Yangon, 27 December 2017

Analysis: The New Condominium Rules

The Ministry of Construction published the Condominium Rules ("**Rules**") - bye-laws implementing the Condominium Law ("**Law**" - English translation here: https://tinyurl.com/ya8rmsy7) - on 15 December 2017 on its homepage. Please find our analysis of the Rules below. An English translation of the Rules is available to our premium subscribers.

1. What do we need the Law and the Rules for?

We think that the main purpose of the Law and the Rules is to address the following five deficiencies:

(a) There is currently no registration system for apartments

As, contrary to land, apartments presently cannot be registered, there is currently no certain way of checking who owns an apartment. Potential buyers therefore risk purchasing from a fraudulent owner, losing the apartment when the real owner turns up. In the same vein, it is risky for a lender to accept an apartment as security for a loan. Private lenders might accept an apartment as security, but banks are reluctant as they find it hard to check title. Consequently, even legitimate apartment owners find it difficult to use the apartment to raise money.

It is common to refer to the "sale" and the "purchase" of an apartment. However, it is presently unclear what is actually transferred: The ownership of the apartment? Or just the right to occupy it?

The Law and the Rules introduce a registration system for units in a condominium. Each unit (apartment) is registered on a separate folio and can be sold, given away or mortgaged like any other piece of real estate. A unit registration certificate certifies ownership.

(b) It is presently difficult to obtain a bank loan for the purchase of an apartment

In order to purchase an apartment from a developer, the purchaser would presently make a down payment and pay the rest in installments over three to four years which is a comparatively short period of time. If an apartment is purchased from a private owner, it is common to pay the entire purchase price in a lump sum up front.

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

A purchaser must therefore presently have a rather large amount of cash readily available.

Developers say that they could sell more apartments if purchasers had the option of obtaining a long-term (e.g., 30 year) bank loan. Presently, it is difficult to obtain a bank loan for the purchase of an apartment due to banks being reluctant to accept an apartment as security. If a loan can be obtained, it usually has to be repaid within a relatively short term of three to four years.

As an exception, Shwe Taung seems to have negotiated a credit facility with AYA Bank that allows purchasers of apartments in two of Shwe Taung's high-end projects to obtain a loan with a term of 15 years.

According to Rule 41, the person whose name is stated in the unit registration certificate "is the legitimate owner of the unit". The owner may deposit the certificate with a bank as security for a loan (in analogy to, e.g., a land grant certificate). Developers hope that this system - which reflects the idea that it should be possible to use apartments as security for a loan with ease - will entice banks to develop long-term credit facilities for potential buyers of (high-end) apartments, thereby expanding the market.

(c) Foreigners presently cannot own apartments

The transfer of an apartment to a foreigner is presently prohibited by the Transfer of Immovable Property Restriction Law of 1987. Developers say that they could sell more (high-end) apartments if foreigners were able to purchase them legitimately. In response, Rule 34 says that up to "40% of the total floor area of a condominium" may be sold to foreigners.

(d) A developer can presently start selling apartments without having funds and without having started construction

Presently, a developer can start selling apartments without having started construction and without funds in its bank account. Buyers making a deposit and paying installments in order to purchase apartments are at risk of losing their money.

In response, the Rules provide that a developer must deposit 20% of the total costs (or such other amount as the Management Committee may stipulate for capital-intensive projects) in a bank account (Rule 15) and may start selling units only after 30% of the foundation work have been completed (Rule 30). The developer must report the use of the funds quarterly to the Management Committee.

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

(e) Management of a building presently not regulated

There are presently no rules on how the building is to be managed once the units are sold. An honest developer will obviously (i) provide for a management team to ensure the maintenance and repair of the condominium and the functionality of the common facilities and (ii) contractually oblige unit owners to adhere to the rules made by the management team for the amicable coexistence of the residents, but what if the developer does not care?

In response, the Law and the Rules provide for an executive committee that is charged with the management of the condominium and answerable to the unit owners grouped together in an "association of members".

2. Sounds good - have all the deficiencies mentioned above gone, then?

No. Presently, buildings with an elevator are marketed as "condominiums" whereas buildings without elevator are referred to as "apartment buildings". However, the Law and the Rules - and all the changes that they bring - only apply to condominiums established according to the Law, i.e., to buildings on "collectively owned land" whose units are separately registered as condominium units. No land has been registered as "collectively owned" and no condominium units have been registered yet. However, the Rules have set the framework for registration, and we hope to see the first "official" condominiums in the not too distant future.

For registration to be possible, however, it is still necessary for the Ministry of Construction to establish "Management Committees" in the Regions and States (most importantly, in Yangon Region as most condominium projects will be located there) and a "Condominium Registration Office".

On the whole, it is important to note that the Law and the Rules (and, consequently, the contents of this analysis) will only apply to a limited number of buildings in Myanmar.

3. Understood. Can an existing building be converted to an official condominium?

Theoretically yes, provided that

(a) the building has at least six floors (s. 2 (a) Law),

(b) it stands on land with an area of at least 20,000 square feet (0.5 acres; 1,858 square metres; s. 10 (d) Law) and

(c) the land owner agrees to convert the land to "collectively owned land" (s. 10 (b) Law).

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

In practice, we expect, however, difficulties if units have already been sold as we think that it would be necessary to (i) track down the current unit owners and (ii) request them to register their units with the Condominium Registration Office - something which they may be reluctant to do if they have to fear tax exposure.

If a developer has sold most or all of the units already, we do not really see a benefit for the developer from going through the trouble of converting an existing building to a condominium as the developer would have made its profit already.

4. Can a condominium be built on any type of land?

A condominium must be built on land which "may be used for housing development" and is of "the type that allows the transfer of ownership" (S. 10 (a) Law). According to our reading of the Rules, the land may be (a) freehold land, (b) grant land or (c) government land leased to the developer under a BOT arrangement.

(a) Freehold land

Freehold land is rare, but exists in Yangon and Mandalay. Ownership is for an unlimited term; the owner does not have to pay rent to the government. The government may confiscate the land only for a public purpose on payment of adequate compensation according to the Land Acquisition Act 1894. A freeholder may sell or otherwise transfer the land, mortgage it and pass it on to his heirs. Freeholders own their land.

The purchaser of an apartment in a building built on freehold land can be rather certain of not having to vacate the apartment due to the land reverting to the government. It is, however, not entirely clear what would happen under current legislation if the land owner sold the land and the new owner requested the apartment owners to vacate the property. If the building is converted to an official condominium according to the Law and the Rules, the unit owners are protected as they individually own their units and collectively own the land so that any unit owner can oppose the sale of the land.

(b) Grant land

A land grant is technically a long-term lease (usually, 30, 60 or 90 years) by the government to an individual or a company. Contrary to freehold land, the grant holder (lessee) has to pay rent to the government, but the rent is only of a nominal amount. Prior to the expiry of the grant, the government may confiscate the land (i.e., revoke the grant) only for a public purpose on payment of adequate compensation according to the Land Acquisition Act 1894. The government may decide not to renew the grant upon its

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

expiry for a public purpose, but we have not heard of such a case in recent years and in practice renewal is almost automatic. The grant holder may sell or otherwise transfer the grant, mortgage it and pass it on to his heirs. A land grant is close to land ownership.

Consequently, the purchaser of an apartment in a building built on grant land can be rather certain of not having to vacate the apartment due to the land reverting to the government. It is, however, not entirely clear what would happen under the current laws if the grant holder sold the grant and the new grant holder requested the apartment owners to vacate the property. If the building is converted to an official condominium according to the Law and the Rules, the unit owners are protected as they individually own their units and collectively own the grant so that any unit owner can oppose the sale of the grant.

(c) BOT land

Under a BOT arrangement, the government (usually, a department in a ministry or a state-owned enterprise) leases land to a developer for fifty years with the option to renew the lease twice for up to ten years each time. Upon the expiry of the lease, the land, including the building, reverts to the government. The developer usually has to pay (i) an up-front land use premium and (ii) annual rent. The annual rent is usually not paid as a lump sum in advance for the entire lease period, but every year. The lease and the BOT contract with the government usually provide for a regular increase of the annual rent (usually, up to 10% every five years). Depending on the size of the land and its location, the annual rent may easily amount to billions of kyat (millions of USD). A BOT arrangement is not comparable to a land grant (although technically, both are leases from the government); the lessee in a BOT scheme is in no position that could be described as being close to ownership.

From a buyer's perspective, apartments in a building on BOT land are less attractive than those in buildings on freehold or grant land.

For one thing, the buyer cannot be sure that the government will renew the lease with the developer after 50 years. The buyers or his heirs may lose the apartment after 50 years; they are likely to lose it after 70 years at the latest. There is an inherent expiry date in buying an apartment in a building on BOT land; in addition to the ordinary wear and tear, the apartment loses value as the expiry date approaches.

More importantly, however, the buyer must place considerable trust in the developer dutifully paying the annual rent every year. If the developer defaults, the government

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

may take back the land and the building and evict the apartment "owners". It is conceivable that a developer disappears after having sold the apartments instead of staying around to pay millions every year. (If it is a mixed-use development, the developer may, however, have an incentive to stay on as it would continue to generate profit from leasing space to businesses.) Even an honest developer will default if it becomes insolvent.

We think that matters are even worse for the buyer of a unit if the building is converted to a condominium under the Law and the Rules as, according to our reading of Rule 54 (f), the unit owners become responsible for paying the annual rent. This means that, if the developer defaults, the apartment owners risk having to pay millions to the government in the developer's stead. In a worst-case scenario for this unit owner, the government may decide to pick one unit owner to pay everything; this unit owner would then be left on his own to get the other unit owners to refund his money.

5. What is "collectively owned land" and how is it created?

According to our reading of the Rules, "collectively owned land" is freehold land, grant land or BOT land to which the following happened:

(a) **Freehold land:** The previous owner (or a developer having concluded a sale and purchase agreement with regard to the land) registered the land as "collectively owned". As a consequence, the apartment (unit) owners automatically own a share in the land.

(b) **Grant land:** The previous grant holder (or a developer having concluded a sale and purchase agreement with regard to the grant) registered the land as "collectively owned". As a consequence, the unit owners automatically hold, according to our understanding of the Rules, a share in the grant. According to our understanding, the conversion to "collectively owned land" would not create new freehold land, in spite of the land being referred to as "owned".

(c) **BOT land:** The developer having taken out a lease from the government registers the land as "collectively owned" with the approval of the Management Committee and the government entity owning the land. As a consequence, the unit "owners" automatically accede, according to our understanding of the Rules, to the position of the previous lessee (i.e., the developer) and in particular are jointly (and severally?) liable to pay the annual rent (Rule 57(z7)(1)). According to our understanding, the conversion to "collectively owned land" would not create new freehold land, in spite of the land being referred to as "owned" and S. 17 of the Law stating that land "which has been

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

registered as collectively owned land may not be owned by any *[government]* department".

It is debatable whether the unit "owners" should be responsible for payment of the land rent as the developer would have included the land rent in the calculation of the purchase price of the apartment. In an ideal scenario, the developer would negotiate with the government entity owning the land and pay off the entire future rent prior to conversion, thereby avoiding a potential liability of the unit owners.

Stamp duty applies to the conversion; the rates should be as follows (but, as is often the case with stamp duty, it may be possible to categorise the instruments that are to be submitted according to Rules 18-21 differently, resulting in duty rates that are different from those below):

- Conversion of freehold land/grant land: 6% of the value of the land in Yangon; 4% in the rest of the country
- Conversion of BOT land: 6% (Yangon)/4% (rest of the country) "of the consideration for the transfer"; the amount of the "consideration" used as the basis for the stamp duty may be subject to debate

There are furthermore registration fees to be paid at the Registration of Deeds Office. In case of a conversion of freehold land or grant land, the fees should be 0.2% of the value of the land.

The conversion of BOT land apparently only has to be registered at the Condominium Registration Office (to be newly created) and not also at the Registration of Deeds Office.

Fees at the Condominium Registration Office are, with the exception of the fees for the registration of the transfer of ownership of a unit, still unknown.

6. Does this mean that foreigners can also own a share of the land?

This question is only relevant in case of freehold and grant land. According to officers of the Department of Urban and Housing Development quoted in the press, foreigners can only own units and not the underlying land. An analysis of the Law and the Rules is inconclusive in this respect, although S. 17 of the Law suggests that all co-owners (including foreigners) are "entitled" to the collectively owned land.

What is certain, however, is that foreigners can purchase units only with a built-in expiry date. According to Rule 36 (which, we understand, was included at the request of the Union Attorney General's Office), a "foreigner having purchased a unit in a condominium is entitled to own the unit for a term equivalent to the term of the condominium".

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

It is not clear whether the "term of the condominium" refers to the period until the condominium is actually dismantled or to a term set by the developer. In any case, a foreigner risks losing his unit for good if the association of co-owners decides to "reconstruct the condominium after dismantling it" (S. 28 Law).

7. What other restrictions are there on foreigners owning units?

Foreigners may not acquire "more than 40% of the total floor area of a condominium" (Rule 34). Before selling a unit to a foreigner, the seller has to enquire with the Condominium Registration Office (still to be created) whether the foreign ownership ratio has been exceeded.

It is not clear whether the purchase of units is restricted to foreign individuals or also open to foreign companies. According to our reading of the Law and the Rules, we suppose that the purchase is restricted to foreign individuals.

Once the new Companies Law is in effect (which is expected to happen on 1 August 2018), companies incorporated in Myanmar with a foreign shareholding ratio of up to 35% will not be considered "foreign" anymore; it should be possible for such companies to acquire units in a condominium.

There is no residence requirement for foreigners to purchase a unit.

With the exception of foreign ownership being limited to 40% of the total floor space and its duration being limited to the "term" of the condominium, a foreign co-owner has the same rights as a local co-owner (Rule 46) and is in particular not required to live in the apartment himself.

8. Can foreigners develop condominiums?

A "foreigner or a foreign company" can be a "co-developer" of a condominium (Rule 2 (d)). It is not entirely clear what this means.

In a 100% Myanmar context, the developer would typically be a construction company that would offer a land owner to build a "condominium" on the owner's land and agree with the land owner to split the building according to a certain ratio; e.g., the construction company would get to sell 50% of the apartments and the land owner the remaining 50%.

The Rules seem to assume that the foreign "co-developer" would act like a construction company in the example above as Rule 33 states that a "list of the units which may be sold by the foreign co-developer according to the business contract" shall be submitted to the Management Committee.

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

In reality, however, foreign participation in the "development, sale and lease of residential apartments and condominiums" occurs through the establishment of a joint venture company with a Myanmar business partner as mandated by MIC Notification 15/2017. Assuming that the Myanmar business partner owns land, he would lease the land to the joint venture company in return for shares in the joint venture company. The joint venture company would obtain an MIC permit or endorsement, sell the apartments in the building and distribute the profit thus generated by way of dividends to the foreign and the Myanmar joint venture partner according to the ratio of their respective shareholdings in the joint venture company. There would be no "list of units" reserved to be sold by the foreign "co-developer".

In the end, we think that it will be necessary to interpret the Rules generously to ensure that foreign companies can engage in the development of condominiums.

9. An MIC permit or endorsement is only valid for a certain period of time. Does this affect unit ownership?

This is not regulated, but we think that one has to distinguish as follows:

(a) In the first alternative, the Myanmar joint venture partner has land (freehold or grant land) and leases the land to the joint venture company in return for shares in the joint venture company. We think that in this case, the Myanmar joint venture partner would have to terminate the lease agreement and instead convert the land to collectively owned land. Each unit owner would in this case automatically acquire a share in the freehold land or the land grant. An expiry of the MIC permit or endorsement in the future would not matter as the MIC permit or endorsement was granted for the purpose of "developing a condominium and selling its units" and this purpose is fulfilled.

(b) In the second alternative, the joint venture company (developer) has taken out a BOT contract from the government. The MIC permit would have the same term as the BOT contract. Unit buyers would face the risks associated with condominiums on BOT land described above. They face an additional risk if the MIC revokes the permit (due to non-compliance of the developer with its terms and conditions) prior to the expiry of the BOT contract as it is conceivable that in this case the government takes back the BOT land and evicts the unit "owners".

10. Who can actually be a "developer" and how can a permit to build a condominium be obtained?

A developer can be a company, organisation, partnership, individual or group of individuals that are not insolvent, have experience, have been tax-compliant in the past and have obtained a

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

business license from the Management Committee (Rule 5). A business license is valid for 5 years (Rule 7). The application can be filed at the same time as the application for a permit to build a condominium if the applicant is an "individual or an organisation" (Rule 5(a)(9)); we are not sure why this is not extended to companies, partnerships and groups of individuals .

The construction of a condominium requires permission from the Management Committee; the required documents and information are listed in Rule 14. Furthermore, the land on which the condominium has to be built has to be converted to collectively owned land as described above.

11. How can a "unit registration certificate" be obtained? How is a unit sold?

In a first step, the developer has to register the units with the Condominium Registration Office (still to be established) after a building completion certificate has been obtained for the building (Rule 39).

This means that there is a significant period in which units can be traded without proper registration as a developer can start pre-sale upon completion of 30% of the foundation (Rule 30).

The Condominium Registration Office then has to issue a "unit registration certificate" for each unit. If a unit has been fully paid, the developer and the buyer shall together register the sale and purchase agreement within 30 days (Rule 40). After this registration, the Condominium Registration Office shall sign and stamp the unit registration certificate. The person whose name is stated in the unit registration certificate is the legitimate owner of the unit and can use the unit registration certificate as security for a bank loan (Rule 41).

The resale of a unit has to be registered in the same manner (we suppose that seller and buyer have to cooperate to effect registration).

In addition to the upper limit on foreign unit ownership, there are the following restrictions with regard to the sale of units:

- The developer shall sell at least 75% of the units in a condominium to buyers in the market (Rule 35).
- Not more than 25% of the units in a condominium may be registered in the name of one purchaser (Rule 37).

The purchaser is liable to pay stamp duty and other taxes (Rule 43). Stamp duty would be 6% (Yangon) or 4% (rest of the country) of the purchase price. "Other taxes" could mean the following:

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

- The sale of the units by the developer is in our opinion subject to commercial tax. The tax rate should be 5%. The Union Tax Law 2017 provides for a reduced rate of 3%, but this rate should only apply to the "sales proceeds from selling a building after having constructed it in the state" and not to the sale of units in a building. The resale of a unit by a private owner should, in contrast, not be subject to commercial tax.
- If the purchaser uses undeclared funds to pay for the unit, he has to pay 15%, 20% or 30% of the purchase price as "income tax on income that has hitherto escaped assessment" if found out by the tax authorities.

Registration fees between Ks. 20,000 and 50,000 arise if a unit is resold (they do not appear to arise if a unit is sold by the developer for the first time); they are borne by the seller (Rule 44 (a)).

12. How are the collectively owned land, collectively owned assets and the expenses divided between the co-owners?

Each unit owner must contribute to the expenses of the condominium according to a ratio that, in essence, is being calculated by dividing the floor area of the unit by the total floor area sold. The "total floor area sold" is the floor area of the condominium that was sold to individual owners as opposed to the collectively owned floor area (Rule 14 (d)).

The method of calculating a co-owner's share in the collectively owned land and assets is not provided for in the Law and the Rules.

13. Can units in a condominium be used for commercial purposes?

Yes, provided that commercial use is restricted to floors that are not used for residential purposes, the owners of the neighbouring units agree and the architectural design prevents annoyance to residents.

14. What is the effect of the conversion to collectively owned land on pre-existing mortgages?

Banks having lent money secured by a mortgage of land which may be converted to collectively owned land may wish to have their legal department check whether the conversion to would have an impact on the mortgage as the concept of collectively owned land is new and its effect on existing mortgages is not regulated in the Law. We have no definite opinion on the subject yet.

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com

15. Can foreign lenders finance the purchase of a unit?

According to S. 26 (d) (i) of the Law, a co-owner can mortgage the unit "to a foreigner", but we suppose that "foreigner" refers to an individual and not to a company, although this is not entirely clear.

16. How is a condominium managed?

About half of the Rules are about the executive committee elected by the association co-owners and its responsibilities. Ultimately, the condominium is managed by the executive committee which is answerable to the association of co-owners; the executive committee may outsource management to professional service providers.

La Pyi Wun Plaza, Room 409 (4th Floor), 37 Alan Pya Pagoda Road, Dagon Township, Yangon
Phone: +95-9-262546284 - E-mail: info@lincolnmyanmar.com - Web: www.lincolnmyanmar.com