



PROPERTY INVESTMENT AND DEVELOPMENT FINANCE IN SPAIN

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1. Introduction:

This is the third in a series of articles dealing with certain aspects of local law and practice concerning property investment and development finance transactions governed by certain jurisdictions in continental Europe.

We have previously dealt with Holland and Italy. This article deals with Spain.

We have already highlighted certain fundamental differences between the regime in continental (largely codified legal systems as opposed to common law) jurisdictions in western Europe. The regime in Spain is not radically different in principle. This article focuses on selective aspects applicable to deals in Spain, although, as stated in previous articles, specialist local advice should be taken as necessary.

2. Investigation of title, due diligence generally and closing mechanics:

- 2.1 The Spanish Civil Code provides for private ownership of land, which is usually held freehold. Interests in land are registerable on the Real Estate Register.
- 2.2 The Real Estate Register is not, as in England and Wales, a State guarantee of title but is conclusive as against third parties, as to ownership and encumbrances. Generally speaking interests and encumbrances not registered on the Real Estate Register are not binding on third parties. The Register will describe the property but will not contain a filed plan (as in England and Wales) and is not necessarily therefore conclusive as to the precise perimeter of the relevant land (depending on how precise the description of the land is, as it appears on the Register). Hence, when instructing a valuer, care should be taken to ensure that the valuer considers carefully the description on the Register and uses his best endeavours to correlate such description with his physical inspection of the land, and such other searches (e.g. the "Catastro", an official institution created for tax purposes where relevant information (plans, surface, etc.) relating to real estate property is registered) in order to ensure, so far as possible, that the land the proposed subject of the security in favour of a lender is, or to be purchased by a purchaser, corresponds with the area of land physically inspected and on which the current use is enjoyed.
- 2.3 Title investigation
 - 2.3.1 Theoretically, it is possible to ask the Registrar ("Registrador de la Propiedad", i.e. the keeper of the Real

Estate Register) to issue a certificate ("Certificado de Dominio y Cargas") regarding the property which would confirm its current ownership and disclose any third-party rights (e.g. mortgages, rights of way) affecting the property (going back as many years as necessary in order to reflect all rights still in force). However, it usually takes a long time to obtain such a certificate from the Registrar and whilst the information contained therein is conclusive, it only speaks as at the date of its issuance, so any matters arising thereafter are not covered. For this reason lenders do not usually make use of this certificate.

- 2.3.2 What usually happens, in practice, is that, as in other continental European jurisdictions, the Notary verifies ownership and encumbrances of the property to be mortgaged, in the same act in which the respective transfer and mortgage deeds are legalised by him.
- 2.3.3 The Notary carries out his own title investigation by reference to the information received from the Registrar and the documents submitted to the Notary for inspection and, when drawing up the mortgage deed for notarialisation, includes in the deed recitals as to ownership and any encumbrances affecting the property. He will also draw attention to any matters appertaining to ownership or use and enjoyment of the property and encumbrances affecting the property which, where the situation is not entirely clear. Hence, in a sense, the mortgage deed itself includes a Notary's confirmation as to good title.
- 2.4.1 In Spain there is a highly effective system of communication between the Notary and the Registrar, which enables the Notary to satisfy himself as to ownership and current encumbrances on the Register. Before signing any notarial deed of purchase of real estate or of constitution of rights in rem (such as a mortgage, for example), the Notary submits an application for registral information (usually by fax) to the Real Estate Register (Section 354 of the Spanish Mortgage Regulations). Then the Registrar, as soon as possible, but in any event within the limit of three working days from the application date save for exceptional reasons, must respond to the Notary (usually by fax), specifying the registral situation regarding the property (Section 354.2). Such response shall confirm, in particular, title to and current encumbrances affecting the property. The Notary may even request that the registral information be communicated on a specific day, as is usually the case when he knows the exact date of closing, so as to ensure that all information is then current.
- 2.4.2 Once the registral information has been forwarded, the Registrar is obliged to notify the Notary, within the ensuing nine days of the submission of any document relating to the property, if it entails a variation of the accuracy of the registral information that has been previously communicated (for example, an attachment of the property or some other encumbrance affecting it is submitted for registration). The Registrar should also report other applications for registration that have been submitted (which is useful for keeping watch on whether the mortgagor might be attempting to sign another transaction at another notary's office!).
- 2.4.3 Upon execution of the mortgage deed before the Notary, the parties request the Notary to communicate to the Registrar completion of the transaction. Such submission for registration will determine priority of the lender's mortgage (as against other encumbrances) but note that the lender's security will not be fully perfected until registration has been completed. Hence, for example the lender will not be able to enforce its security at the time of submission for registration, but only when registration is completed.
- 2.4.4 Note that, if the Registrar receives such communication by fax outside office hours, the Registrar will record the application at the start of the next business day.
- 2.4.5 It will be seen from the above that, to avoid the possibility of applications for registration of intervening encumbrances following the Notary's initial application for registral information, the usual practice is to time closing of the transaction to coincide, as closely as possible, with the date of receipt of information from the Registrar (i.e. not rely on the aforesaid nine working days period within which the Registrar might communicate further applications). Having regard to the importance of the communication of execution of the mortgage to the Registrar, good practice is for immediate communication to the Registrar following closing.
- 2.4.6 Such communication has a validity of ten working days, during which period the actual notarised deed must be

physically submitted to the Registrar. If submitted, the initial ten working days will turn into a sixty working day period during which such provisional submission retains its priority. (Note that the sixty days are not a "further" sixty days. The initial priority of ten days just converts into a priority of sixty days counted since the initial submission of the document). This enables the "gestor", a professional appointed by the lender to deal with registration and recover from the Registrar the original deed in order to attend to submission thereof to the tax authorities for payment of relevant taxes, following which it is returned to the Registrar in order for registration to be completed.

2.4.7 Note that if submission occurs outside the aforesaid ten or sixty working day periods, that will not of itself affect the validity of the relevant mortgage, but could affect its priority in the event of intervening applications for registration of other encumbrances. Furthermore, as stated above, it will be difficult to enforce security pending final registration, therefore it is in the interest of the lender to ensure that the Notary proceeds with all steps expeditiously.

2.5 Role of External Lawyers

2.5.1 In terms of pure title investigation and verification of encumbrances affecting the property, external lawyers would not be expected to be involved to the same extent as the Notary and the Registrar, although they could be involved in general due diligence on the property, as would be the case in an English law transaction.

2.5.2 External lawyers, or alternatively the lender's in-house lawyers, would usually review (at least in a general way) or double-check the fax communications between the Registrar and the Notary in order to make sure the procedure is followed as expected and the information supplied is sufficiently clear.

2.6 Further diligence (occupational leases, environmental, planning etc) might be dealt with by a combination of the lender, external lawyers, the valuer and specialist consultants.

3. Security:

The lender's primary security will be a mortgage on the property. Usually the notarised mortgage deed contains (i) recitals regarding title and encumbrances (see 2 above) (ii) the loan terms and (iii) the security itself.

3.1 The mortgage documentation should contain core terms (amount of loan, interest rate, repayment and prepayment, amortization, default interest, covenants regarding the mortgaged property, e.g. to maintain it or keep it in good repair, and events of default, etc), but the provisions are not necessarily as extensive as one may find in English law loan and security documents. This is partly because certain matters are already provided for by Spanish law.

3.2 Spanish law and practice usually distinguishes between clauses of the mortgage loan which have personal effect and those which are effective against third parties. Whilst compliance with the former may only be claimed from the mortgagor (and his assignees) as a party to the mortgage loan, compliance with the latter may also be claimed from or affect persons who acquire the property (even without expressly assuming liability for performance). A negative pledge, for example, will not bind third parties. However, other undertakings such as the obligation to keep the property duly insured, to allow the lender to visit the property for inspection etc, are binding on third parties.

3.3 It is necessary, as a matter of law, to limit the amount in respect of which the relevant property is encumbered by the relevant mortgage. A mortgage may not cover obligations apart from the principal amount of the loan, ordinary and default interest (up to a maximum of five years), expenses in relation to foreclosure and other expenses directly related to the property such as insurance premia and priority rights of third parties. It is doubtful that other rights, even if they are related to the loan, may be included as part of the same mortgage.

- 3.4 An interesting issue arises in relation to break costs in relation to the loan. Following certain case law, some Registrars will not accept full registration of mortgages including purported security for break costs as they are of the opinion that that obligation is at best contingent and is not an actual obligation (like interest) which relates to the loan on an ongoing basis. Therefore, in order to secure such obligation with a mortgage, a separate mortgage would, in theory, be necessary (but in practice, for commercial reasons, very unlikely to be agreed with the customer). There is a clear distinction between actual and contingent obligations. Note that this proposition only affects land mortgages. It is possible therefore to allocate items such as break costs to other security (non-land), for example assignments of rental income. Such other security (non-land) usually simply secures "all" obligations arising from the loan, without restriction.
- 3.5 Alternatively, another form of mortgage ("hipoteca de maximo") might be utilised. This form of mortgage is capable of securing actual and contingent liabilities up to an overall maximum amount. This form of mortgage will apply e.g. to revolving credit facilities. However, enforcement might be less straightforward than in the case of a mortgage securing defined actual liabilities as the lender will be put to prove of quantum of the obligations secured.
- 3.6 Usually, upon enforcement, the lender will only be able to recover up to the maximum stipulated amount in the mortgage. Save under certain exceptional circumstances, any residual liability can only be claimed by personal action against the borrower or by enforcement of other security.
- 3.7 Only certain provisions appearing in a notarised mortgage are eligible for registration at the Register. Clearly the encumbrance created by the mortgage itself is registerable. Certain events of default are registerable; certain are not. If they are not registered, the lender will not be able to rely on those defaults in order to trigger enforcement of the mortgage security, although that proposition is peculiar to land mortgages (and would therefore not, in theory, affect e.g. share pledges, assignments of rental income etc which have no relationship with the Real Estate Register).
- 3.8 Non-registered interests are not binding against third parties. A negative pledge, for example, is not registerable. As it is not registerable, a purchaser's ownership by party C (purchaser) of the relevant property would not be prejudiced by the fact that it might have been sold by party A (owner) in breach of a negative pledge in party B's (mortgagee's) mortgage (although the purchaser would take the property subject to the mortgage itself, on the assumption that it was duly registered).
- 3.9 The position above is no different, in principle, to the position under English law. A sale or mortgage effected in breach of a negative pledge could still, of itself, be valid in the hands of a purchaser or subsequent mortgagee. However, unlike the position in Spain:-
- 3.9.1 the breach of the negative pledge would constitute an actionable event of default, so the lender could accelerate the loan and enforce the security. The property would still be burdened, in the hands of the purchaser, by the lender's mortgage and the lender's first mortgage would take priority over any subsequent encumbrance;
- 3.9.2 it would be expected that a notice would appear on the Land Register for the relevant property whereby the Registrar would not accept a prospective transfer or second mortgage unless the consent of the first mortgagee had been obtained, so, in reality, the relevant purchaser or second mortgagee would not be able to obtain registration of their interest.
- 3.10 In reality, of course, it would be unlikely that a purchaser would accept a transfer of the property where a prior encumbrance was shown on the Register. In any event, the property would remain burdened with the lender's first mortgage. A subsequent mortgagee might take a mortgage knowing that a prior mortgage existed and, there, the material difference between English and Spanish law is that, unlike under English law, the taking of the second mortgage in breach of the negative pledge would not of itself cause an event of default such that the lender could immediately trigger acceleration and proceed to enforce the first mortgage. It would, nevertheless retain priority.

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- 3.11 There is considerable legal authority, in particular "Decisions of the Directorate General Registrars and Notaries" (DRGN) regarding provisions which may be registered on the Register and those which may not. Clearly, non-payment may be registered as an event of default and relied upon accordingly. In practice, for the most part, enforcement tends to be triggered by non-payment so that the absence of other registered events of default is not necessarily of concern. Nevertheless, breach of loan to value and debt service cover ratios might be of concern. It appears that a "serious" breach of a loan to value covenant is registerable but not a debt service covenant per se.

Insolvency is not of itself a registerable default. The individual Registrar has discretion as to, within certain parameters, what provisions he will decide to accept for registration. There are generally accepted uniform rules regarding what is registerable and indeed, under the Civil Procedure Law, non-payment in particular must be accepted for registration. Where external lawyers are engaged, they would expect to oversee the registration process and challenge Registrars in the event of perceived unjustified rejection of an application for registration of a particular provision. This applies especially to the provision regarding non-payment of a single instalment as an event of default that accelerates maturity of the whole loan because a duly registration of this clause is critical if the lender wants to enforce the security by using the procedure described below.

- 3.12 In any event, as stated above, full events of default are typically included in the mortgage deed, if only to provide, at least in theory, triggers for enforcement of other, non-land, security. For share pledges, the issue of registration or non-registration of events of default do not affect enforcement. However, enforcement does require the involvement of a Notary and a mortgagor may always go to court to challenge the triggering of a default by a lender and a Notary will have little option but to stop the enforcement process. It is fair to say that Spanish law generally is more debtor-friendly than English law, one of the effects of which is that enforcement of any security in circumstances other than where non-payment has occurred may be problematic and is inherently subject to the vagaries of judicial discretion!
- 3.13 Cross-collateralisation is problematic, so that, where different real estate properties are owned by different subsidiaries in a group, the lender will not be able to use excess realisation proceeds from the sale of one property to go towards repayment of a loan secured by another (which would typically be achieved under English law by the creation of a cross guarantee structure).
- 3.14 Note that, for portfolio transactions (and for subdivisible property), appropriation of portions of the loan to individual titles, individually registered as separate units at the Real Estate Register, is mandatory. This might give rise to some difficulty in the event that some properties in the portfolio were to do better than others in terms of fluctuations in value. For this reason the lender should ensure that the mortgage debt is properly divided and allocated per property. Otherwise, the mortgagor may request redemption in respect of a property with a disproportionately high security value. Where security is required over a property which comprises different "units" registered as such on the Real Estate Register, in order to avoid potential problems concerning allocation as between titles, it may be necessary to amalgamate the property into a single title. However the costs of this process may be high (especially stamp duty) so from a commercial point of view it is usually difficult to demand this from the customer, so the lender often accepts an appropriation of portions of the loan to individual units.
- 3.15 Stamp duty is payable on mortgage documents, up to 1% (detailed calculations depend on the Spanish region where the property is located) of the mortgage liability which, as discussed above, is much higher than the principal of the loan. Since the payment of such stamp tax is legally protected with a first priority as an encumbrance on the real property (always with a higher rank than the mortgage), it is advisable to deduct it from the advances made to the mortgagor in order to ensure its payment.
- 3.16 Notarised and Registration fees are not particularly high (totalling perhaps several thousand euros) and are of little concern in comparison to stamp duties. For loans of over approximately EUR 6,000,000, it is possible for the notary freely to negotiate his fees. Consequently, it is advisable to take this into consideration when choosing a Notary. Incidentally, the lender usually prefers to choose the notary since this simplifies the

preparation of the mortgage deed, while the mortgagor usually prefers to use its own notary in order to negotiate better fees.

4. Other security:

Other security may include:

4.1 An assignment by way of security of rental income (pledge).

4.1.1 Such an assignment is usually taken in addition to the land mortgage itself. The right to rental income is a personal right (leases being personal rights rather than interests in property "in rem"). As such, the right to rental income is not registered at the Register.

4.1.2 The right to rental income is capable of being assigned to a third party who could take priority in the event that the lender had not previously perfected (see below) its interest in such income.

4.1.3 Furthermore, in an enforcement situation, with an assignment of rental income, the lender would be able to appropriate rental income immediately without having to go through the fuller enforcement procedures applicable to land mortgages (see below).

4.1.4 Note, however that it is unlikely that a third party could take priority over the lender in relation to rental income as the mortgage deed itself, if properly drafted, will extend the security to rental income. However, the lender may still be susceptible to a third party assignee which has given notice to tenants (by way of perfection) prior to the lender.

4.1.5 From a legal perspective notification to the tenants of the assignment and pledge is always required for full effectiveness of security over rent. The Notary is only responsible for notifying tenants of the existence of the security (in respect of which he would send an extract from the assignment document dealing in particular with the requirement to remit rental income to a designated account of the mortgagor, while it is complying with its obligations, or to a designated account of the lender in case of non-fulfilment and subsequent enforcement of this assignment in guarantee), if so required by the parties. Note that mortgagors are usually uncomfortable with such notifications because they are afraid the tenants will mistakenly pay the lender before an event of default occurs or, even worse, deny payment for other "real" reasons, excusing non-payment on the basis of a presumed uncertainty as to whom is entitled to receive payment.

4.1.6 Typically, therefore, an immediate notification at the time of the creation of the mortgage is only made in the case of key lettings. For other lease agreements, the lender will usually have to accept, from a commercial point of view, the ability to serve notice in the future (e.g. upon an event of default or any other predetermined circumstances) rather than a full notification ab initio. Certainly, at the latest upon existence of an event of default, the lender would expect to be authorised to receive rents directly from the tenants and apply them accordingly (see further below).

4.2 Further security: note, having regard to the general Spanish law principles outlined above, it is necessary for the mortgagor to be obliged to formalise extension of the existing security as new leases are granted and a contractual obligation in that regard is typically included in the mortgage deed.

4.3 Pledge on designated rental income and other deposit accounts.

4.4 Pledge on shares

4.5 Parent-company guarantees or other guarantees

4.6 Assignment of any receivables arising from work contracts for the construction/redevelopment of the property.

4.7 Assignment of rights to VAT credits (usually only taken as security for specific VAT credit facilities).

4.8.1 Pledge on property insurances. Perfection involves notification to the insurer and the pledge recorded on the insurance policy. The lender is usually designated as loss payee. Nevertheless, some mortgagors demand that the lender may not freely use the funds to prepay the loan, except if an event of default occurs. Such request might be acceptable as long as the parties agree that certain kinds of damage to the building are to be considered in themselves an event of default (i.e. damage affecting a value in excess of z [x]).

4.8.2 The inter-relationship between landlord and tenant rights to insurance money and the rights of the mortgagee are different under Spanish law compared to English law. Remember that a lease, under Spanish law, is not a right in rem (i.e. an interest in land per se) but is a series of personal rights as between landlord and tenant. In the event of damage or destruction, the tenant may have personal rights as against its landlord as to application of insurance monies, but those rights would not be binding as against a mortgagee who has been designated a loss payee. The mortgagee could insist on appropriation of the insurance monies towards repayment of the loan if it is then due (or otherwise placed on deposit pending repayment) rather than application to repair damage to the property, leaving the tenant with a personal right as against its landlord.

However, the tenant may ultimately be entitled to refuse to pay the rent or even terminate the lease. Certainly, upon destruction, the lease would terminate in any event. Hence, having regard to potential loss of income with which to service the loan, it may not be in the interests of the mortgagee to insist on appropriation of insurance money towards repayment of the debt rather than have the same apply to repair/reinstate (unless maturity of the loan has occurred and the mortgagor has not voluntarily repaid the loan in which case the lender would obviously use the proceeds of the insurance to repay the loan).

4.8.3

It is not market practice for insurance policies to include standard mortgagee/non-invalidation wording (as per English law) whereby the policy will not be avoided/vitiated as against a mortgagee (or possibly other parties e.g. a freeholder) where the insurer might otherwise have been able to avoid the policy as against the mortgagor as a result of non-disclosure or act or omission on the part of the insured.

Nevertheless, the Act on Insurance Contracts ("Ley del Contrato de Seguro") includes some protective rights in favour of any mortgagee, such as the non effectiveness of the termination of an insurance contract as against a registered mortgagee until one month has elapsed since the mortgagee was informed about the fact that caused the termination of the contract. Furthermore, any mortgagee is entitled to make payment of any pending premium (in order to keep the contract in force) even in case the mortgagor opposes to such payment.

5. Treatment of rental income:

5.1 It is usually a term of the mortgage deed that a bank account is designated into which the mortgagor undertakes to pay all rental income (including service charges and VAT). In the absence of an event of default, the mortgagor would usually have full authority to operate such account, apply service charges, account for VAT and utilise net rental income to service the mortgage debt, but the lender could insist on the operating mandate for the account being structured so that the lender had authority to make withdrawals to service the debt (although such proportion might well be the subject of a difficult commercial discussion with the mortgagor!).

5.2 Where the mortgagor has appointed a managing agent to collect rental income, the mortgage deed will typically stipulate that the net rental income (after appropriation of service charges, VAT etc by the managing agent out of the proceeds) is remitted by the managing agent to the mortgagor and applied for debt service in

the usual way. The lender would typically simply obtain authority to request statements of account from the account holding bank (typically the mortgagor's lender) to monitor movements on such account.

- 5.3 It is not usual for the lender to insist on a specific pledge over the monies from time to time held in any of the accounts referred to above. In reality, given that rental income is typically paid on a monthly basis, the lender's exposure, in terms of time, is relatively small (i.e. if money is not in the account to, or the next interest payment is not made, an event of default will occur and the lender may accelerate/enforce accordingly).
- 5.4 Note also that, having regard to the inherent difficulties under Spanish law of creating security over non-specific assets, which could include fluctuating balances in such an account, there may be legal doubt in any event as to the full effectiveness of a pledge over such account.
- 5.5 It is not common practice to obtain a managing agent's duty-of-care letter or undertaking whereby it undertakes directly with the lender to carry out its duties with due care and attention, and covenants directly with the lender to make sure the rental income goes to the designated rent account. Furthermore, the lender would not necessarily expect to vet the terms of the managing agent's appointment or to take any pledge on it.

6. Enforcement of property security:

- 6.1 As referred to above, the regime regarding enforcement of land security is more involved than enforcement of other forms of security.
- 6.2 As already mentioned, enforcement, by any of the processes referred to below, is dependant on the occurrence of a registerable, and registered (on the Register) event of default contained in the mortgage deed.
- 6.3 There are various processes for mortgage enforcement in the case of land mortgages. In all cases, a public auction procedure is required.
- 6.4.1 In Spanish law the most common and quickest procedure for collecting the mortgage loan is the procedure regulated in Section 681 et seq. of the new Civil Procedure Act ("LEC") which came into force on 1 January 2001.
- 6.4.2 The advantage of this procedure is that it allows the auction of the mortgaged property to be arranged almost immediately without the debtor having any right to challenge it other than in very restricted circumstances which go to the validity of the debt secured (e.g. prior extinction of the secured obligations).
- 6.4.3 There are certain restrictions on the use of this procedure, notably:-
- (i) it is in practice only available for in case of non-payment (that is to say, non-payment on the due date of interest or repayment instalments);
 - (ii) the non-payment default must be registered at the Land Registry;
 - (iii) it is a highly formalised process and strict adherence to the applicable legal formalities is required. The mortgage deed must include specific stipulations regarding the auction process, including specified reserve price, manner in which demands may be served etc. Usually the lender expressly reserves, in the mortgage deed, the right to use this form of enforcement procedure;
 - (iv) steps in a section 681 enforcement process include making demand and the court arranging a public auction.
 - (v) all told, the likely timescale for realisation of assets, whether under this procedure or under certain other applicable provisions, is 6 months.

7. Syndicated Loans

- 7.1 In the case of syndicated loans, whilst the lead lender would act as agent for the lenders in relation to the loan, property and other security should, so far as possible, be registered in the name of all of the lenders.
- 7.2 This is not always practicable, for example in the case of a pledge over shares, where perfection of the security involves possession by the creditor. Hence, in that case, the lead lender would take possession and hold for the rest of the syndicate. Similarly, for practical reasons, the lead bank is sometimes appointed as sole beneficiary of the insurance policies, which simplifies the enforcement process. There is, however no concept, as in English law, of a trust such that the lead lender would hold the benefit of the security on trust for the syndicate lenders as beneficiaries.

8. Development Finance

- 8.1 Whereas, for projects in England, it is not unusual for a mortgagor to enter into a development agreement with the owner of a piece of land whereby the developer would obtain a contractual right to build thereon, usually followed by the grant of a valuable interest therein upon completion of the works (e.g. a freehold or perhaps a long leasehold at a low rent), such structure is not conventional in Spain. It is usual for the mortgagor to acquire the land itself (freehold) and develop accordingly. However, it is possible for the mortgagor to be granted a surface right (derecho de superficie) or a form of concession granted by a public authority (administrative concession). In this case, the landowner would grant to the mortgagor the right to construct and maintain a building on the landowner's land.
- 8.2 Such superficie right is itself a right in rem, like an English law long lease i.e. an interest in land. This has important consequences from a lender's security point of view. In particular, in the case of contractual development rights under English law, the lender would expect so-called "step-in" rights whereby, if circumstances arose whereby the landowner wished to terminate such contractual rights, the lender would expect protection whereby the rights would not be so terminated without notice being given to the lender and the lender having the opportunity to "step-in" and remedy the situation. In Spain, such rights are unnecessary as one would expect to deal with rights in rem (as above) rather than contractual rights. The mortgagor will either own the freehold or where a superficie is involved, the superficie, being an interest in rem, rather than a contractual right, cannot easily be terminated (unless the superficie right includes any specific restriction or limitation, which should be investigated by the lender prior to the transaction).
- 8.3 Additionally:-
- (i) it has often been the practice to date where, even if a special purpose company is set up as the mortgagor to undertake a particular project, a full recourse parent company guarantee will have been taken for full repayment of the loan, or at least whereby the guarantor guarantees completion of the project. Hence, direct recourse to contractor/professionals has been less important than would be the case for a UK lender lending on a project with limited recourse basis;
 - (ii) a lender could take a share pledge over all the shares in the mortgagor so that, on default, it would expect to be able to take control of the project in lieu of the mortgagor. Nevertheless, there would still be an issue for the lender in terms of ensuring that the contractors/professionals did not terminate their engagement in circumstances which had caused the default situation to arise in the first place. A creditor with a pledge is not entitled to appropriate the shares (art. 1859 Spanish Civil Code) in the case of default. The lender can rather force a public sale (auction) of the shares and if a bidder purchases the shares the price will be used to repay the loan. Otherwise the lender may acquire the shares and become owner of the mortgagor. In the case of default the lender usually reserves in the pledge agreement the right to use the voting rights of the shareholder as it deems so fit, but this provision is not easily enforceable because the by-laws need to be amended at that time with the

consent of the shareholders for the full effectiveness of that provision, and the lender cannot count on the shareholders' cooperation for this purpose; a provision in the by-laws ab initio (prior to an event of default having occurred) whereby the voting rights may only be used by the pledgee of the shares is not common.

- (iii) it is also possible, but unusual, within the terms of the relevant building contract or professionals' terms of engagement to include provisions in favour of the third party (ie the lender) whereby the lender as third party would have power to issue instructions to the contractors/professionals that variations to the works, terminate the contract upon breach by the contractor/professional in lieu of the mortgagor. Such contracts in favour of third parties therefore effectively give the lender rights, in the case of a development finance project, which can be exercised directly against the contractor/professionals. Since the relevant provisions are structured as a "contract in favour of a third party", the lender will have to accept any stipulations made between the mortgagor and the contractor/professionals in the contract itself. However, it would be for the mortgagor to factor in such third party provisions during the contract negotiation process to assist in making the relevant contract "bankable". It will therefore come down to the relative strengths of the negotiating position of the mortgagor and the contractor/professionals as to whether the latter would allow such third party provisions.

8.4 Having regard to the above, it is important for the lender to understand that there may be circumstances where the lender might ultimately be accepting the position that, if it does not have, by reference to appropriate documentation, rights to "step-in", it will need to take a practical view. In particular, it will need to monitor the progress of the development carefully to ensure that the works are done properly and, if there is a default, it would be well advised to contact the building contractor and members of the professional team at the earliest opportunity to keep them "on side"!

8.5 Another aspect of collateral warranties is the "duty of care" element whereby a contractor/professional will hold itself out contractually as offering the lender, as funder, the same duty of care as the relevant party owed to the mortgagor.

Such duty of care agreements are not that relevant in Spain as, by Spanish law, any owner of a building (or part/parts of it) suffering loss as a result of construction or design defects which arise any time within specific timeframes (one, three or ten years depending on the nature of the defect) may claim (subject to the statute of limitations applicable to legal actions two or fifteen years depending on the circumstances) damages from the parties which participated in the construction process. (Spanish Civil Code (art. 1591 CC) and the Law on Regulation of Construction (Ley de Ordenacion de la Edificacion). Hence, one is not as concerned with separate duty of care agreements with developers, tenants, purchasers and funders, nor successive assignments to successive parties with an interest in the property. Note however that:-

- (i) the lender, as a creditor, has, by law, no direct legal right of action against the relevant contractor, although a party acquiring the property, e.g. as a consequence of the foreclosure of the mortgage, will have;
- (ii) the remedies referred to above apply by operation of law but they may be extended or complemented in the construction documentation itself. Therefore it is still in the interest of the lender to obtain an assignment by way of security of all rights arising from the construction and related contracts.