

B2B: Certain Aspects of Lease Agreements for Future Things

By [Ekaterina Lapidus](#)

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Ekaterina Lapidus
Senior Associate
Dentons

RF SAC Plenum Rulings of November 17, 2011 No.73 ("Ruling No.73") and of January 25, 2013 No.13 ("Ruling No. 13") introduced new rules on the leasing structure for future things. In particular, Ruling No. 13 states that a lease agreement concluded by a landlord that does not have title to the leased property at the time it is concluded because the thing that is the subject of the lease agreement has not been created by the landlord or acquired from a third party should be treated as a lease agreement for a future thing. However, the landlord must have ownership of the property at the time it is delivered to the tenant. Therefore, the landlord not having title to the leased property does not entail the invalidation of a lease agreement for a future thing in accordance with arts. 168 and 608 RF CC.

Certain aspects of drafting a lease agreement for future real estate

When drafting a lease agreement for a future thing it is essential to clearly indicate the material conditions of the agreement. The material conditions include:

- Identification of the leased property
- Term of the lease agreement
- Rent amount
- Procedure for registration of title to the leased property
- Procedure for transfer of the leased property
- Principal rights and obligations of the parties under the lease agreement

Notably, with respect to identification of the property the Plenum has provided in section 15

of Ruling No. 73 that the parties do not have the right to challenge an agreement on the basis of a failure to properly identify the leased property, including by claiming the agreement was not concluded or is invalid, if a lease agreement does not duly identify the leased property but is actually performed by the parties (for example, the property was delivered to the tenant and there was no dispute concerning the landlord's due performance between the parties before such transfer). This means that it will be very difficult to challenge a lease agreement for a future thing that is actually being performed on the basis that the leased property was not sufficiently identified.

Structure

The lease of a future thing structure means that where an immovable property has not yet been built or acquired by the landlord, the parties do not need to conclude three agreements: preliminary lease agreement, short-term lease agreement and long-term lease agreement, or two agreements — a preliminary lease agreement and a long-term lease agreement. Instead, a single agreement is sufficient — the lease agreement for a future thing.

The classical structure for the lease of a future thing involves the following main stages of implementation:

- The parties sign a lease agreement for the future thing at a stage when the landlord has not built or purchased the leased property, and therefore does not have registered ownership title to the leased property;
- The landlord completes construction of the leased property;
- The property is commissioned;
- The landlord registers title to the leased property;
- The leased property is officially transferred from the landlord to the tenant;
- The lease agreement for the future thing signed by the parties earlier is registered.

However, in practice tenants need the landlord to transfer the completed property at a stage before or after commissioning. This is primarily because the tenant needs time for fit-out and renovation works. This means it is necessary to transfer the property for fit-out and renovation works before it is commissioned or immediately thereafter.

In the context of the lease agreement for a future thing structure, recent RF SAC practice has largely settled the issue of transferring the leased property before the landlord has registered title to the leased property (whether before or after commissioning of the leased property).

In particular:

- Transfer of a leased property by the landlord as the lawful owner of the leased property before registration of title — the RF SAC Plenum stated that a lease agreement with a person that is the lawful owner of a property that it has newly created or which has been transferred to it (for example, under a sale-purchase agreement), and the title to which has yet to be registered, is not contrary to the provisions of art. 608. RF CC and cannot be invalidated on that basis (see section 10 of Ruling No.73);

- Transfer of leased property before commissioning — the RF SAC Plenum stated the following:

- absence of permission to commission a capital building that is to be leased at the time the property is transferred to the tenant does not in itself entail the invalidity of a lease agreement. At the same time, the RF SAC plenum also stated that under the RF APeC, a tenant and/or landlord guilty of operating a property without a commissioning permit may be subject to administrative prosecution where the corresponding grounds exist (art. 9.5(4) RF APeC).

- at the same time, the RF SAC Plenum directs courts to take into consideration the fact that the transfer of a leased property to a tenant before commissioning for the purpose of repair and fit out works is not contrary to the RF Civil Code (see section 11 of Ruling No.73).

Practical application of the structure: pros and cons

The main pros of this structure are:

- The ability to conclude the principal agreement (lease agreement for a future thing) at the construction stage, or when the landlord has signed the agreement to purchase the leased property but has not yet registered its title;
- Straightforward contractual structure: a single agreement — lease agreement for a future thing — rather than two (preliminary lease agreement and long-term lease agreement) or three (preliminary lease agreement, short-term lease agreement, and long-term lease agreement) agreements;
- Time savings on agreeing and signing the contractual documentation (only the lease agreement for a future thing to be agreed, rather than three agreements);
- Solves the issue of depreciation of inseparable improvements, which arises because the amortization period is split when using a short-term lease agreement and long-term lease agreement structure, where the amortization period begins under the first lease agreement (short-term lease) and ends with the expiration of the first lease agreement (short-term lease). With a lease agreement for a future thing, the amortization period begins and ends within a single agreement (lease agreement for a future thing);
- If the obligation to deliver the leased property is not performed under a lease agreement for a future thing (including because the landlord has not created or acquired the thing that is the subject of the lease agreement), the landlord must reimburse the tenant the losses caused by the breach of contract;
- Unlike a preliminary lease agreement, the nature of a lease agreement for a future thing assumes that settlements will be made between the parties.

Problems with the practical application of this structure include:

- "Lease agreement for a future thing" as a form of agreement is not provided for in the Russian CC, while the Russian SAC Rulings are not formally sources of law. The notion of lease agreement for a future thing is not found in the Russian CC. The concept has been

developed by the RF SAC and set out in the corresponding RF SAC Plenum Rulings (Ruling No.73 and Rulings No.13);

- Registrars have no experience registering lease agreements for future things. For instance, calls to a number of FRS offices showed that most registrars are unfamiliar with the lease of a future thing structure and experience registering such agreements is the exception, rather than widespread. At the same time, practically all the registrars we asked were willing to register a lease agreement for a future thing once the landlord had registered title to the leased property;

- Vague and ambiguous rules on certain aspects of the lease of future thing structure. In particular: (1) the treatment of payments for use of the leased property before the title certificate is received (there is no judicial practice on this matter at present); (2) certain aspects of the recovery of losses and penalties in the event that the landlord fails to perform its obligations to transfer the leased property.

- A lease agreement for a future thing with respect to an unauthorized building is void, i.e., invalid upon effecting the transaction.

Conclusions: The present situation is that the lease of a future thing structure has been conceptually formulated and set out by the respective RF SAC Rulings (Ruling No.73 and Ruling No.13), however, it is not being used in practice by real estate market participants. This is particularly true for large foreign and Russian real estate market players, who prefer more conservative approaches and structures, primarily because of the size of their investments. It is likely that the elimination of some of the practical problems for application of the structure referred to above (including legislation to provide for lease agreements for future things in the RF CC, registrar awareness of the practical aspects of registering a lease agreement for a future thing, and elimination of vague and ambiguous rules on lease agreements for future things) will promote the use of this structure by real estate market participants.

At the same time, it should be noted that in any case (whether using the standard lease structure or a lease agreement for a future thing) a detailed analysis of the risks associated with the specific project, and the inclusion of special remedies for such risks is essential.

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