



PROPERTY INVESTMENT AND DEVELOPMENT FINANCE IN ITALY

by Neil Murray

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1. Introduction:

This is the second in a series of articles on property investment and development finance in certain continental European jurisdictions (the first dealing with Dutch law aspects).

This article deals with certain aspects of property investment and development finance by reference to Italian law and practice.

Virtually all of the principal differences between English and Dutch law and practice, highlighted in the introduction to the Dutch law article, apply in the case of property finance transactions in Italy.

Of particular interest to prospective lenders in Italy is a special form of security, peculiar to land, called a "**credito fondiario**". Credito fondiario is a form of financing secured over land (which has been available to lending banks, in the form in which it is currently regulated, generally since 1993) which has certain advantages over the alternative form of mortgage ("**credito ipotecario**"). It can only be used in certain circumstances and its application is discussed further below.

Before discussing the security regime in detail, we will look first at the mechanics of a typical property transaction from a prospective lender's standpoint.

2. Investigation of title, due diligence generally and closing mechanics:

- 2.1 The Italian Civil Code provides for private ownership of land and land is usually held freehold i.e. in perpetuity, under which the owner has the right to use the property, and can therefore mortgage it, grant leases and other rights. There is a Land Registry ("**Registri Immobiliari**") and a Land Registrar ("**Conservatore dei Registri Immobiliari**").
- 2.2 Regarding title investigation, in theory, it is possible to ask the Registrar to issue a certificate ("**certificato ipocatastale ventennale**") regarding title to the property which would confirm current ownership and disclose any third party rights (e.g. mortgages, rights of way) affecting the same (going back at least twenty years). However, in practice, particularly in big cities such as Rome or Milan, it may take up to a year to obtain such a certificate. As in other continental jurisdictions, therefore, the Notary has a central role in relation to establishment and transfer of title to, and taking security over, property.

The Notary would be instructed to check title to the property (going back at least twenty years) and to deliver a stamped report, which can be given for the benefit of both the property owner and a mortgagee. This would cover the same matters as the above-mentioned property certificate i.e. title per se and any third party rights affecting the property which would be discoverable as a matter of public record.

The borrower/property owner would expect to have such a report delivered to it before entering into a binding agreement to purchase the property. The Notary would also be expected to check the authority of the proposed signatories to **all relevant documentation** (not only the documentation signed by public act/certified by the Notary). A lender could devise a standard form of report for a Notary appointed by it to issue and stamp.

The borrower usually chooses the Notary. A lender would need to decide whether it should insist on the use of its own Notary (which could have cost implications).

- 2.3 In terms of title investigation, external lawyers would not undertake the twenty year title investigation. However, to liaise with the Notary and check his report against the most recent "cadastral", title and mortgage documents to make sure that the Notary's report is accurate at least as to current ownership. They could also be involved in general due diligence on the property in terms of raising enquiries of the seller's solicitors as would be the case in an English law transaction, depending on the size and complexity of the transaction (e.g. in syndicated deals, large portfolios etc).

Regarding investigation as to the planning situation, and environmental issues, a lender would usually refer these matters to its valuer for comment and recommendation as to whether specialist structural, environmental or other reports are required. The valuer would also check occupational leases, but only as to their commercial terms. Legal investigation of occupational leases may well be undertaken by a lender with an in-house legal capacity.

External lawyers or the lender's in-house team (as decided by the lender) would also conduct corporate due diligence (capacity and due authorisation). Under Bank of Italy regulations and Law No. 675 of 31 December 1996, lenders are also obliged to obtain the consent of their customers for the use of data relating to the customer. The lender would also need to undertake money laundering/"know your customer" diligence ("**Antiriciclaggio**"), although the Notary would also, in the course of his duties, conduct some of these investigations.

- 2.4 Closing mechanics: on the appointed day for completion, all parties would attend at the Notary's office, where the relevant documents requiring notarisatioin are read out and subsequently stamped/notarised. It is important to appreciate that the credito fondiario (see below) will not be fully perfected as a security until the mortgage has been registered at the Land Registry and a "stabilising" (hardening) period of ten days has elapsed. This means that the borrower may have to fund an acquisition out of its own resources, or perhaps through a bridging loan, if it is not able to negotiate with the seller that payment occurs only after the "stabilisation" of the mortgage and the lender does not wish to run the risk of, for example, intervening insolvency in the ten day stabilising period and insists that the money is only made available after that period has expired.

Alternatively the lender could take a commercial view of the situation (perhaps particularly where the customer is a substantial entity rather than an SPV?) and disburse the funds at the time of notarisatioin (known as a "single act" transaction rather than "double act" involving signature followed by a ten day period prior to disbursement).

The Notary, immediately after the execution of the loan documents, would lodge the relevant registration application to the Land Registry to register the mortgage and would later report that the mortgage had become a perfected mortgage (after the ten days). Registration could take longer than ten days, so, in disbursing the funds prior to both registration at the Land Registry and the lapse of the aforesaid ten-day period, the lender would be taking a view both on insolvency of the borrower during the ten days' stabilising period and the

possibility that the security would not be properly registered at the Land Registry or that another mortgage on the same property is recorded in the Land Register with priority (but see next paragraph).

Note that there is no procedure as under English law whereby the lender can have a search made at the Land Registry prior to completion and afford itself a priority period whereby it has thirty business days to register its mortgage and provided it does so the mortgage will take effect as a first-ranking security notwithstanding the creation of any other mortgages and applications to register other mortgages since the date of the search. Hence, there is a theoretical risk that another mortgage could have been created in favour of a third party and priority, it seems, would be determined by whoever got their application to the Land Registry first! In reality, non-registration as a prior ranking mortgage at the Land Registry appears to be a small risk and recourse to the court is available in the event of failure (e.g. by the Notary) to duly register.

3. Security - credito fondiario:

3.1 Credito fondiario is a particular form of financing secured over land which has certain advantages, discussed below. Credito fondiario, prior to 1993, could only be used by a specific type of mortgage lending organisation. The 1993 decree extended its use such that it is now available to lending banks generally and is now commonly used in the Italian market.

3.2 Credito fondiario is a regime involving property-specific security where the amount lent is not greater than 80% of the value of the property (including the value of the works to be performed on the same). This should be contrasted with a credito ipotecario which is a mortgage over land but is not subject to the 80% loan to value criteria i.e. the lender could lend up to 100%, but the more creditor-favourable (see below) credito fondiario regime would not be applicable.

Although credito fondiario is normally granted in connection with the property to be financed, it is not limited to direct property financing. It could be taken, for example, where acquisition of the property took place by way of a corporate acquisition (of the property owning company) with that company mortgaging the property to secure the corporate acquisition finance, although care would need to be taken in relation to financial assistance issues.

Note that the credito fondiario regime is only available in respect of debt governed by Italian law i.e. it would not be available where the underlying loan is, say booked in London and governed by English law.

3.3 The security comprised in the credito fondiario has the advantage that it is subject to the relatively short ten days' hardening period. It does require registration at the Land Registry in order for the security to be fully perfected. The relevant documentation requires notarisation. Either two or three documents would comprise the lender's credito fondiario security, those being (i) the mortgage contract (under credito fondiario legislation: Art. 38 et seq of Legislative Decree of 1 September 1993, No. 385 and DPR of 29 September 1973, No. 601), (ii) general mortgage conditions (which are attached to the mortgage contract) and (iii) a "disbursement" document which recites the notarisation of the credito fondiario, refers to disbursement of funds on the appointed date for completion and might also cite the relevant interest rate. It should be possible to streamline the procedure whereby most of the loan terms and security arrangements could be included in a single mortgage contract.

3.4 Credito fondiario documentation should contain core terms (amount of loan, interest rate, repayment and pre payment, amortisation, default interest and covenants regarding the mortgaged property e.g. to maintain, keep in good repair etc) but typically the provisions are not as extensive as one might find in English law loan and security documents. This is in part because certain matters are already provided for by law.

For example, there is a statutory provision whereby in the event of non-payment a period of thirty days must have elapsed from the due date before the lender can issue any notification of default/intention to enforce

security. Indeed, under *credito fondiario* law, a "late payment" is deemed to occur when it is made by the borrower between 30-180 days after the due date. In other words, the law grants to the borrower a "grace period" with respect to late payments.

Credito fondiario law further provides, for the benefit of the borrower, that the lender cannot terminate a *credito fondiario* loan unless the borrower pays late (as defined above) on seven occasions, even if non-consecutive. Therefore, (i) a lender would not be entitled to terminate the *credito fondiario* (although interest will accrue on the relevant sum) (a) if any payment is made within the "grace period" (i.e. within thirty days from the due date) or if less than seven late payments have been made by the borrower; (ii) the lender will be entitled to terminate the *credito fondiario* if (a) the borrower makes late payments on at least seven occasions (even if non-consecutive); or (iii) the borrower does not pay any of the instalments at any time, or pays one instalment more than 180 days after the due date.

Therefore, the lender must (save where the borrower has become insolvent or its financial condition has substantially deteriorated) wait either for seven late payments, as defined above, to occur or for a total of 180 days from the original date of non-payment before it can terminate the loan agreement and then proceed to sell the property. Even then, it is necessary to go through a public auction procedure, discussed under enforcement procedures below. The court must also sanction the sale. Note that this is a feature of *credito fondiario* that is perhaps less advantageous than a *credito ipotecario*, where the 180-day period would not apply and termination/enforcement could occur sooner. There is something of a trade-off here: a *credito ipotecario* carries with it a one-year hardening period rather than ten days, but there is no 180-day waiting period.

It is customary to include in the documentation other defaults (insolvency, breach of covenant etc) where it appears that the aforementioned 180 days' statutory period does not apply.

- 3.5 Ongoing control by the lender is generally more limited, as a matter of practice, than under English law documentation; for example, a lending bank would not necessarily expect to be able to vet the granting/surrendering of occupational leases, agreement as to rent reviews and general property management. There would of course be a general negative pledge in terms of creation of further security.
- 3.6 A maximum secured amount must be inserted in the mortgage contract, inclusive of fees, rolled-up interest etc. Cross-collateralisation is problematic i.e. where different properties are owned by different subsidiaries in a group and the lender desires to be able to use excess realisation proceeds from one property to pay off a loan secured on another (which would usually involve the creation of a cross-guarantee structure). Cross-collateralisation may become more feasible under the new legislation involving certain reforms to Italian company law. Such legislation is not expected to come into force until 2004, so further comment is premature.

Note that, for portfolio transactions (and for sub-divisible property), ordinarily the borrower has the right, as a matter of law, to request appropriation of portions of the loan to individual properties in the portfolio or part or parts of a property (as the case may be). This might give rise to difficulty where some properties in the portfolio might do better than others in terms of fluctuations in value. Commercially, the lender might decide to allow sales from the portfolio provided that the loan to value ratio, following sale (and application of net sale proceeds as appropriate) was such that the loan to value ratio was maintained and, possibly, that the properties remaining in the portfolio were not of a lesser quality than the properties sold. The documentation should expressly reflect what is desired commercially.

Furthermore, as a matter of law, the borrower has the right to obtain a pro rata reduction in the worth of mortgage to the lender (by way, alternatively, of decrease in the amount secured thereby or by way of exclusions of certain portions of the property) once at least one-fifth of the loan has been repaid, provided that (i) the value of the property still mortgaged is sufficient to secure the loan; and (ii) the designated loan to value ratio is maintained.

As to syndication, a cost issue may arise whereby additional mortgage stamp duty would be involved in the event that German mortgage banks, in particular, desire to be brought into a syndicate (as they would require specific security, which would mean a further mortgage contract).

- 3.7 Note that the credito fondiario regime specifies that it is only possible to include a single prepayment fee in the mortgage contract, which fee must represent the entirety of the lender's expectation in relation to break costs, prepayment fees etc and must include the formula chosen for calculation of such fee, together with a worked example. This requires careful drafting. Prepayment fees in excess of 4% and 2% of fixed and floating rate loans respectively might be regarded by Italian law as excessive.

In terms of notarial fees and stamp duty on the mortgage document, the Notary's fee for a credito fondiario rather than a more traditional land mortgage is 50% of the usual fee. In addition there is a A125 flat fee for registration at the Land Registry (in respect of which the Notary would invoice the borrower). There is also a 0.25% government tax (Imposta Sostitutiva) which the borrower is required to pay and which is typically deducted from the advance together with other fees e.g. legal, valuation etc.

4. Other security:

Might include:-

- 4.1 an assignment of rental income in favour of the lender. The Notary may be responsible for notifying tenants of the existence of the security (in respect of which he would send an extract from the assignment document dealing in particular with the requirement to remit rental income to a designated account);
- 4.2 a pledge over designated rental income and other designated deposit accounts. Generally rental income can be dealt with in the same way as under an English law loan document i.e. the borrower or its managing agent procuring that net rental income is placed in a blocked deposit account pending application to service debt. However, it is not common practice to obtain a managing/rent collecting agent's so-called "duty of care" letter whereby it undertakes direct with the lender to remit rental income etc;
- 4.3 a pledge over shares - often taken;
- 4.4 a parent or other guarantee: these must be registered at the Public Registry in respect of which a A125 fee and duty is payable. However, provided that the execution takes place by way of exchange of correspondence, registration would not occur in the absence of default, in order to save cost. Alternatively, the relevant guarantee provisions can be inserted into the loan contract itself so that it can be notarised (and applicable fees paid) at the time of notarisation of all of the loan and security documents;
- 4.5 pledges over rent deposit accounts: these are not commonly taken, but can be;
- 4.6 an assignment of any receivables arising from work contracts executed for the construction/restructuring of the property, including any indemnification/ compensation rights deriving from the securities assisting the exact performance of the contract (e.g. performance bonds);
- 4.7 an assignment of VAT credits/reclaims;
- 4.8 a pledge over property insurances: perfection involves notification to the insurer and the pledge recorded on the insurance policy. The lender can be designated as loss payee so that insurance monies could be used to repay the loan or towards reinstatement, as the lender decides. In the event of damage or destruction of tenanted premises, where a lender is cited as loss payee/pledgee, it will have control over the insurance money, although in reality a mortgagee may, from a commercial standpoint, need to have regard to the interests of tenants.

5. Enforcement of property security:

Enforcement procedure under *credito fondiario* law is more streamlined than under the enforcement procedure applicable to *credito ipotecario*. Note however, that even under the *credito fondiario* regime, enforcement (in terms of realisation of the security, in particular by way of sale of mortgaged property) might easily take four years, and otherwise up to five years!

The "Titolo Esecutivo", i.e. the document issued by the Notary upon execution of the loan and security documents need only be taken to the court in order to institute enforcement proceedings, i.e. it does not need to be served on the borrower. However, it is necessary to provide some evidence in support of the fact that the lender's enforcement powers have become exercisable, i.e. there has been a default, but it is enough to present to the judge a calculation of amounts due. The onus is then on the borrower to prove that the amounts due have actually been paid. It is not enough to show solvency and the **ability** to pay.

Under *credito fondiario* law, all rental income from the property may be immediately appropriated by the lender and, following enforcement (see below), the net sale proceeds may be remitted immediately to the holder of the *credito fondiario* rather than, as would otherwise be the case, put in a suspense account pending a judge's order as to allocation of realisation proceeds.

Enforcement involves attachment of the mortgaged property by way of notice to the borrower by a court bailiff (also registered at the Land Registry).

Once a statutory ten day period has elapsed, the lender may apply to the court for the sale of the property, which sale may be effected with or without a public auction process, depending on the circumstances and the court's order.

As with other articles in this series, it is not proposed to go into detail regarding possible application of insolvency legislation (set-aside on the grounds of transactions at an under-value, preferences etc). It is worth pointing out, however that the regime is generally rather kinder to the holder of a *credito fondiario* than it is to the holder of the more conventional *credito ipotecario*.

6. Syndicated Loans:

The absence of the English law trust concept means that taking security for syndicated loans needs to be done in a different way. Generally, so far as possible, the security should be registered in the name of all of the lenders. Where not practicable, the lead lender would hold the relevant security for the syndicate and apply realisation proceeds accordingly.

7. Development/construction finance:

7.1 Whereas, for projects in England, it is not unusual for a borrower to enter into a development agreement with the owner of a piece of land whereby the developer would obtain a contractual right to build thereon, usually followed by the grant of a valuable interest therein upon completion of the works (e.g. a freehold or perhaps a long leasehold at a low rent), such structure is not conventional in Italy. It is usual for the borrower to acquire the land itself (freehold) and develop accordingly. However, it is possible for the borrower to be granted a surface right (*diritto di superficie*). In this case, the landowner would grant to the borrower the right to construct and maintain a building on the landowner's land.

7.2 Such *superficie* right is itself a right in rem i.e. vests as a proprietary interest capable of registration and over which a registered mortgage can be taken (rather than a mere pledge of contractual rights). Title to the building would therefore vest in the borrower as grantee whilst title to the underlying land would remain with the landowner. The *superficie* may be perpetual or granted for a term of years, whereupon the land, together

with the building on it, would revert to the landowner. Effectively, therefore a *superficie* might be likened to an English registered long lease at a nominal ground rent. It is of course possible that, in the case of a purchase of a newly-built investment property that the right to be purchased is in fact a *superficie* rather than a freehold (although this would not be common and in any event the nature of the right would be disclosed by legal diligence).

- 7.3 The above legal structure has important consequences from a lending bank's security point of view. In particular, in the case of contractual development rights under English law, the lender would expect so-called "step-in" rights whereby, if circumstances arose whereby the landowner wished to terminate such contractual rights, the lender would expect protection whereby the rights would not be so terminated without notice being given to the lender and the lender having the opportunity to "step-in" and remedy the situation. In Italy, such rights are unnecessary as one would expect to deal with rights in rem (as above) rather than contractual rights. The borrower will either own the freehold or where a *superficie* is involved, the *superficie*, being an interest in rem, rather than a contractual right, cannot easily be terminated.
- 7.4 Whilst a lender's security package would be similar to that under English law, (pledges over the borrower's rights and entitlements under development documentation, pre-sale and/or letting agreements etc), collateral warranties/"step-in" documents are not common. Often reliance is placed on a share pledge over all the shares in the borrower so that, on default, it would be able to take control of the project (i.e. step in) in lieu of the borrower.

It is also possible, but unusual, within the terms of the relevant building contract or professionals' terms of engagement to include provisions in favour of the third party (i.e. the lender) whereby, irrespective of default, the lender as third party would have power to issue instructions to the contractors/professionals that variations to the works, terminate the contract upon breach by the contractor/professional in lieu of the borrower. Such contracts in favour of third parties therefore effectively give the lender rights, in the case of a development finance project, which can be exercised directly against the contractor/professionals.

Generally, however, it is important for a lender to understand that there may be circumstances where it might ultimately be accepting the position that, if it does not have, by reference to appropriate documentation, rights to "step in", it will need to take a practical view.

Note that the "duty of care" aspects of collateral warranties are largely irrelevant as, by law in Italy, a party suffering loss as a result of construction or design defects may claim at any time within ten years from completion of the relevant works.