land may be designated for the development of tourist complexes, residential buildings, and villas, and most commonly requires financing pre-determined in the tender procedure. For land designated for the development of villas, the lessee may be granted an ownership right to the land beneath the villas and land surrounding the villas when being used for their primary purpose. In practice, the use/disposal of the leased land during and upon expiry of the lease term is the most controversial aspect of this legal structure.

Long term lease of state-owned land under applicable laws

General terms

According to the State-Owned Property Act (STPA), state-owned property or property owned by a municipality may be leased out for (i) up to 30 years, subject to approval by the Government of Montenegro or related municipal government, or (ii) up to 90 years, subject to approval by the Parliament of Montenegro based on a proposal by the Government of Montenegro. The Parliament of Montenegro, at the proposal of the Government, also decides on the disposition of state property valued over EUR 150,000,000.

State property may be disposed by public auction or on the basis of collected bids, and in exceptional cases by private treaty. If a lease has been granted for the development of a hotel-tourist complex, the lessor may grant the lessee its consent for the further disposal of such facilities, in line with planning documents and the corresponding lease agreement. Furthermore, for land designated for the development of villas, the lessee may be granted an ownership right to the land beneath the villas and land surrounding the villas being used for their primary purpose, in consideration of the market value of the land and in line with planning documents and the lease.

Coastal area

A long-term lease agreement sets forth all terms and conditions of the lease. It is, however, interesting to note that, if the leased land encompasses a coastal area, such part of the land may not be leased as the coastline represents a natural resource that cannot be leased or otherwise disposed of. However, in line with the procedure envisaged by the Montenegrin Sea Act, the use of such land may be granted to the lessee by way of an agreement executed with the public company entrusted with protecting the marine resources in Montenegro (JP Morsko Dobro).

The recent practice in Montenegro, instead of two separate agreements (one with the Government of Montenegro and one with JP Morsko Dobro), is to have tripartite lease agreements, the parties to which are the government as lessor, the investor as lessee, and JP Morsko Dobro as the usage right grantor concerning the segment of the leased land representing a maritime resource.

Disposal of state-owned leased land/facilities

During the development of projects constructed on the state-owned land, especially for the purpose of financing, the questions arise whether the investor may sell or mortgage (i) the constructed facilities/buildings and (ii) the leased land.

As a general rule, a person/entity mortgaging a property as a security for its/other debt must be the owner of the mortgaged property. Accordingly, land in leasehold may not be disposed of (except through sub-lease/assignment) and mortgaged. On the other hand, the owner/developer of a facility may be registered in the Cadastre of Real Estate as the owner of the facility once the relevant permits for construction/usage have been obtained, and hence may dispose of the facility.

Mortgages are perfected through registration in the Montenegrin Real Estate Cadastre. The subject of a mortgage can be an individually determined and liquid real estate, or any co-ownership share in a real estate. In case the value of the mortgaged property increases during the term of the mortgage, the mortgage extends to such increase in value. The subject of a mortgage can also be a facility under construction or any part of such facility (apartment, office, garage), provided that a valid construction permit has been issued for the facility. A mortgage on a facility under construction is registered on the land on which such facility is being constructed; following registration of the facility in the CRE, the mortgage is registered *ex officio* on the constructed facility or a part thereof.

Disposal of constructed facilities/buildings

However, contrary to the general rule, long-term lease agreements usually contain certain restrictions on the disposal of facilities under construction. The rationale behind these restrictions is to prevent the outflow of funds prior to finalisation of a project (investment of funds). Namely, although most commonly the government may terminate the agreement in case of breach by the investor (eg, failure to comply with the investment programme), the question is how to return/regain ownership over facilities purchased from the investor by third parties acting *bona fide*?

In light of the above, the most common restrictions in long-term lease agreements are:

- Disposal of the facilities requires prior written government approval.
- Establishment/foreclosure of the mortgage over the facilities (ie, transfer of ownership) is subject to written government approval.(Sometimes the mere establishment of a mortgage granted in favour of third-party developers would not require prior written government approval, whereas foreclosure of a mortgage [ie, transfer of ownership through mortgage rights] would.)

Finally, it is interesting to note that restrictions similar to the foregoing may be found in agreements selling and developing state-owned property.

Disposal of leased land

As indicated above, pursuant to the applicable Montenegrin laws, a mortgage over land can be established solely over land in freehold, whereas, in relation to leasehold, only for the land beneath and servicing the villas may be disposed of (provided that such land is purchased by the investor).

Most commonly under the lease agreements, the government is not obliged to grant lenders any security interest in the government's freehold interest in the site or any part of it. Moreover, a freehold may be granted only for apartment buildings and the land underneath them (once constructed). Therefore, a mortgage can be created only over the facilities/buildings (based on the construction permit), and not over the land surrounding the apartment buildings or any other part of the site.

Most significant development projects in Montenegro are based on a long-term lease granted by the government. The lease is usually for 90 years.