

THE REAL ESTATE
LAW REVIEW

EIGHTH EDITION

Editor
John Nevin

THE LAWREVIEWS

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PREFACE

I am delighted to introduce the eighth edition of *The Real Estate Law Review*. The continued success of the *Review* confirms its relevance to real estate practitioners and their clients. Real estate is increasingly viewed on a global basis and readers can only benefit from a general understanding of how individual jurisdictions operate within the global real estate market.

This edition extends to 31 jurisdictions, and we are delighted to welcome new contributions from distinguished practitioners from around the world. I am very grateful to all contributors for their hard work and essential role in compiling this eighth edition. Each chapter provides an invaluable insight into key legal issues and market trends in the author's jurisdiction and, together, they offer an up-to-date synopsis of the global real estate market.

The *Review* seeks to identify distinctions in practice between the different jurisdictions by highlighting particular local issues. We believe that this offers investors and occupiers and their professional advisers an invaluable guide to real estate investment outside their own domestic market. Overseas investors are increasingly prepared to look beyond traditional markets and sectors to exploit international opportunities as and when they arise. Often, investors need to act quickly, and we hope that the *Review* provides an advantageous starting point to understanding cross-border transactions in the light of the reader's own domestic forum.

International economic and political instability continues to have a significant effect on the global real estate market. In the UK, Brexit-generated uncertainty remains as negotiations for leaving the EU are still ongoing as we approach the 29 March 2019 deadline. However, the continued attraction of UK real estate to overseas investors confirms that each event or development in a particular country must be seen in a global context to ascertain the bigger picture. It is no longer possible to ignore globalisation and view real estate markets in isolation. Brexit notwithstanding, the UK remains a safe haven for investors from around the world, and investment levels in London and the wider UK market remain buoyant.

In addition to all the distinguished authors, I would like to thank the members of the Law Review team for their tireless work in compiling this eighth edition of *The Real Estate Law Review*.

John Nevin

Slaughter and May

London

February 2019

JAPAN

Norio Maeda, Takuya Shimizu, Keisuke Yonamine and Yujin Gen¹

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The basic ways in which real estate can be held are either holding ownership title to real estate directly or holding a beneficial interest in a trust that holds title to real estate in connection with large-scale commercial investments.

Land and buildings are considered separate and independent real estate. Therefore, one person can hold title to land while another person can hold the title to a building on the land. When different persons own a building and the parcel of land upon which the building is located, the two owners will typically enter into a contract such as a land-lease agreement where the building owner is permitted to use the land.

Joint title to real estate, which is governed by the rules under the Civil Code, is one form of title that can be held by multiple persons. Condominium title to a condominium that is part of a building, which is governed by both the rules under the Condominium Law and by the Civil Code, is another form of title that can be held by a single person separately from other condominium owners of the building.

Trust beneficial interests in real estate are typically issued when a real estate owner places the real estate in a trust. The trustee holds title to the real estate placed in the trust. The owner, on the other hand, holds a trust beneficial interest that represents a contractual relationship with the trustee under a trust agreement. Under this, the beneficiary may instruct the trustee to administer and manage the real estate in the trust and to distribute profits earned from the real estate (after deducting costs and expenses for administration and management of the real estate). Trust beneficial interests are used for various reasons, including delegating administrative duties from the beneficiary to the trustee and deferring taxes related to real estate transfers by transferring the trust beneficial interests instead.

ii System of registration

Ownership title and other property rights with respect to real estate are typically registered in the real estate registry maintained by local registration offices. Trustees are typically the registered owners of real estate that is placed in trust. The general rule is that transactions including the sale and purchase of real estate and creation of a mortgage on real estate take effect upon execution of agreements between the parties, and that no formalities are required; however, the holder of ownership title or other property rights with respect to real estate must

¹ Norio Maeda is a partner, Takuya Shimizu is a counsel, and Keisuke Yonamine and Yujin Gen are associates at Nishimura & Asahi.

have its interest registered in the appropriate real estate registry to assert its rights against a third party. This means that generally, to perfect a right over real property, there must be a valid agreement between the parties and the right must be registered in the name of the holder. The registration is governed by the Real Estate Registration Law.

While registration of a real property right in the name of a certain person does not necessarily mean that the person actually holds the registered right, registration is usually considered strong evidence. Neither the local registration office nor the government guarantees the accuracy of the real estate registry. A registration in the real estate registry only reflects and records the transactional activities that private persons described in their applications for registration.

iii Choice of law

In the context of a cross-border transaction, choice of law rules are provided in the Act on General Rules for Application of Laws. Under the Act, if the subject matter is a property right or other right that can be registered in the real estate registry, the law of the jurisdiction in which the real estate is located shall be the governing law; however, under the Act, any law chosen by the parties can govern a contract. Despite the Act permitting the parties to choose the governing law of the contract, parties usually choose Japanese law as the governing law of a sale and purchase agreement with respect to real estate, because of the rule that Japanese law governs property rights in Japan.

II OVERVIEW OF REAL ESTATE ACTIVITY

Japan has developed various innovative real estate investment structures during the past few decades.

The GK-TK structure and the specified-purpose company (TMK) structure (discussed in detail in Section IV, below) are frequently used in real estate investment transactions. Japanese real estate investment trusts (J-REITs) (discussed in Section IV, below) have made it possible for investors with smaller amounts of capital to invest in real estate through the purchase of listed J-REIT securities. The listed J-REITs have become major players in the Japanese real estate investment market using the accumulated capital of investors, and the flow of capital through listed J-REITs into the real estate investment market has contributed to the growth of the real estate industry.

The increase in flexibility offered by such investment structures has resulted in a greater influx of domestic and foreign capital into Japanese real estate. The response to demands from an increasing number of participants has made the real estate investment market more sophisticated and attractive, and many investors consider the Japanese real estate market to be an important focus in their global investment strategy.

Although the global economic turmoil in the late 2000s affected – and slowed down – activities in the Japanese real estate investment market (including activities by lenders), it also prompted the Japanese government to develop various regulations. The government has taken various measures to relax regulations and enhance market activities. Since then, we have seen a reversal in the prices and transaction volume of real estate. The transaction volume for Japanese real estate in fiscal year 2014 recovered to a level nearly as high as that of fiscal year 2007, previously recorded as the year with the highest transaction volume prior to the global economic turmoil. Although the transaction volume substantially declined in the second half of fiscal year 2015, the transaction volume continues to gradually improve

and remains at the higher end, nearly as high as fiscal year 2006 prior to the beginning of the global economic turmoil. For the past several years, financial institutions have been in great competition to provide real estate financing, and investors have been able to raise funds for their real estate investments with relatively relaxed conditions, including lower interest rates. This has enhanced the real estate transaction market in Japan. However, upon a discovery that a financial institution engaged in real estate financing fraud, including the manipulation of documents for credit analysis and with respect to which the Financial Services Agency of Japan took administrative actions, financial institutions in Japan appear to have tightened real estate financing conditions, which may temporarily constrain the volume of real estate transactions in Japan.

III FOREIGN INVESTMENT

There are no direct restrictions on acquisitions of commercial or residential real estate in Japan by foreign investors, either directly or through a vehicle. Similarly, establishment of a corporation by foreign investors to invest in commercial or residential real estate is not restricted. In theory, under the provisions of the Alien Land Law, a cabinet order may limit the rights of foreign investors related to land in Japan on the grounds of reciprocity or national security. At the time of writing, however, there has been no such limitation, as no such cabinet order has been issued.

Under the Agricultural Land Act, an authorisation by the relevant authority is required to acquire certain agricultural land. This authorisation can only be granted if the purchaser is qualified as a farmer or a qualified corporation for owning agricultural land. It would not be easy for foreign investors to be granted such an authorisation.

After a foreign investor's acquisition of shares or equity of a corporation, or acquisition of real estate or a right related to real estate, a post-transaction report to the government authority may be required pursuant to the Foreign Exchange and Foreign Trade Law (FEFTL). A post-transaction report of payment or receipt of payment may be required in the case of cross-border payments or payments between a foreign investor and a Japanese resident in accordance with the FEFTL.

IV STRUCTURING THE INVESTMENT

When choosing an investment structure, the legal, accounting and tax implications must be considered, because each can be a driving factor for the choice. The most popular structures and investment vehicles used for real estate investments in Japan are the GK-TK structure, the TMK structure and the J-REIT. The Real Estate Specified Joint Enterprise Act (REJEA) was amended in 2013 to enable a GK-TK structure (see below) to invest in real estate without requiring the limited liability company (GK) as the contractual anonymous partnership (TK) operator vehicle itself to obtain a licence.

i GK-TK structure

A GK is one type of corporate entity under the Companies Act. In some respects, it is similar to an LLC in the United States; however, it is not itself a pass-through entity for tax purposes. When a GK is used as an asset investment vehicle, typically an investor leverages its investment by third-party loans and makes its own investment in the GK through a TK arrangement. The TK arrangement is a bilateral (not multilateral) contractual partnership relationship

created for the investment purposes by the TK interest holder, called the TK investor. The other party to the contract is called the TK operator. Under the GK-TK structure, the TK operator is the GK. A TK arrangement qualifies for favourable tax treatment if the TK investor is a passive investor with minimal control over the management of the GK and the contributed funds under the arrangement. If the TK arrangement qualifies, the GK is permitted to deduct distributions to the TK investor from its taxable profits in addition to deducting debt payments. This tax-efficient combination of a GK and a TK arrangement is called a GK-TK structure.

Typically, a GK-TK structure has been used to make investments in trust beneficial interests in real estate, and loans backed by real estate. If a GK holds real estate directly, by raising funds from TK investors, it will generally be subject to a licensing requirement under the REJEA. Therefore, the GK-TK structure has usually been structured to invest in trust beneficial interests in real estate, not in real estate itself. An exemption from the licensing requirement under the REJEA (newly introduced in 2013) allows the GK-TK structure to invest in real estate itself if certain requirements are satisfied.

A GK-TK structure that is used to invest in a trust beneficial interest in real estate will subject the GK to the strict registration requirement under the Financial Instruments and Exchange Law (FIEL), unless an exception applies. One of the exceptions available under the FIEL is the QII exemption, which essentially requires that:

- a* there is at least one qualified institutional investor (QII) under the FIEL among the TK investors (the requirements to qualify as a QII are now stricter after the amendment to the relevant cabinet order and cabinet office ordinance under the FIEL, which became effective on 1 March 2016);
- b* the number of non-QII TK investors (if any) is 49 or less (non-QIIs are limited to certain categories, which includes a foreign corporation, after the 1 March 2016 amendment to the relevant cabinet order and cabinet office ordinance under the FIEL, while there were no limitations imposed on non-QIIs before the amendment);
- c* none of the TK investors is a disqualified investor as detailed in the FIEL; and
- d* the GK, as the operator of the TK arrangement, files with the government authority a notification regarding the QII exemption (the requirements for the notification to be filed by the GK are now more complex, compared to the previous simple requirements).

As noted above with respect to the relevant requirements, the requirements of the QII exemption were amended in 2016.

Another exception available under the FIEL is the exemption by outsourcing to a registered discretionary investment manager. Under this exemption, the GK retains a registered discretionary investment manager (a 'registered financial instruments operator' under the FIEL) as its asset manager to manage its trust beneficial interest in real estate on a discretionary basis. This exemption requires, among other items, that:

- a* the GK enters into a discretionary asset management agreement with the registered discretionary investment manager that authorises the manager to make a discretionary investment decision on behalf of the GK on its trust beneficial interest in real estate;
- b* the TK agreement provides that under the asset management agreement described above, the GK authorises the manager to make a discretionary investment decision on its behalf on its trust beneficial interest in real estate;

- c* the TK agreement provides an outline of the asset management agreement described above, including the fees (or the fee arrangement) to be paid to the asset manager from the assets managed under the GK-TK structure;
- d* both the TK agreement and the asset management agreement described above provide certain duties of the asset manager, such as the asset manager's duty of loyalty and duty of care of a prudent manager, both owed to the TK investor in carrying out the investment management of the trust beneficial interest in real estate held by the GK;
- e* the GK manages its assets of the GK-TK separately from its own assets (and its other investment assets managed for other investors, if any) and the asset manager supervises such separate management; and
- f* the asset manager files a notification to the authority of the outsourcing by the GK prior to the GK entering into the TK agreement.

REJEA structure

Since the 2013 amendment to the REJEA, the REJEA allows a GK-TK structure to invest into real estate directly, without the GK as the TK operator vehicle needing to obtain a licence, if certain requirements are met. It is hoped that this GK-TK structure under the REJEA will enhance investment into real estate without the need to involve a trustee in respect of a trust beneficial interest at the underlying real estate level. The most recent amendment in 2017 to the REJEA has also made certain changes to the GK-TK structure and its requirements.

The GK-TK structure under the REJEA essentially requires that:

- a* the GK must be established for the sole purpose of distributing proceeds and profits from transactions related to the subject real estate;
- b* the GK as the TK operator delegates (1) the management of transactions related to the subject real estate to a real estate specified joint enterprise business operator (REJEB operator) that is licensed to conduct its business under Article 2, paragraph 4, item 3 or Article 2, paragraph 6, item 2 of the REJEA, and (2) the solicitation of investments into the TK operator by the TK investor (or investors) to a REJEB operator that is licensed to conduct its business under Article 2, paragraph 4, item 4 of the REJEA;
- c* only investors falling into one of the categories of 'special investors', which include a licensed REJEB operator and a QII (as defined under the FIEL), make TK investments in the TK operator, if the TK operator is to conduct the development of land as a site for buildings, construction of a building, or repair or renovation of a building, the cost of which exceeds 10 per cent of the value of the real estate held by the TK operator (or exceeds ¥100 million if the REJEB operator retained by the GK is an operator of a 'small-sized real estate specified joint enterprise' as described in Article 2, paragraph 6, item 2 of the REJEA); and
- d* the agreement for (1) as described in (b) above to be entered into between the GK and the REJEB operator must stipulate certain items specified under the REJEA.

Under these requirements, the REJEA allows a licensed REJEB operator to be involved in a TK arrangement investing into real estate, not as a TK operator itself, but as a manager for the TK operator vehicle, as long as the delegation of the management covers (1) and (2) as described in (b) above. To enhance the use of this GK-TK structure under the REJEA,

a GK-TK structure satisfying the above-mentioned requirements will benefit from reduced registration and licence tax, and real estate acquisition tax. For more details on the reduction of these taxes, see Section V, below.

With respect to the 2017 amendment to the REJEA. The REJEB operator mentioned in (b) above can be an operator of a small-sized real estate specified joint enterprise, newly introduced under the 2017 amendment to the REJEA. After the 2017 amendment to the REJEA, the GK-TK structure can also be set up using the framework of the investment arrangement to be invested only by 'super professional investors', not the GK-TK framework as described above that has been available since the 2013 amendment to the REJEA.

ii TMK structure

A TMK incorporated under the Asset Liquidation Law (ALL) is another type of corporate entity often used as a real estate investment vehicle. This entity may only be used to liquidate or securitise certain assets. This investment platform is used to make investments in real estate, trust beneficial interests in real estate, and loans and TMK bonds that are backed by real estate. A TMK is typically funded by issuing TMK bonds and preferred shares that meet certain tax qualifications required for the preferential tax treatment of the TMK. If a TMK, its bonds and its preferred shares are properly structured, and the TMK meets certain other requirements under the Tax Code, it is permitted to deduct distributions to the preferred shareholders from its taxable profits in addition to deducting debt payments.

One of the requirements for the preferential tax treatment is that its TMK bonds be purchased by an institutional investor or other similar person or entity (a Tax II or equivalent investor) as defined in the Tax Code. Certain QIIs under the FIEL and certain other QIIs meeting additional requirements fall under the definition of a Tax II or equivalent investor. One of the important steps in setting up a TMK structure is to find a TMK bondholder that is a QII and is a Tax II or equivalent investor.

When using a TMK structure, it is also important for the TMK to comply with strict regulations under the ALL. These regulations include a requirement to file an asset liquidation plan with the government authority. The asset liquidation plan of a TMK outlines how its assets are to be liquidated or securitised. A TMK structure requires close attention being paid to the regulations regarding the asset liquidation plan.

iii J-REITs

A J-REIT is a type of investment fund formed under the Law concerning Investment Trusts and Investment Companies (ITL). A J-REIT established to invest in and manage real estate assets uses investors' funds to purchase real estate assets, in return for which investors receive investment units. The investment units of a J-REIT can be listed and traded on the stock exchange. If a J-REIT's investment units are listed, the J-REIT must comply with the rules of the stock exchange in addition to the ITL. Under the ITL, a J-REIT must retain an asset management company (a registered financial instruments operator under the FIEL) to manage its investment. In practice, all investment decisions for a J-REIT are designed to be made by its asset management company.

Unlike an ordinary corporation, which is subject to corporation tax on its profits, a J-REIT is exempt from taxation if certain requirements are satisfied, including:

- a the J-REIT is not engaged in any business other than that permitted for J-REITs;
- b the J-REIT would not be classified as a family corporation as defined in the Tax Code at the end of its fiscal period;

- c the J-REIT distributes more than 90 per cent of its profits as dividends to the holders of its investment units for each fiscal period; and
- d more than 50 per cent of the investment units on an aggregate issued amount basis have been offered in Japan.

The basic concept underlying the J-REIT legislation is that unlike a GK-TK structure or a TMK structure, a J-REIT's investments are not limited to certain assets specified at the time of its start-up. By raising long-term funds through a combination of debt and equity financing, a J-REIT can continue to accumulate and replace its investment portfolio for a longer term. At the same time, however, it would distribute most of its profits (more than 90 per cent) to the holders of its investment units for each fiscal period as described above, and therefore may not have sufficient internal reserve funds. When structuring a J-REIT, it is important to mitigate the potential risks of not having sufficient funds to deleverage its debt during an economic downturn. Because a J-REIT would practically be restricted regarding the amount of reserves it may retain, it should adopt another financial strategy to mitigate the potential risks, such as keeping its debt-to-asset ratio at a conservative level.

V REAL ESTATE OWNERSHIP

i Planning

City Planning Law

The City Planning Law is the primary national law that governs real estate development and zoning.

Under the City Planning Law, land development is strictly controlled in urbanisation control areas. Developers are required to obtain approval from local government authorities for developments in areas designated for urbanisation. Approval is given if the proposed development meets certain requirements under the City Planning Law.

There are various local laws established under the framework of the City Planning Law. Local government authorities are granted the power to control land use in accordance with the City Planning Law and the local laws.

Building Standards Law

The Building Standards Law provides regulations with respect to construction of a building, including regulations with respect to its use and the ratio of its total floor area to its site area.

Under the Building Standards Law, the appropriate local government authority must approve construction work for a building before the work commences. Furthermore, a completion inspection of the building by the appropriate local government authority is required upon completion of work.

ii Environment

Under the Soil Contamination Countermeasures Law, if a manufacturing factory that uses certain hazardous materials ceases its operations, the owner, manager or occupant of the land (the landowner) must examine the land and test for contaminants. In addition, in the case of the development of a large area of land (at least 3,000 m²), the developer must notify the appropriate local government authority at least 30 days before any change is made to the land. After receiving such notice, if the authority determines that the land may be

contaminated in the manner designated by the Soil Contamination Countermeasures Law, it may order the landowner to investigate. The local government authority may also order a landowner to examine land and conduct testing for contaminants if it determines that the land may harm the health of inhabitants in the neighbourhood through underground water or otherwise in the manner designated by the Soil Contamination Countermeasures Law. If the result of an examination of the land reveals that the relevant regulations have not been met, local government authorities will designate the land as a contaminated area and require appropriate measures, including cleaning up the land, to prevent public health from being impaired.

iii Tax

Stamp taxes, registration and licence taxes, and real estate acquisition taxes apply when the ownership title of real estate is transferred.

General

Stamp taxes are paid by affixing a revenue stamp on a taxable document. An agreement to transfer the ownership title to real estate requires a stamp tax of progressive amounts generally ranging from ¥200 to ¥600,000, based on the purchase price provided in the agreement. A range from ¥200 to ¥480,000 will apply to an agreement entered into between 1 April 2014 and 31 March 2020.

Registration and licence taxes are imposed when registering certain matters with respect to real estate with the appropriate local registry. The tax rate to register a transfer of ownership title to buildings is generally 2 per cent. A rate of 1.5 per cent will apply to a registration regarding a transfer of land occurring between 1 April 2013 and 31 March 2019, and a rate of 0.3 per cent will apply to a transfer of ownership title to certain qualified residential buildings that are acquired by an individual by 31 March 2020, to be used for residential purposes.

Real estate acquisition taxes are imposed on a purchaser of real estate at a rate of 3 per cent (for land and for residential buildings), or 4 per cent (for non-residential buildings); provided that the reduced tax rate of 1.5 per cent will apply to residential lands that are acquired by 31 March 2021.

Beneficial treatment

Transfer to a TMK

If a TMK acquires real estate and meets certain requirements, it may qualify for the following tax benefits:

- a* the registration and licence taxes to register the acquisition until 31 March 2019 will be reduced to 1.3 per cent; and
- b* the real estate acquisition tax rate is currently two-fifths of the original rate, and this reduced rate will apply until 31 March 2019.

Transfer of trust beneficial interest

Using a trust structure where the trustee holds ownership title to real estate provides certain tax benefits. Stamp taxes for real estate trust agreements and for sale and purchase agreements for a trust beneficial interest in real estate is ¥200, which is substantially less than stamp taxes for a sale and purchase agreement of the real estate itself. While registration and licence taxes and real estate acquisition taxes will be imposed on a purchaser of real estate, the following

reduced registration and licence taxes will be imposed on real estate being placed in trust, and on a trust beneficial interest in real estate being transferred from the initial holder to the purchaser:

- a* on placing the real estate in trust: 0.3 per cent (for land), or 0.4 per cent (for buildings); and
- b* on the transfer of the trust beneficial interest: ¥1,000 for each building and piece of land.

Real estate acquisition taxes are not imposed on real estate when it is placed in trust or on the transfer of the trust beneficial interest.

However, when the holder of a trust beneficial interest in real estate (other than the initial holder) terminates the trust agreement and receives delivery of the real estate from the trustee, registration and licence taxes at a rate of 2 per cent will be imposed upon registration of the real estate transfer. Upon such a transfer, real estate acquisition taxes will also be imposed on the beneficiary at a rate of 3 per cent (for land and for residential buildings), or 4 per cent (for non-residential buildings).

By applying the tax benefits of a trust structure as described above, a substantial amount of taxes related to a real estate acquisition can be deferred until the trust agreement is terminated and the real estate is delivered to the beneficiary.

Transfer of real estate to a GK-TK structure under the REJEA

If a GK-TK structure under the REJEA (as discussed in Section IV, above) acquires one or more of: (1) an old building to be rebuilt or renovated (defined as a building older than 10 years or a building seriously damaged by natural disasters); (2) land used for a building that is to be rebuilt or renovated; and (3) land planned to be used for a building newly built on the land, by meeting certain other requirements, it may qualify for the following tax benefits:

- a* the registration and licence taxes to register the acquisition until 31 March 2019 will be reduced to 1.3 per cent; and
- b* the real estate acquisition tax rate is currently half of the original rate, and this reduced rate will apply until 31 March 2019.

Notwithstanding the above, if a GK-TK structure is used for a small-sized real estate specified joint enterprise, the following real estate acquired by the GK-TK structure may qualify for the following tax benefits if it meets certain other requirements:

- a* the registration and licence taxes for registration of a building acquired until 31 March 2019 for the purpose of rebuilding or renovating will be reduced to 1.3 per cent; and
- b* the real estate acquisition tax rate for a building constructed before 1 January 1982 and acquired for the purpose of rebuilding or renovating, and the land acquired as the site of the building is currently half of the original rate, and this reduced rate will apply until 31 March 2019.

iv Finance and security

Mortgages on real estate are the most frequently used form of security interest in real estate.

In general, once the mortgage is registered, it is granted priority over unsecured creditors; however, even a registered mortgage is subordinate to tax claims against the mortgagor that

became due prior to the registration of the mortgage. The registered mortgage will also be subordinate to any previously registered mortgages or other previously registered security interests on the same real estate.

Another form of security interest in real estate that is frequently used is a pledge over a trust beneficial interest in real estate. If real estate is held in the form of a trust beneficial interest in real estate, the lender would create a pledge over the trust beneficial interest and not a mortgage on the real estate itself. Perfection of the pledge is made by obtaining the consent of the trustee with a date certified by a notary public.

TMK bondholders are granted a security interest by operation of law, which is a statutory general security interest on all the current and future assets of the TMK granted in their favour under the ALL. The statutory general security interest will also secure (by operation of law under the ALL) all the TMK bonds subsequently issued. In many cases, therefore, holders of TMK bonds do not create a mortgage or pledge on the real estate or trust beneficial interest in real estate held by the TMK. This is mainly because the mortgage and pledge securing the bonds need to be held by a trustee in accordance with the Secured Bond Trust Law, and additional costs to establish such a trust arrangement are not considered economically justified in many cases.

VI LEASES OF BUSINESS PREMISES

The Land Lease and Building Lease Law (LLBLL) and the Civil Code regulate real estate leases. The general rule is that the LLBLL is applicable to land leases that are made for the purpose of the lessee owning a building on the land, and to building leases. The LLBLL takes precedence over the Civil Code when their provisions overlap.

i Types of lease

The LLBLL provides for various types of lease, including the following.

Land lease for the purpose of a lessee owning a building on the land

Ordinary land lease

Under the LLBLL, a land lease made for the purpose of the lessee owning a building on the land (other than a fixed-term land lease as discussed below) has a 30-year term, unless the parties agree to a longer term. Such land leases are automatically renewed for a term of 20 years for the first renewal and 10 years for subsequent renewals unless otherwise agreed by the parties. The lessor cannot object to such renewal without a justifiable reason. Generally, a justifiable reason is not easy to establish, and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term land lease

A fixed-term land lease made for the purpose of the lessee owning a building on the land is not renewable under the LLBLL; however, the parties are not prohibited from entering into a new lease agreement at the expiry of the lease. Fixed-term land leases were introduced because concerns of landowners about the strict restrictions on the ability of the owners of land to refuse to renew a land lease were considered to inhibit effective use of real estate. There are three types of fixed-term land leases:

- a a general fixed-term land lease available for either residential purposes or business purposes (the fixed term is 50 years or longer);
- b a land lease with a special agreement by which the lessee assigns the building on the land to the lessor (the lease agreement can provide for the lessor's right to obtain the building on the land from the lessee at a reasonable price to terminate the lease after 30 or more years following the commencement of the lease); and
- c a fixed-term land lease for business purposes (the fixed term is 10 years or more but must be shorter than 50 years).

Building leases

Ordinary building lease

A building lease usually has an agreed term. Under the LLBLL, a building lease with an agreed term (other than a fixed-term building lease as discussed below) is automatically renewed and the lessor cannot object to the renewal of the building lease without a justifiable reason. Generally, a justifiable reason is not easy to establish and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term building lease

A fixed-term building lease is not renewed under the LLBLL; however, the parties are not prohibited from entering into a new lease agreement at the expiry of the lease term. The parties can agree on the fixed term without restriction on its duration.

ii Typical provisions

There are typical provisions for leases of business premises in Japan regarding increase or reduction of rent, termination and assignment of lease or sublease.

Rent increase or reduction

Under the LLBLL, if the amount of rent payable becomes inappropriate (e.g., if it differs significantly from the market rent), the lessor or the lessee may request that it be increased or reduced. This applies both to land leases made for the purpose of the lessee owning a building on the land and to building leases. The parties to the lease agreement, however, can eliminate the right to request an increase in rent by agreeing not to increase the amount of rent for a certain period. The right to request a reduction cannot be eliminated from a lease that is not a fixed-term building lease.

Termination

Under the Civil Code, if one party breaches an agreement, the other party can terminate it; however, under Supreme Court precedents, a lessor cannot terminate a real estate lease agreement if the lessee can establish the existence of a special circumstance where a relationship of mutual trust remains between the lessor and the lessee even after the breach. Failure to pay rent for several months would usually entitle the lessor to terminate the lease, because such non-payment would usually be regarded as destroying the relationship of mutual trust.

Assignment of lease or sublease

Lease agreements usually prohibit the lessee from assigning the lease or subletting without the consent of the lessor.

VII DEVELOPMENTS IN PRACTICE

i An overview of the Integrated Resort Promotion Act (IR Act)

The Integrated Resort Promotion Act was enacted on 20 July 2018 and will be implemented in the future (specific date unknown) to promote integrated resorts in Japan. The IR Act regulates the establishment and operation of complex tourist facilities comprised of casino facilities and (1) international conference centre facilities, (2) exhibition facilities, (3) tourism attraction enhancement facilities with performances that utilise Japan's tradition, culture, art and the like, (4) facilities for transporting tourists, and (5) hotel facilities and other facilities operated by private business operators ('specified complex tourist facilities').

Business entities and authorisation

Private business operators that plan to establish and operate specified complex tourist facilities ('casino business operators') are required to obtain a licence from the casino committee, which is established pursuant to the IR Act. The casino committee will then exempt the private business operators from criminal liability with respect to the prohibition on certain types of gambling. Further, persons who intend to obtain 5 per cent or more of the voting rights or shares in a casino business operator must obtain permission from the casino committee.

Owners of sites for specified complex tourist facilities may not lease the site to casino business operators or transfer title to the sites without permission from the casino committee. Persons who own and operate casino facilities and provide such facilities to casino business operators must obtain a licence from the casino committee.

Entry restrictions

Casino business operators are required to prohibit the use of the casino facility by persons whose family members or other related persons have submitted a request that such person be prohibited from using the casino facility, and persons who are determined to have a gambling addiction and may be adversely affected if allowed to use the casino facility. Persons under the age of 20 are prohibited from entering a casino facility. Japanese nationals or foreigners who reside in Japan are prohibited from entering a casino facility more than three times over seven consecutive days, or more than 10 times over a period of 28 consecutive days. Casino business operators are required to confirm whether a visitor is prohibited from entering the casino facility.

Advertising regulations

The display of advertisements and the handing out of flyers promoting the casino business outside of the area of specified complex tourist facilities is prohibited, except for places that are designated by the ordinance as facilities for overseas visitors whose main transportation method is public transportation.

Restrictions on lending

Casino business entities are permitted to make loans to persons to play games at the casino, but such permission is in general limited only to loans to foreigners who do not reside in Japan. However, both Japanese nationals and foreigners who reside in Japan are permitted to borrow money from casino business operators if such Japanese national or foreign borrowers deposit to the account managed by the casino business operators an amount that is greater than the designated amount set forth in the rules of the casino committee.

Payment to the Treasury

Casino business operators are required to pay 15 per cent of the gross profit of their casino business to the Japanese government and another 15 per cent of the same gross profit to a designated prefecture. Casino business operators are also required to pay the amount designated by the casino committee to the Japanese government for the casino committee's operation costs.

The designated area and future schedule

Under the IR Act, specified complex tourist facilities may be constructed only in licensed areas, which are restricted to three undetermined areas. Certain local municipalities, including Tokyo, Yokohama, Osaka, Wakayama, Kushiro, Tomakomai, Nagoya and Sasebo, have expressed interest in submitting an application to obtain a licence. The issuance date of the licences has not yet been determined; however, each of the interested local municipalities has been engaged in promotional activities to obtain a licence.

ii An overview of the Act regarding the Facilitation of Use of Land with an Unknown Owner (Unknown Owner Land Act)

The Unknown Owner Land Act was enacted on 6 June 2018, during a time where there was an increase in the number of land plots with unknown owners and a decrease in the need for land because of the declining and aging population. This Act facilitates the expropriation of land with an unknown owner for the purpose of public works, and the establishment of land use rights over land with an unknown owner, to operate a business for the improvement of community welfare.

Unknown land ownership

'Land with an unknown owner' is defined as land whose owner cannot be identified even pursuant to a reasonably diligent search. The 'land with an unknown owner' on which certain buildings do not exist and which is not used for any business or other purpose ('subject land with an unknown owner') is to be dealt with under the Unknown Owner Land Act.

Expropriation

As a general rule on expropriation, a local expropriation committee must issue a decision for the relevant local municipality to acquire and vacate the relevant land for the purpose of land expropriation under the Land Expropriation Act. However, with respect to the subject land with an unknown owner, a local expropriation committee will be deemed to have made

a decision to acquire and vacate the land if the prefectural governor has issued such decision in accordance with the Unknown Owner Land Act. This will expedite the expropriation procedures for subject land with an unknown owner.

Land use right for a business for the improvement of community welfare

One of the goals of the Unknown Owner Land Act is to enhance businesses for the improvement of community welfare, which include (1) temporary roads, temporary kindergarten buildings, parking lots and the like, (2) hospitals, clinics, parks, green spaces, open spaces and the like, (3) facilities that contribute to the improvement of community welfare, such as shopping facilities, cultural and educational facilities and the like, of which there is a shortage in the surrounding area. Private business operators may operate a business for the improvement of community welfare. Under the Unknown Owner Land Act, the land use rights for a business for the improvement of community welfare is established pursuant to a decision by the prefectural governor. Any buildings or movables that are on land with an unknown owner may be removed from such land or demolished. The maximum term of the land use right is 10 years, and the term can be extended for additional 10-year periods without any restrictions on renewal. Persons who use the subject land with an unknown owner must make an advanced deposit to account for (1) compensation in an amount equivalent to the estimated value of the building if a building is demolished and (2) compensation in an amount equivalent to the rent for the land for the entire term of the land use right. The amount of the rent mentioned in (2) above in the immediately preceding sentence is determined by the prefectural governor in the above-mentioned decision to be issued under the Unknown Owner Land Act.

iii Amendment to the Civil Code

Enacted in 2017, the amendment to the Civil Code is expected to come into effect on 1 April 2020. The amendment is expected to bring significant changes to Japanese contract law and the legal practice on contracts, as the changes are focused on Chapter III, 'Claims', one of the five Chapters of the Civil Code that prescribes the rules on contract law. With the anticipated effect of the amendment on the contract law practice, the administrative authorities and the industry groups are actively taking actions to adapt to the amendments to the Civil Code, including reviewing the amendment's impact on their operations, amending the provisions of the contract template, and establishing an internal system to respond to the results of the amendment. This is a historical amendment as this Chapter has not undergone any significant amendments in the past 120 years. A substantial part of the amendment will simply clarify the rules through revision of the language and incorporate directly into the Chapter the rules established by the courts and prevailing interpretations of legal issues. However, there are also a number of rules that underwent significant changes in view of improving the law on contracts. Two material rules that underwent significant changes in this amendment and are expected to have a substantial effect on real estate transaction practice are summarised below.

Warranty against hidden defects and liability for non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale

The amended Civil Code changes the term 'defects' for the purpose of the statutory warranty against hidden defects to 'non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale'. Once this change comes into

effect, in theory, the physical status of the real estate alone will not determine the liability of the seller, but such liability will be determined by considering both the physical status of the real estate and the intent of the seller and the buyer (without consideration for whether the intent was explicitly expressed in a written contract). Under the amended Civil Code, the remedies that the buyer can have recourse to for 'non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale' will be more in line with the general default principles of contract law, where the buyer will be able to:

- a* require the seller to complete performance of the contract;
- b* request a reduction of the purchase price;
- c* receive compensation from the seller in an amount that places the buyer to a hypothetical position that the buyer would have been in had the non-conformance not occur (but only if the non-conformance is attributable to the seller);
- d* terminate the real estate sale and purchase contract; or
- e* a combination of any of these remedies.

The remedies available to the buyer set forth above specifically refer to the remedies available under the law. The amendment does not alter the ability of the parties to contractually agree to waive the warranty against hidden defects and the liability for non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale.

The theory of liability under the statutory warranty underlying the amended Civil Code is based on a theory that differs from that of the current Civil Code. This may result in the difference in the applicable liability arising out of non-conformance with the terms of the contract in connection with the type, quality and number or amount of the subject of sale under the amended Civil Code.

The traditional interpretation of the warranty against hidden defects is based on a unique legal theory wherein a seller's duty to deliver would always be deemed satisfied when a seller delivers the specified item subject to the sale (including a specific piece of real estate) to the buyer. In other words, after the delivery, it is theoretically arguable that no matter what defects are hidden in the delivered specified item, there can be no failure of the seller to perform under the contract. Therefore, the current Civil Code provides a special protection for the buyer of a specified item subject to the sale in the form of the warranty against hidden defects. Based on this unique legal theory of the warranty, the amount of the seller's liability under the warranty will be equal to the cost resulting from the buyer's reliance on the sale and purchase transaction; namely, the buyer can only recover the cost of the transaction. Although the buyer may have recourse to terminate the agreement, under the warranty against defects, the concept of a special protection for the buyer requires that the hidden defects render the purpose of the sale and purchase unachievable.

On the other hand, the amended Civil Code takes the position that in the case of delivery of a specified item with hidden defects, the seller will not be deemed to have completely performed its duties in the sale and the seller will remain obligated to complete the performance against any non-compliance of the seller with the terms on the type, quality and number or amount of the subject of sale under the contract. The buyer will, therefore, be able to recover compensation against those uncured defects in an amount that restores the buyer to a hypothetical position that the buyer would have been in had the non-conformance not occur (but only if the non-conformance is attributable to the seller). The amount of liability of the seller in this case will be the same as in a conventional non-performance of a

contract, and may include lost profits resulting from the non-conformance. In accordance with conventional non-performance cases, the buyer will also be able to request complete (specific) performance of the contract, or a reduction of the purchase price. Under the amended Civil Code, the buyer may also terminate the contract unless the relevant defects are minor.

As there may be various ways for sellers to limit their liabilities arising out of non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale under the amended Civil Code, sufficient preparation for the new liability framework will therefore be essential for the players in the real estate market. In order for the seller to control the liability arising out of non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale under the amended Civil Code, the seller should make more disclosure to the buyer to ensure that the buyer has the same understanding as to the subject of sale in connection with the type, quality and number or amount of the subject of sale in the contract. The seller may also wish to contractually limit the remedies available to the buyer in the case of non-conformance with the contract terms in connection with the type, quality and number or amount of the subject of sale under the amended Civil Code. It is possible for the seller and the buyer to define in the contract what remedies are available to the buyer in the case of the non-conformance in question. It is also possible for the seller and the buyer to limit in the contract the level of non-conformance required for the remedies to be given to the buyer under the amended Civil Code.

Requirements to assert the right to invalidate a fraudulent conveyance

The amended Civil Code will provide clarification and guidance to the requirements to assert the right to invalidate a fraudulent conveyance by a seller with poor financial health, thereby conforming the requirements of such invalidation to those set forth in the bankruptcy and other insolvency statutes.

To further clarify, the amended requirements for invalidation of a real estate sale and purchase transaction made with a reasonable sale price generally require that at the time the sale is conducted: (1) there is an imminent risk at sale closing that the seller may conceal the sale proceeds or take other similar actions; (2) the seller intends to conceal the sale proceeds or take other similar actions; and (3) the buyer is aware of such intent of the seller described in (2). All of these requirements must be met under the bankruptcy and other insolvency statutes for the bankruptcy and other insolvency trustee to avoid a fraudulent conveyance in the relevant proceedings. As these requirements are generally recognised as providing clear guidance in practice, their introduction will provide stability to the sale and purchase transactions in the real estate market.

The amended Civil Code also includes provisions that improve the framework used for the above-discussed invalidation of fraudulent conveyance. One of these amendments is with respect to the enforcement of a judgment. Specifically, once the court renders a judgment that invalidates a fraudulent conveyance, the judgment will be binding on the seller and all of its creditors. This amendment is expected to clarify the legal relationship among all parties involved in a fraudulent conveyance case. Along with providing a framework to clarify the requirements to invalidate a sale of real estate by a seller with poor financial health, the amendment will in effect benefit the real estate market participants by providing added

stability to the real estate sale and purchase transactions. However, that even after the amended Civil Code becomes effective, if a fraudulent conveyance is made before the effective date of the amended Civil Code, the current Civil Code will apply to such fraudulent conveyance.

VIII OUTLOOK AND CONCLUSIONS

Since the IR Act was enacted (as discussed in Section VII above), according to media reports, there are numerous developers and operation companies, including foreign companies, marketing themselves to the national and local governments in Japan with respect to the construction and operation of specified complex tourist facilities. The market for the specified complex tourist facilities may become a new frontier for real estate development in Japan in the near future. The Japanese government has also established a new system for real estate business regarding land with an unknown owner (as discussed in Section VII above). While it is uncertain how the Unknown Owner Land Act will be implemented in the future, this is potentially a new area of real estate development. With respect to the general legal framework in Japan, the government has introduced a historical amendment to the Civil Code to establish a 'user-friendly' legal framework (as discussed in Section VII above). The recent introduction of new areas for the real estate development and the renewal of a certain legal framework may lead to more activity in the Japanese real estate market, where there has been a steady volume of Japanese real estate transactions during the past few years.

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