



The Legal 500 & The In-House Lawyer
Comparative Legal Guide
Japan: Real Estate (3rd edition)

This country-specific Q&A provides an overview of the legal framework and key issues surrounding real estate law in Japan.

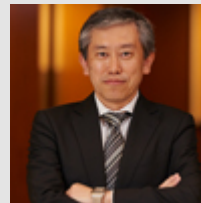
This Q&A is part of the global guide to Real Estate.

For a full list of jurisdictional Q&As visit <http://www.inhouselawyer.co.uk/index.php/practice-areas/real-estate-third-edition/>

**NISHIMURA
& ASAHI**

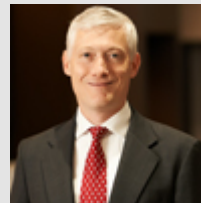
Country Author: Nishimura & Asahi

The Legal 500



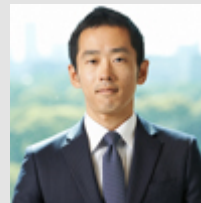
Hiroshi Niinomi, Partner

h_niinomi@jurists.co.jp



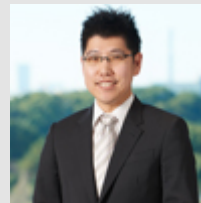
Nathan G. Schmidt, Partner

n_schmidt@jurists.co.jp



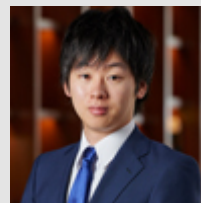
Koki Hara, Counsel

k_hara@jurists.co.jp



Naoto Yamamoto, Associate

na_yamamoto@jurists.co.jp



Suguru Kuroda, Associate

s_kuroda@jurists.co.jp

1. Overview

Under the laws of Japan, ownership of land and buildings is separately indicated. The owner has the right to use, obtain profit from, and dispose of the real property.

There are no restrictions on who can be an owner, so foreign entities are eligible to own real property. However, foreign entities tend not to purchase real property on their own account, but generally instead to establish a vehicle in Japan to own real property due to the tax considerations.

It is also common to purchase real property by way of beneficiary interests, under which a trustee becomes a legal owner of property, mainly due to tax benefits.


Leasing rights are common under the laws of Japan. The rights are governed not only by the Civil Code but also the Act on Land and Building Leases that provides lease right holders with legal protection to some extent. Certain provisions that are disadvantageous to the lessee may be regarded as invalid under the Act.

There is a real estate registration system under which ownership, other rights in relation to property use, and security interests over real property are registered in accordance with the Real Estate Registration Act.

In addition, amendments to the Civil Code will come into effect on April 1, 2020 (as amended, the "Amended Civil Code"). The scale of the amendments are relatively broad affecting a range of transactions included leases, guaranties and assignments of claims. The Amended Civil Code will accordingly affect real estate transactions, although the basic framework for such transactions will remain consistent.

2. How is ownership of real estate proved?

In practice, the parties rely on the registration of real property. This is because, in principle, any transfer or creation of ownership or any other real rights must not be asserted against third parties unless they are registered in accordance with the Real



Estate Registration Act. In addition, once an application for registration of a transaction is submitted, the certificate of registered matters of the property cannot be issued until the application process has been completed. Accordingly, third parties are able to know that there would be new rights regarding the property which are not stated in the latest certificate. It is therefore a general practice to review the registration of a target property before proceeding with a transaction.

On the closing date, the application for registration should be submitted after confirming that the registration does not show any unexpected rights to the target property that are inconsistent with the transaction. However, there is a minor risk that a court might determine that another third party who is not indicated in the registration is the true legal owner or holds a proprietary interest. Given that the risk is low due to the stringent requirements of such a determination, legal due diligence on the real rights, including careful examination of the certificate of registered matters of the property, is generally deemed to be sufficient to mitigate the risk of contested title; therefore, no title insurance system has developed in Japan.

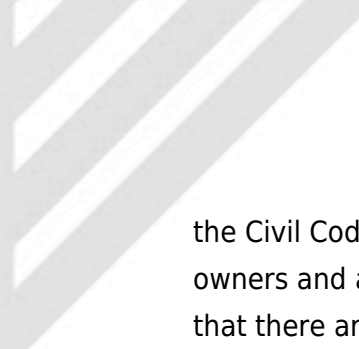
3. Are there any restrictions on who can own real estate?

There are no restrictions on who can own real estate. It is possible for foreign entities to directly own land and buildings in Japan or hold trust beneficiary interests under the laws of Japan. Having said that, it is quite common to own real property or to hold beneficiary interests through a Japanese entity. Lastly, it is necessary to conduct a tax analysis in order to determine which is more advantageous in terms of corporate tax, withholding tax, and other taxes.

4. What types of proprietary interests in real estate can be created?

(1) Ownership

Under the laws of Japan, an entity or person that owns property has the right to freely use, obtain profit from, and dispose of the property. In relation to ownership, the Civil Code allows multiple entities or people to own a property together, which is called co-ownership (kyoyumochibun-ken). The basic rules regarding co-ownership are stated in



the Civil Code. It is also possible to enter into a co-ownership agreement among the co-owners and agree how to use, manage, and modify the property. It should be noted that there are some restrictions under the law; for instance, co-owners are unable to agree not to demand the partition of property over five years.

The Act on Building Unit Ownership, etc. allows for part of the property, which shall be structurally divided and can be used as if the part is single property, to be the subject of unit-ownership (kubunshoyu-ken) or other proprietary interest. Generally, bylaws stipulating the rules including the management of the building and common space are established in accordance with the Act. Consequently, it is essential to review the co-ownership agreement or bylaws if acquiring co-ownership or unit-ownership.

It is also common for mainly tax reasons (including acquisition tax and registration tax) to have such types of ownership as beneficiary interests. A trust agreement is generally agreed between a trustee and the owner of a property. Based on the trust agreement, the trustee holds the ownership of the property for the benefit of the entity as the beneficiary.

(2) Use of property

There are several types of rights in relation to property use under the Civil Code, mainly, leasing rights (chinshaku-ken) and superficies (chijo-ken). Leasing rights are the most common types of rights to use property and governed not only by the Civil Code but also the Act on Land and Building Leases, which provides lease right holders with legal protection. For instance, a standard leasing agreement cannot be terminated unless the lessor has “justifiable grounds” under the Act and gives at least six months’ notice of termination to the lessee regardless of the terms of the leasing agreement (please refer to Question No. 15).

The Act allows the leasing right to be perfected once, in respect of the building lease the lessee obtains the possession of a building or in respect of a land lease, the ownership of the building is registered. Instead, it is also possible to register leasing rights for perfection although the registration of a leasing right is uncommon due to the registration fee.

(3) Security interests

A mortgage (Teito-ken) or pledge (Shichi-ken) is a common security interest that can be created over real property. Please refer to Question No. 19.

5. Is ownership of real estate and the buildings on it separate?

Ownership of land and buildings on the land is separate. Accordingly, it is possible to own a building on land owned by a third party. In such a case, the owner of the building needs to have leasing right to, or other legal grounds for owning a building on, the land.

6. What are common ownership structures for ownership of commercial real estate?

Although it is possible for foreign entities to directly own land and buildings in Japan, it is rather common to own real property through a Japanese entity such as a *kabushiki-kaisha* ("KK") or a *godo-kaisha* ("GK") incorporated under the Companies Act.

In the real estate financial market, it is common to use (i) a GK together with a *tokumei-kumiai* agreement ("TK"), which is one type of partnership agreement under the Commercial Code or (ii) a *tokutei-mokuteki-kaisha* (TMK) incorporated under the Act on the Securitization of Assets in order to reduce applicable taxes.

There are some factors to determine which structure is appropriate, for instance (i) regulations (different types of regulation would apply to the scheme depending on the type of SPC and the type of asset the SPC is holding), (ii) the need for a clear tax opinion (under the GK-TK structure, it is generally difficult to obtain an unqualified tax opinion regarding the avoidance of double taxation), and (iii) managing cost (the cost using the TMK structure is typically higher).

(1) GK-TK structure

One important aspect of the GK-TK structure is that the TK agreement allows avoidance of double taxation. However, the requirement for the avoidance is not

clearly prescribed by the laws of Japan, and a legal and tax opinion with respect to that point is difficult to provide.

A GK is rather more simple and flexible than a KK in terms of governance. It is possible for a GK to be established solely with one entity as a member appointing one individual as a managing officer (*shokumu-shikkousha*). An *ippan shadan hojin* ("ISH") is commonly used as a member of a GK to achieve governance neutrality and bankruptcy remoteness. This is because the officers of an ISH cannot change or be appointed by the contributors of ISH once the individuals are appointed under the articles of association. This means that the ISH can be free from the funder (sponsor)'s control.

(2) TMK structure

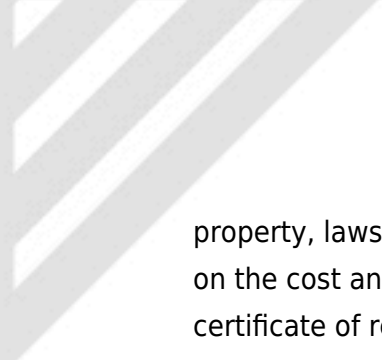
Unlike the GK-TK structure, the requirements for special tax treatment of a TMK are clearly prescribed by the tax laws of Japan; therefore, by fulfilling those requirements, an investor can avoid double taxation. A TMK can issue two types of equity: specified shares which are similar to ordinary shares in a KK; and preferred shares. The voting rights of a preferred shareholder are limited under the Act on the Securitization of Assets.

On the other hand, the Act requires (i) one director and statutory auditor from a governance view point, and (ii) preparation of a specific asset liquidation plan, which must be submitted to the authority.

7. **What is the usual legal due diligence process that is undertaken when acquiring commercial real estate?**

In practice, legal counsel generally review important agreements (such as lease agreements, property management agreements, etc.), reports (appraisal reports, engineering reports, soil reports, and disclosure statements explaining the important points of the property), and documents (certificates of registered matters) regarding subject property to check whether there is any material issue that would prohibit the purchaser from acquiring the subject property.

The scope of legal due diligence ("DD") typically includes a review of rights on the target property, tenants and lease agreement, any other related agreements regarding the property (including property management agreement), regulations applying to the



property, lawsuits, and other similar issues. Although the scope could differ depending on the cost and characteristics of the target property, it is essential to review the certificate of registered matters (please refer to Question No. 2). Where any issue is found in the reports, legal counsel generally proceed to investigate the issue in detail from a legal perspective.


DD generally proceeds with the following steps. First, it is necessary to determine the scope of the legal DD. Information regarding the target property is then provided to the potential buyer subject to the NDA or LOI to be provided. In some cases, question and answer session would be scheduled between the seller and the potential buyer. The potential buyer decides whether to proceed with the transaction based on the outcome of the legal DD.

8. What legal issues (if any) cannot be covered by usual legal due diligence?

Legal counsel do not normally conduct on-site DD, so the issues requiring physical inspection of property would not be covered by DD. For instance, the following matters would not be covered: the matters requiring physical DD related to (i) regional regulations; (ii) architecture or construction; (iii) environment; (iv) city planning or zone use; and (v) actual boundary. An appraisal report, engineering report, and property report is usually provided to investigate those points not covered by the legal DD. Where those reports highlight specific issues, legal DD on the specific issues would be undertaken.

9. What is the usual process for transfer of commercial real estate?

In most cases, real estate transfer starts with the exchange of a LOI between the seller and purchaser providing a rough outline of the terms and conditions of the transfer (including the estimated purchase price) and confidentiality, and then due diligence on the target property is conducted through the review of documents disclosed by the seller.



The sale and purchase agreement for real estate is usually executed after due diligence has begun. In Japanese practice, it can be seen that the sale and purchase agreement is signed on the date on which the target property is transferred to a purchaser. In cases where a sale and purchase agreement is executed before due diligence has been completed, the closing of the real estate transfer may be conditioned upon the completion of due diligence satisfactory to the purchaser.

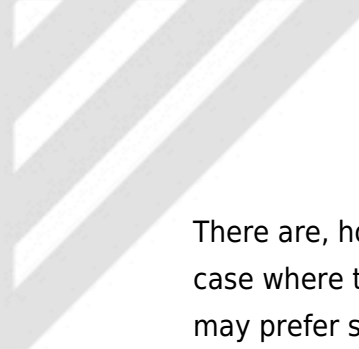
Meanwhile, the seller prepares documents to be delivered to the purchaser on the closing date, such as the termination of security interest on, or the existing contracts related to, the target property, a confirmation letter regarding the boundary, and filing documents for the transfer registration.

Subsequent to the process above, the transfer transaction is closed. The purchaser pays the total amount of the purchase price (in the case of lump sum payment), or the rest of the purchase price (in the case where a purchaser has paid a deposit (or other partial payment) prior to the closing) on the closing date when the title of the target property is transferred from the seller to the purchaser. The amount of the payment as to the purchase price would be adjusted in accordance with the executed sale and purchase agreement. Ownership transfer registration (or registration of change of the beneficiary in a trust beneficiary interest transaction) is filed on the closing date.

In addition, a bidding process kicks in in the case of a bid project. For example, a bidding offer will be required within the time slot designated by the seller.

10. **Is it common for real estate transfers to be effected by way of share transfer as well as asset transfer?**

Share transfer is not a common way to transfer real estate since many more factors are involved in share transfer transactions. For example, the purchaser may need to conduct due diligence on the company issuing the shares as well as the target real estate held by the company, and latent obligations and duties which are not on financial statements disclosed may become red flags to the transaction.



There are, however, share transfer transactions in some cases. For example, in the case where the target real estate has unrealized capital gains, the seller and purchaser may prefer selling the shares of the company holding the real estate rather than the sale of the real estate to avoid realization of the capital gain in the real estate, and, in turn, to circumvent corporate tax that would be triggered. Also, other taxes associated with the transfer of real estate, such as real estate acquisition tax, are not charged in share transfer transactions (please refer to Question No. 14). There may be tax benefits for choosing a share transfer depending on the details of the transaction.

11. On the sale of freehold interests in land does the benefit of any occupational leases and income automatically transfer

As a general rule, upon the transfer of the ownership interest in land, the contractual status of the lessor as to the land, including the right to rental income, is automatically transferred to an assignee of the land if the lease is registered, or if the lessee owns premises registered under their name on the land. Obligations to return lease deposits to the lessee after the end of lease contracts are also automatically transferred upon the transfer of the ownership interest in land. This doctrine has been established by judicial precedents, and has now also been stipulated in the Amended Civil Code.

However, under the Amended Civil Code, the contractual status of lessor may remain with an assignor if both parties agree that the contractual status of the lessor is not transferred to an assignee, and that an assignee leases the land back to an assignor. If the contractual status of lessor is automatically transferred to a new landlord as a result of ownership change, then it can be interpreted that consent to the change of lessor (from the new landlord to the old landlord) be required to be obtained from a lessee in the case that the old landlord keeps leasing the land to a lessee by renting such land from the new landlord. This may cause unnecessary administrative workload, and complicate contractual relationships with a lessee, and thus the Amended Civil Code allows that the contractual status of lessor may remain with an assignor as above.

12. **What common rights, interests and burdens can be created or attach over real estate and how are these protected?**

As a general rule, upon the transfer of the ownership interest in land, the contractual status of the lessor as to the land, including the right to rental income, is automatically transferred to an assignee of the land if the lease is registered, or if the lessee owns premises registered under their name on the land. Obligations to return lease deposits to the lessee after the end of lease contracts are also automatically transferred upon the transfer of the ownership interest in land. This doctrine has been established by judicial precedents, and has now also been stipulated in the Amended Civil Code.

However, under the Amended Civil Code, the contractual status of lessor may remain with an assignor if both parties agree that the contractual status of the lessor is not transferred to an assignee, and that an assignee leases the land back to an assignor. If the contractual status of lessor is automatically transferred to a new landlord as a result of ownership change, then it can be interpreted that consent to the change of lessor (from the new landlord to the old landlord) be required to be obtained from a lessee in the case that the old landlord keeps leasing the land to a lessee by renting such land from the new landlord. This may cause unnecessary administrative workload, and complicate contractual relationships with a lessee, and thus the Amended Civil Code allows that the contractual status of lessor may remain with an assignor as above.

13. **Are split of legal and beneficial ownership of real estate (i.e. trust structures) recognised?**

As the answer to Question 4 above explains, there are several types of rights and interests in real estate. Further, a security interest can be created over real estate. Although Japanese law recognizes some security interests, such as mortgages (*teitouken*), pledges (*shichiken*), security by way of assignment (*jyoutotanpoken*), and retention rights (*ryuuchiken*), mortgages (*teitouken*) are most commonly used by creditors to secure their claims since they are not required to take possession of secured real estate under the concept of mortgage, as opposed to pledge, and transfer tax will not be charged unlike in security by way of assignment.

Seizure (*sashiosae*), provisional attachment (*karisashiosae*) and preservative attachment (*hozen sashiosae*) can be burdens over real estate. These will be attached by court order on real estate owned by a debtor so that real estate is compulsorily sold to make distributions to the creditors.

The mortgages and burdens, such as seizure, above are protected by registration. With registration, for example, creditors can secure priority over subsequent security interests, and assert the security interest or seizure towards a person who has acquired the real estate after these are created.

14. **What are the main taxes associated with commercial real estate ownership and transfer of commercial real estate?**

1. Fixed Asset Tax, City Planning Tax

A fixed asset tax, and city planning tax are imposed each year on January 1st on a person who is registered in the tax registration as the owner of the land, building and depreciable assets. Upon a transfer of real estate, the seller and purchaser usually agree on an adjustment clause for the purchase price pursuant to which the seller bears these taxes for the period up until the day preceding the closing date, and the purchaser bears these taxes for the period from the closing date.

2. Real Estate Acquisition Tax, Registration and License Tax

When real estate is transferred, a transferee is charged a real estate acquisition tax. Also, a registration and license tax is also charged when registration for transfer of purchased real estate is made. The tax rate for these taxes is decided depending on the assessed value of the real estate transferred.

In the case of a transfer of a beneficial interest in a trust, taxation for the real estate acquisition tax will not occur as a trust beneficiary interest is not real estate. In addition, the amount of registration and license tax in connection with the change of trust beneficiary upon the transfer of the trust beneficiary interest is JPY1,000, which is much lower than such tax imposed in the case of real estate.

3. Consumption Tax

The seller of the building is charged with consumption tax and local consumption tax when the building is transferred. These taxes do not apply to the transfer of land. Although the tax is imposed on the seller, the purchaser usually pays the amount of the tax on top of the purchase price.

4. Income Tax

Rent and sale proceeds from properties constitute taxable income. For foreign investors who are treated as non-residents for tax purposes, this income is subject to withholding tax if they directly invest in the properties without a local entity (a resident). Such withholding tax does not apply to a resident who receives rent and sale proceeds from properties.

15. **What are common terms of commercial leases and are there regulatory controls on the terms of leases?**

The Act on Land and Building Leases is a key statute controlling leases both for land and for buildings. One of the purposes of the Act is to provide stability in the lease, and to protect tenants. The Act includes some compulsory provisions. If the terms and conditions of the lease agreed upon by the lessor and lessee are contrary to such compulsory provisions, then the lease terms would be void. The Act should be carefully reviewed when the lease contract is prepared.

1. Contract Type of Land Lease

The general rule of the term of the land lease is that the lease period should be equal to, or longer than, 30 years. If the lease period is agreed to be shorter than 30 years, the lease period is deemed to be 30 years, unless exemptions apply. The land lease is generally renewed upon the end of the lease period as long as a tenant holds a building on the land, unless there are justifiable grounds for the lessor's objection to the renewal. The lessor may not freely terminate the lease, nor will the lease terminate even by the passage of the lease period.

However, if the lease is recognized as a fixed-term land lease, or a fixed-term land lease for business purposes, the renewal mechanism, described above, does not apply. Under these types of contracts, the parties may agree that a lessee does not have a right to demand that a lessor purchase the premises on the land, which right is provided under the Act on Land and Building Leases. A fixed-term land lease should be entered into in written form, and the lease period needs to be equal to, or more than, 50 years. A fixed-term land lease for business purposes, on the other hand, is required to be made by a notarial deed, and is only applicable to cases where the lessee's objective in the lease is to own buildings used solely for business. The duration of the fixed-term land lease for business purposes should be at least 10 years (but no longer than 30 years) or at

least 30 years (but no longer than 50 years).

2. Contract Type of Building Lease

As a general rule, upon the lapse of the term of a lease, a building lease will be renewed with conditions identical to those of the existing contract. The lessor may not terminate the lease unless it has justifiable grounds for giving a termination notice to the tenant. However, if the lease falls under a fixed-term building lease specified under the Act on Land and Building Leases, the renewal mechanism described above does not apply. Such lease will be terminated with notification given during the period from one year to six months prior to the expiration of the lease period. A fixed-term building lease needs to be executed in writing, and the lessor is required to explain in a separate form to a tenant the fact that the lease will not be renewed. One of the characteristics in a fixed-term building lease is that the lease party may agree to exclude a statutory right by which they demand to increase or decrease the amount of building rent under the circumstances where the existing rent becomes unreasonable due to economic fluctuations, etc.

3. Common Terms

In addition to the basic terms in the lease, such as rent, common service charges, and deposits, Japanese lease agreements typically include, among others, allocation of costs and responsibilities regarding repair of the building, the manner in which the amount of rent is amended, termination events, the manner of vacation, and other similar items.

16. **How are use, planning and zoning restrictions on real estate regulated?**

The City Planning Law is the fundamental source of use, planning, and zoning restrictions on real estate. Under the City Planning Law, the area in which real estate resides is categorized as a “city planning area”, a “quasi-city planning area”, or “other”. If the real estate is located within an area categorized as a “city planning area” or “quasi-city planning area” then, in principle, a development permit will be required to develop the real estate. The difference between a “city planning area” and a “quasi-city planning area” is that a “quasi-city planning area” does not entail the Districts and Zones mentioned below, because the regulations are generally not intended to actively promote development in the “quasi-city planning area” but rather to preserve that city’s environment.

In terms of degree of urbanization, the city planning area includes two main categories

of area classification, “urbanization promotion areas”, which consist of those areas where urban areas have already formed as well as those areas where urbanization should be implemented preferentially and in a well-planned manner within approximately the next 10 years, and “urbanization control areas”, which are those areas where urbanization should be controlled. In general, development is more restricted in urbanization control areas than in urbanization promotion areas.

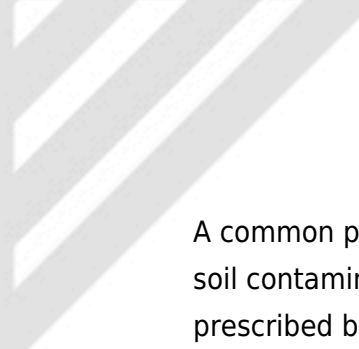
Furthermore, in terms of usage of the real estate, city planning areas are further divided into many districts and zones such as, for example, low-rise exclusive residential districts, commercial districts, and industrial districts. In each district and zone, there are different restrictions concerning what types of buildings can be constructed.

Additionally, the Construction Standards Law, which regulates the construction of new buildings and the refurbishment of existing buildings in city planning areas and quasi-city planning areas under the City Planning Law, is just one example of the many laws related to the City Planning Law, at both national and regional levels. As a result, it is difficult to judge precisely which laws apply to any given property, and the best way to find out is to check the “explanation sheet of important matters” (*juyo jiko setsumei sho*) for the building. Therefore, if you want to know the entire landscape of the restrictions, an “explanation sheet of important matters” (*juyo jiko setsumei sho*) prepared by the broker or the seller is usually one of the major documents that should be reviewed, as it includes important information such as zoning restrictions.

For further confirmation, you can consult directly with the municipality in which the property is located.

17. **Who can be liable for environmental contamination on real estate?**

In the absence of an exception under a relevant law, the landowner is liable, in principle, for damage caused to third parties arising from the real estate. Therefore, a buyer may be responsible for environmental contamination (including soil pollution) of the real estate.



A common problem in real estate transactions (particularly those relating to land) is soil contamination. If the soil is contaminated and does not conform to the standards prescribed by the Ordinance of the Ministry of the Environment, or the site is classified as harmful to human health or as posing a threat of such harm, the land will be designated as an area requiring action under the Soil Contamination Countermeasures Law. The landowner will be required to take the measures necessary, such as, for instance, the removal of the contaminated soil, to remedy the contamination. The measures to be taken will depend on the class of hazardous substances found on the land as well as on the state and degree of contamination. If the pollution meets certain requirements, the owner may claim the cost of removal against the polluter. A prefectural governor may order the polluter, rather than the owner, to take the required countermeasures if (i) it is clear that the soil contamination was caused by the person other than the owner, (ii) where it is appropriate to require said person (hereinafter including his successors by inheritance, merger, or split) to take an action for removal and (iii) the owner has no objection to such an action being taken.

When you buy or sell real estate, the seller and the purchaser can agree upon the allocation of any liabilities which may arise from environmental issues regarding the subject properties, by the making of relevant representations and warranties and indemnification provisions and other related terms in their agreement.

18. **Is expropriation of real estate possible?**

The Compulsory Purchase of Land Law establishes the requirements and procedures for the expropriation of privately owned real estate by the government. The expropriation is processed by evaluating whether the project that requires the expropriation will be in the public interest, and then determining the appropriate manner and amount of compensation. Owners of expropriated assets are generally entitled to reasonable compensation, which is decided upon by the expropriation committee. In principle, the compensation should be in the form of money, but there are some exceptions, such as the provision of substitute real estate.

In practice, land expropriation is very rare, and purchasers can check the likelihood of this occurring, or whether the target property is subject to an expropriation plan, by

reviewing the “explanation sheet of important matters” (*juyo jiko setsumei sho*) or other documents prepared by the broker.

19. **Is it possible to create mortgages over real estate and how are these protected and enforced?**

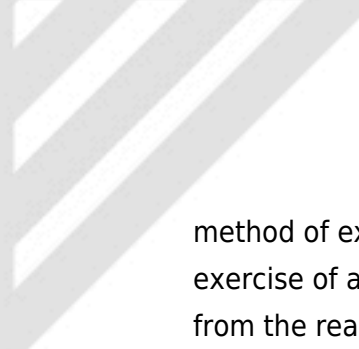
Creating mortgages including revolving mortgages over ownership and superficies of real estate is possible, and is in fact the usual practice in the market.

When you create a mortgage, it is not necessary for possession to be transferred. Mortgages can be created through mere agreement of the parties, and the fulfilment of the requirement of perfection by registering the mortgage. It should be emphasised that parties who take out a mortgage on the real estate should ensure they have disposal authority.

However, in practice, in order to save on registration costs, some lenders allow only provisional registrations to be made. Once a mortgage based on the provisional registration is formally registered, that mortgagee enjoys priority over those mortgagees whose mortgages were registered after the provisional registration. However, provisional registration is merely for securing priority, and thus it is not possible to enforce the mortgage, unless formal registration is subsequently completed. Therefore, it is vital that lenders ensure that they are always in possession of all documents necessary to allow them to formally register such a mortgage.

A mortgagee shall have the right to receive the performance of his or her claim prior to other obligees. If more than one mortgage is created with respect to the same property, the order of priority of those mortgages shall follow the chronological order of their registration. Furthermore, mortgages principally extend to the things that are an integral part of the properties that are the subject matter of the mortgage, except for buildings on the mortgaged land.

Mortgages can be enforced through the method of a secured real property auction (meaning the exercise of a real property security interest through an auction), or the

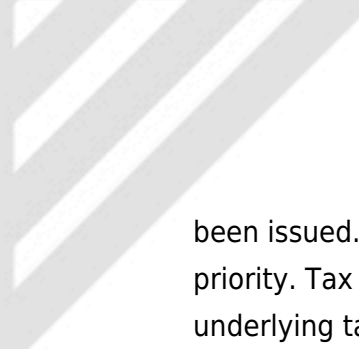


method of execution against earnings from the secured real property (meaning the exercise of a real property security interest by the method of allotting the earnings from the real property to performance of the secured claim) under the Civil Execution Law.

Exercise of a real property security interest under the Civil Execution Law shall be commenced only when all of the designated documents have been submitted.

When an event of default under a mortgage occurs, and the applicable mortgagee adopts the method of a secured real property auction, the applicable mortgagee can initiate the secured real property auction by filing an application for foreclosure with an execution court. The execution court shall, in order to commence the secured real property auction, issue a commencement order for a compulsory auction in which it will declare that the real property shall be seized for the obligee. In the process under the Civil Execution Law, the property owner is given certain opportunities to contest, and secured creditors with perfected liens, creditors with judicial liens, and the tax authorities will be given a chance to register their claims with the court. The court will then order an appraisal to set a minimum bid for the auction, and the sale at auction will extinguish any liens on the property, with title immediately passing to the winning purchaser. The court will then distribute the sales proceeds in order of priority. Tax liens will have priority over mortgages only to the extent that the underlying taxes were due and unpaid prior to the provisional registration of the applicable mortgage.

When an event of default under a mortgage occurs, and the applicable mortgagee adopts the method of execution against earnings from the secured real property, the applicable mortgagee can initiate the execution against earnings from the secured real property by filing an application with an execution court. The execution court shall, in order to commence an execution against earnings from the secured real property, issue a commencement order for compulsory administration in which it will declare that the real property shall be seized for the obligee. It will also prohibit the obligor from disposing of the earnings if the obligor has a claim for rent or any other right to seek delivery pertaining to earnings from the real property. The execution court shall appoint an administrator simultaneously with the issuance of a commencement order for execution against earnings from the secured real property. The administrator may conduct administration, collect earnings, and conduct a realization with regard to the real property for which a commencement order for compulsory administration has



been issued. The administrator will then distribute the sale proceeds in order of priority. Tax liens will have priority over mortgages only to the extent that the underlying taxes were due and unpaid prior to provisional registration of the applicable mortgage.

Alternatively, lenders can consent to a voluntary sale of the property by mortgagor, and many lenders are able to obtain more money and a faster recovery through this method. If there is a willing purchaser, and the property owner is cooperative, a voluntary sale may make more sense for all parties. In the case of structured finance of real estate, the parties often set the rule of a voluntary sale of the property by mortgagor under the lender's instruction.

20. **Are there material registration costs associated with the creation of mortgages over real estate?**

The main cost of the creation of a mortgage is the registration and license tax. Registration and license tax is 0.4% of the secured loan amount. On the other hand, the lodgement of a mere provisional registration costs only JPY 1,000 for each item of real property. In addition, stamp taxes apply and lawyer fees will be incurred.

21. **Is it possible to create a trust structure for mortgage security over real estate?**

Under Trust Act, it is possible to create a trust structure for mortgage security over real estate. However, trust structures for security are not commonly used in the market.

One of the reasons for this is that there is a conflict of interest in being both the lender and trustee. Specifically, if a lender becomes the trustee of a mortgage security, it becomes difficult to collect the claim preferentially. Additionally, as the fee received for acting as a trustee is relatively low, it appears that there are few trust banks willing to undertake the role of trustee of a mortgage security.

22. **What is the main legislation relating to commercial real estate ownership?**

The Civil Code is the fundamental legislation governing the ownership of real estate (as mentioned in 1. and 11. above, the Amended Civil Code will come into effect on April 1, 2020). The Act on Building Unit Ownership, etc. provides for unit ownership in buildings such as some types of apartments and condominiums which are structurally divided and have multiple owners.

If real estate is held in trust, the trust structure will be governed under the Trust Act, which provides for the creation of the ownership of the trust beneficiary interest. Further, if the trustee engages in conducting trust business, the Trust Business Act (or the Act on Engagement in Trust Business by Financial Institution) will apply. In addition, the laws related to restrictions on ownership of real estate are the Act on Land and Building Leases, and the Facilitation of Reconstruction of Condominiums Law.

As for procedures and perfection, the Real Estate Registration Act provides procedures for registering the ownership of properties. However, it should be noted that registering the ownership of properties does not directly demonstrate or guarantee the real estate ownership, but is rather a requirement for perfection, although it practically plays an important role in real estate transactions.