

## **FOREIGN INVESTORS COUNCIL, AMCHAM AND NALED PROPOSAL FOR CONVERSION OF USAGE RIGHTS TO PROPERTY RIGHTS**

Foreign Investors Council, AmCham and Naled, hereinafter referred to as Associations, attach great importance to the conversion of right to use to freehold right over construction land into the ownership title because the existence of recognizable and undisputable right over the real estate is considered as a precondition for investment. Therefore, Associations have been very active in finding an acceptable and enforceable solution for process of conversion.

After several unsuccessful attempts to undertake the process of conversion, which on several years stopped the investments and lead to legal uncertainty, Associations have taken an attitude that conversion of right to use with compensation fee shall be abolished and that conversion into the ownership right shall be without compensation fee in all cases, without of the manner of acquisition of right to use. We deemed that positive effects of such solution would be greater than losses that would state have due to unpaid compensations for conversion.

However, after recent meetings with representatives of the Ministry of Civil Engineering, Transport and Infrastructure, as well as with representatives of the EU/European commission, the Associations are familiar with the new conditions that process of conversion shall satisfy, affecting primarily at Law on State Aid Control. Associations have decided to act proactive, to review all the available to conversion and come up with arguably the most adequate proposal for solution of the conversion process.

In the analysis, we paid special attention to:

- i. The limiting impact of the decision of the Constitutional Court and the explanation of such decision ("Official Gazette of RS" no. 98/2013) to possible models of conversion;
- ii. The necessity to respect the provisions of the Law on State Aid Control ("Official Gazette of RS" no. 51/2009), during the implementation of the conversion;
- iii. The protection of the interests of the former owners of nationalized property in the process of conversion, with respect to the provisions of Law on Property Restitution and Compensation ("Official Gazette of RS" no. 72/2011, 108/2013, 142/2014);
- iv. The previous experience in the conversion, with the focus on the capacities and limitations of the administration in the implementation of the process of conversion;
- v. The different effects of possible models of conversion to the commercial and financial system of the country.

In formulating the solution for conversion the special problem is that some of the preconditions mutually conflicted. In order that future module of conversion could meet all the above mentioned criteria, it is necessary to clearly and unambiguously explain what is the conversion and with such transparent attitude to be consistent in making decisions.

For this reason, we believe that we should first reach a consensus about essence, objectives and principle of the conversion:

- A. Conversion is the transfer of the REMAINING scope of rights over the construction land to the persons that already have right of use over such land. It is important to understand that

this is not alienating of public property land, because the lands that are subject to conversion are in the fullest extent already alienated. The persons who have the right to use construction land have the largest scope of rights of any natural person or legal entity may have on the land, including the most importantly right of construction on such land. To widest scope of rights that any natural person or legal entity may have on the real estate, ownership title, missing a small part of a scope – right of disposal, i.e. free traffic as well as the possibility of mortgage registration.

- B. Conversion, except it has to enable the transition from anachronistic right to use into the most widely represented ownership title over the construction land, it also increases the scope of rights that natural persons and legal entities have over land. This increases the VALUE of the rights that natural persons and legal entities have over the land, and increases the value of the land.
- C. Conversion transfers the additional rights to the natural persons and legal entities which already have the right to use and creates ADDITIONAL VALUE, i.e., the scope of rights that natural persons and legal entities have changes and creates the new value of the land, i.e., the value of the rights that natural persons and legal entities have over the land increases, i.e., the value of the land increases.
- D. In cases where conversion creates additional value, the conversion cannot be performed without compensation fee or below actual value, because such conversion would represent an illegal state aid.
- E. The compensation fee for the conversion shall not be a para-fiscal levy – compensation which the price does not match the value of the goods/provided services. Specifically, we believe that is unacceptable denial of the previous acquired rights (right of construction) in course to collect the compensation fee for conversion which is significantly higher than additional value that holders of the right to use the construction land gained with the conversion.
- F. The compensation fee for the conversion shall correspond with the amount of additional value that is created in process of conversion. This would have complied with provisions of the Law on State Aid Control insisted on by EU and it would avoid possible interpretation of the institute of conversion as state aid to specific subjects (would not be created favorable market position relative to competitors). By taking the market value of the land as the basis for calculating the compensation fee for any person who may be entitled for conversion with the compensation fee, would exclude the effect of giving more favorable position in the market to certain individuals unlike the previous law provision (price of capital or assets paid in bankruptcy/privatization/executive proceeding) which was declared unconstitutional.
- G. The price of capital/assets paid in privatization/bankruptcy/executive proceeding shall not be taken as a deduction/benefit in the conversion because of the decision of the Constitutional Court. Also, we believe that the price paid for capital/assets and even the land itself is not relevant in the process in conversion. The price paid for the land was actually the price paid for the acquisition of the right to use of such land, and here we discuss about acquisition the additional rights that were never purchased nor paid. For this reason, any previous payments for capital/assets shall not be benefits or important elements in determination of the compensation fee for conversion. This new solution would incorporate recommendations from the decisions of the Constitutional Court.

- H. As most of the rights over the land already alienated, the return of this property to its previous owners is not possible because it would assume subtraction of the rights over the land from current users, which they have acquired in previous period in accordance to Law. Therefore, the Law on Property Restitution and Compensation stipulates that the right of use over the privatized legal entities is excluded from the restitution. However, the state in this case sells the additional rights over the land which is the subject of restitution, but it certainly cannot be subject of natural restitution. For this reason, we believe that all proceeds from the sale of additional rights over the land for which exist the request for restitution should belong to the user of restitution, i.e., all funds generated by conversion of the land on which exist the request for restitution should belong to person entitled to restitution on such land. Additionally, the funds paid to the user of restitution on this basis should not represent the total amount of compensations that the user should receive for the land, because the compensation is received for the property that was previously alienated and cannot be returned in natural restitution (in this case for the right to use over the land that was previously alienated and cannot be returned), and conversion is only the sale of the additional rights and income for the sale of additional rights which could be theoretically returned in natural restitution. We believe that this would protect the rights and interests of the former owners of nationalized property in the process of conversion, insisted on by EU.
- I. Previous experiences in the conversion have shown that administration has neither the knowledge nor will to implement procedures that are complex. A special problem is rendering any merit decision by administrative officers. Based on previous experience, we may say that is necessary to predict the procedure that is technically easy implementable and does not require issuance of any merit decision by administration.
- J. Respecting the above mentioned principles, especially the one that compensation for conversion should correspond to the amount of additional value created in the process of conversion, shall not jeopardize the financial stability of the country. The state in this case creates the additional value, which would be charged. The solutions in which the state would charge more than amount of additional value created by conversion, especially in denial of previously acquired rights (right of construction) for the purpose of compensation fee for conversion which is significantly higher than created additional value may lead to serious macroeconomic disturbances in the country. Revocation of previously acquired rights diminishes the value of the rights that natural persons and legal entities have over real estate, diminishes the value of the pledged real estate/mortgaged real estate by commercial banks. This would increase the number of uncollectible claims of commercial banks which would put at risk their business. Greater reduction in the real estate value, i.e., significantly higher compensation fee for conversion of the amount of additional value created by conversion may lead to collapse of several banks and may possibly cause a “domino” effect.

On the basis of all mentioned above, before defining specific solutions for the conversion, it is necessary to identify cases where is additional value created by conversion and just in case such additional value quantify. We have identified several examples of real estate where acquired additional value is different:

1. Construction land for regular usage of the buildings, which is in state, i.e. public ownership, which was a part of property on which the holders of the right to use were or are commercial companies or other legal entities to which provisions of the law governing the privatization,

bankruptcy and executive proceeding were applicable, may be subject of conversion the right to use into the ownership title with compensation fee (article 103 of previous Law). The holders of the right to use over the construction land for regular usage of the buildings have indirectly had the all scope of rights that could be acquired with ownership title as well, because in addition to the right to use over the land they also had the ownership title on the buildings constructed on such land. They can encumber the land for the regular usage of the buildings by registering a mortgage on the buildings. Also, through the transfer of the buildings the land is being transferred as well. Therefore, we believe that conversion of such land does not create additional value and that conversion of such land should be done without compensation fee.

2. Undeveloped construction land in state, i.e. public ownership which was a part of property on which the holders of the right to use were or are commercial companies or other legal entities to which provisions of the law governing the privatization, bankruptcy and executive proceeding were applicable, may be subject of conversion the right to use into the ownership title with compensation fee (article 103 of previous Law). The conversion of this land creates the additional value. On this land cannot be established mortgage and they are not free for trade. However, on this land was possible construction of the buildings until 2009 and with construction of facilities would be practically gained the missing part of the scope of rights to the rights of ownership title. Also, the trade can be performed indirectly – turnover of the shares of companies that have the right to use or trading with the buildings under construction, i.e. obtaining the utilization permit and selling the “building” which construction is not been initiated yet. However, financing construction is difficult when the land is under the right to use because the banks cannot establish a mortgage on such land. Additionally, indirect trading requests more time, costs and have more risks. The additional value created from conversion of such land is inconsiderable, but definitely exists. Qualifying of additional value could accurately be done if there was a market where right to use and ownership title parallel exist, but this is not a case. By the analysis of additional cost caused by indirect trade of such land, as well as the problems of difficult financing, we believe that created additional value would be in the range between 10% to 25% of current market value of the land, i.e. we believe that value of such land would be increased between 10% to maximum 25% by conversion. In consideration of above mentioned, Associations suggest that the amount of compensation fee for the conversion of undeveloped construction land on which the holders of right to use were or are commercial companies or other legal entities under enforcement of the provision of the law governing the privatization, bankruptcy and executive proceeding should be **20% of its current market value** (market value of the right to use over the land).
3. Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority (Article 134 of previous Law) and is registered in the public record - in a unique real estate cadastre. The holders of rights to use over this land did not lost the right of construction by Act from 2003, because they registered their right to use in the public record, but they lost that right in 2009, as well as other holders of rights to use on developed or undeveloped land. The holders of rights to use that land acquire additional identical rights as well as holders of rights to use on undeveloped land which were or are commercial companies or other legal

entities to which provisions of the law governing the privatization, bankruptcy and executive proceeding were applicable (Article 103 of the previous Act). In view of this, Associations suggests that amount of the compensation fee for the conversion of the undeveloped construction land which is acquired for construction, in accordance with the previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority (Article 134 of the previous Act) and is registered in the public record - in a unique real estate cadastre, should be **20% of its current market value** (the market value of the right to use over the land).

4. Undeveloped construction land in state ownership which has been acquired by encumbrance, where absolute transfer rights tax is paid and land user is registered in the public record - a unique real estate cadastre, and which can not be converted without compensation. The holders of rights to use over this land did not lost the right of construction by Act from 2003, because they registered their right to use in the public record, but they lost that right in 2009, as well as other holders of rights to use on developed or undeveloped land. The holders of rights to use that land acquire additional identical rights as well as holders of rights to use on undeveloped land which were or are commercial companies or other legal entities to which provisions of the law governing the privatization, bankruptcy and executive proceeding were applicable (Article 103 of the previous Act). In view of this, Associations suggests that amount of the compensation fee for the conversion of the undeveloped construction land which is acquired by encumbrance, where absolute transfer rights tax is paid should **be 20% of its current market value** (the market value of the right to use over the land).
5. Developed land other than land for regular use of buildings on which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding. We believe that this land is a special group because in practice it represents the combination of the previous cases. We find that this land is much more similar to the construction land for regular usage of the buildings than to the undeveloped construction land. Through the transfer of the buildings the right to use over entire land is being transferred as well, not only the right to use over the land for regular usage of the buildings. This would be the case with the implementation of the mortgage, except the cases where from the land other than land for regular use of buildings can be made separate parcel. The additional value created by conversion of this land is significantly less than the value created by conversion of the undeveloped construction land. However, we may conclude that in this cases exist certain additional value. In consideration of above mentioned, Association suggest that the amount of compensation fee for the conversion of Developed land other than land for regular use of buildings on which the holders of right to use were or are commercial companies or other legal entities under enforcement of the provision of the law governing the privatization, bankruptcy and executive proceeding should be **10% of its current market value** (market value of the right to use over the land).
6. Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority (Article 134 of previous Law) and is not registered in the public record - in a unique real estate cadastre. The holders of the right to use over this land have already lost the right of construction by

the Law from 2003, and the value of the scope of rights that users have is quite low. Practically, they should pay the full value for acquisition of the right to use (which provides a right of construction (the largest part of the current market value of the right to use the land), and over this amount to pay for the additional value acquired through conversion. For the acquisition of construction rights (the right to use that allows the construction right) we believe that it should be charged 70% to 90% of the current market value, while for additional rights acquired by conversion should be charged additional 10% to 25% of the current market value of the land, i.e. the conversion of this land should be charged between 80% to 115% of the current market value. In consideration of above mentioned, Associations suggests that amount of the compensation fee for the conversion of the undeveloped construction land which is acquired for construction, in accordance with the previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority should be **100% of its current market value** (the market value of the right to use over the land that allows the construction right).

In order to meet all the above mentioned principles and charge the conversion corresponding with the additional value created in the process of the conversion (and the requirements of the Law on State Aid Control, i.e. the requirements of the EU) and applied previous "price list" it is necessary to determine the land for the regular usage of the buildings. Determination of the land for the regular usage of the buildings is a complex technical process and in event of a large number of requests it is expected that administration would not be able to process them within reasonable deadline and that it will significantly slow down or disable process of the conversion. The process of determination of the land for regular usage of the buildings is intended for situations where on one parcel exist more buildings owned by different owners and where is a need to distinguish their ownership. Additionally, this procedure requires fully commitment of the Cadastral office, which already acts slow in existing cases, so with the new requests would be waited for years. For this reason, we believe that in the conversion process does not need to implement standard procedures for determining the land for the regular usage of the buildings. Standard procedure for the determination of land for regular usage of the buildings should be replaced by a simple mathematical operations which can determine the minimum area of land for regular usage of the buildings. The actual surface area of land for the regular usage of the building may be higher than this specified minimum surface area of land for regular usage of the buildings, but in the conversion process due to the simplification of the process will be used minimum surface area of land for regular usage of the buildings.

Process of the conversion shall find a solution to convert the right to use into the ownership title, without determining land for the regular usage or modification of other cadastral data – number or surface area of the cadastral parcel. The Cadastral office should be minimum included in this process – only with delivering with the final and enforceable resolution of conversion.

Therefore, we believe that similar effect could be achieved in much more simplified administrative procedure.

The basic assumptions of conversion procedure which satisfy all above mentioned criteria are as follows:

- i. The procedure of conversion shall be run by the authority in charge of legal affairs of the local self-governmental unit (the Authority);
- ii. The applicant of the conversion shall submit the application for conversion for one or more cadastral parcels, within a single complex. The process of conversion is conducted for individual cadastral parcels. When several cadastral parcels formed an integral part of formed constructive parcel, applies unique process of conversion of cadastral parcels that are part of the constructive parcel, i.e. the process is conducted as for a single cadastral parcel.
- iii. Along with the application, beside the documentation on which method is established acquisition of the right to use over the land, the applicant shall attach the Excerpt from the Cadastral office and Information on Location for the cadastral parcels that conversion is requested;
- iv. On the basis of submitted documentation, the Authority shall determine:
  - a) The basis for conversion, i.e. weather it is about:
    - a.1 The land in state, i.e. public ownership, which was a part of the assets of on which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding.
    - a.2 The Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority.
    - a.3 The Undeveloped construction land in state ownership which has been acquired by encumbrance, where absolute transfer rights tax is paid and land user is registered in the public record - a unique real estate cadastre, and which can not be converted without compensation.

Also, the competent authority shall determine the total surface area of the cadastral parcel for which the application for conversion is submitted, which cadastral parcels are:

- A.1 Developed construction land which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding **(A1)**.
- A.2 a) Undeveloped construction land which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding; b) Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority (Article 134 of previous Law) and is

not registered in the public record - in a unique real estate cadastre. c) Undeveloped construction land in state ownership which has been acquired by encumbrance, where absolute transfer rights tax is paid and land user is registered in the public record - a unique real estate cadastre, and which can not be converted without compensation **(A2)**.

A.3 Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority **(A3)**.

b) Total surface area of horizontal projections of the buildings (surface area under the buildings), for the buildings constructed on the cadastral parcels (A1), determined on the basis of Excerpt from the Cadastral office. If the holder of the right to use the land for the construction of a new buildings removed an existing objects from the cadastral parcels for which request conversion and until the enforcement of the Conversion Act received construction permission for a new object, as relevant surface area of the horizontal projection will be taken a horizontal area surface of the object for which construction permits were issued. If the investor removed the existing objects, but do not get a construction permit for the new object until the day of enforcement of the Conversion Act, shall pay a fee for the conversion of undeveloped land as defined for other cases of undeveloped land described in the article "A2" in this document **(B)**.

c) Maximum percentage of allowed occupancy for constructed cadastral parcels (A1) for which is submitted application for conversion, determined on the basis of the Information on Location **(C)**.

v. The Authority shall calculate the compensation fee for conversion at each of the basis, as follows:

A.1 For developed construction land which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding, by formula:

$$10\% \times D \times (A1 - B/C)$$

A.2 For undeveloped construction land a) which the holders of the right to use were or are commercial companies or other legal entities to which were applicable the provisions of the law governing the privatization, bankruptcy and executive proceeding; b) Undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority (Article 134 of previous Law) and is not registered in the public record - in a unique real estate cadastre. c) Undeveloped construction land in state ownership which has been acquired by

encumbrance, where absolute transfer rights tax is paid and land user is registered in the public record - a unique real estate cadastre, and which can not be converted without compensation, by formula:

$$20 \% \times D \times A2$$

A.3 For undeveloped construction land in state ownership which has been acquired for the purpose of construction, in accordance with previously applicable laws that regulated construction land until May 13<sup>th</sup> 2003 or on the basis of the decision of competent authority, by formula:

$$100\% \times D \times A3$$

Where is **D** the unit value of the land calculated in accordance with the regulations governing the property tax,

- vi. The Authority renders the resolution which shall establish the right for conversion and the compensation fee for the conversion. After the compensation fee is paid, the applicant is entitled to register the ownership title.
- vii. Due to the unreliability of the valuated value of the land by the Tax administration should be established second level for appeal which would be quick and efficient. The Government would establish a commission which shall decide on appeals and thereby would be avoid a large numbers of appeals procedures which would anyway become a practice in conversion procedure. The commission would be composed from the experts and independent professional appraisers.
- viii. If the applicant disagrees with the decision of the Commission, he would have the option of proving the market value in front of the Court, which would allow an independent body to assess the market value of the land.
- ix. The incomes from conversion over the land which are the subject of the restitution shall be paid to the beneficiary of the restitution over such land and these resources should not be counted in determination of the amount for compensation which beneficiary should receive for such land or the total amount of compensation for restitution.

Finally, we believe that the conversion process should entirely be arranged by one regulation - the new law, which would take over the solutions that already exist in the Law on Planning and Construction (and these provisions would be abolished).

We believe that proposed solution is:

- In compliance with decision of the Constitutional Court
- Complies with the provisions of the Law on State Aid and Control
- Protect the interests of the former owners of nationalized property
- Does not represent a para-fiscal levies, i.e. the compensation for conversion correspond to the amount of additional value created in process of conversion – has been determined fair compensation fee for conversion

- Take care about the capacities and limitations of the administration in implementation of the conversion procedure and engage Cadastral office at minimum
- Does not put at risk the financial system of the state because the state only charges the created additional value