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THE URBAN LEASE REFORM

Editorial

In this edition of the *NewsLextter* we will analyse the main aspects of the Act – approved by Parliament on the 21st of December 2005 and recently promulgated by the Portuguese President – which incorporates the current Government's intention to execute the long-awaited and much needed revitalisation of the urban lease market.

This Act, which will enter into force 120 days after its publication in the Official Gazette, will approve the New Urban Lease Regime ("*Novo Regime do Arrendamento Urbano*" - NRAU). Said regime will apply to all lease agreements executed after its date of entry into force and also, albeit with some limitation, to pre-existing leases.

It is, unquestionably, a highly controversial subject, given its strong social and economic implications, which have been generating a heated debate involving notably landlords and tenants' associations and real estate promoters. Regardless of the multiple issues raised by the Act now promulgated, we want herein to address its main aspects: thus we will start with a general overview of the reform and afterwards proceed to the analysis of the most relevant aspects of the new substantive urban lease regime as well as of the measures adopted in a bid to try to reverse the tendency for perpetuity of the leases which characterises the legislation still in force. We will moreover deal with the alterations that are going to be introduced at the procedural level and with the transitory provisions applicable to the update of the rents and to the transfer of the lease by death of the tenant in the older leases, without losing track of other important changes in legislation.

The objectives of this Act are ambitious but its effect will depend on the extensive development of the rules to be made via the enactment of additional legislation, as foreseen in the Act itself. Finally the market's reaction will have a fundamental role to play in this regard.

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General Overview

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The Government's goal with the New Urban Lease Regime ("*Novo Regime do Arrendamento Urbano*" - NRAU), which is currently awaiting publication, is to operate a profound change of the urban lease legislation currently in force. More specifically it is the Government's intention to put a stop to decades of what has been called "vinculismo"[1] and its negative effects, without neglecting the real estate owners' responsibility of ensuring that their properties also have a social function.

Among the objectives the NRAU aims to achieve we highlight the following: promoting and stimulating the urban lease market; creating attractive conditions for private investment in the real estate area, so as to restore the economical agents' confidence; inciting urban rehabilitation; updating (in a phased manner) the rents that were frozen in the past; rendering accountable those proprietors that fail to ensure a social function for their properties; speeding up eviction proceedings and increasing the number of cases in which court proceedings are not required as a pre-condition for enforcement proceedings.

In terms of structure, the law that will approve the NRAU will, in general terms, consist of four essential parts:

a) The first one respects to the **amendments to be introduced in several legal instruments**. These amendments will essentially fall over the Civil Code (in which a significant part of the urban lease substantive rules will be re-introduced) and the Civil Procedure Code (to which several rules of a procedural nature, presently included in the Urban Lease Regime ("*Regime do Arrendamento Urbano*" - RAU) will be transferred); in addition alterations will be made in respect of some specific aspects of other legal instruments, such as the Code of Municipal Tax over Real Estate ("*Código do Imposto Municipal sobre Imóveis*" - CIMI) and the Real Estate Registration Code ("*Código do Registo Predial*");

b) The second part will contemplate the so-called "general provisions", which will rule several aspects related notably with communications to be made between parties to lease agreements, with eviction proceedings, with the deposit of the amounts due

further to the lease with the clerk to the court and with the determination of the value of the rent;

c) The third will include a set of **"transitional provisions"**, some of which will be applicable to housing leases entered into under the RAU[2] and to non-housing leases entered into after Decree-Law nr. 257/95, of 30th September 1995, and others, - the majority - of housing lease agreements entered into before the enforcement period of the RAU and non-housing agreements entered into prior to the entry into force of Decree-Law nr. 257/95, of 30[3] September 1995;

d) Finally, the fourth and last part will consist of several "final provisions", notably related with the application of the NRAU in time, with the revocation of several legislation related with urban leases currently in force and with the approval of several legal instruments aimed at ruling numerous aspects of the NRAU.

Analysing the changes that will be introduced in the **urban lease substantive regime** – which, as referred, will be included in the Civil Code – we note a clear intention of assuring a greater contractual freedom for the parties when defining the contents of lease agreements, which, in the future, will hopefully result in a greater balance between landlord and tenant.

This greater contractual freedom – especially where non housing leases are concerned – arises, mainly, out of the fact that many of the aspects currently regulated by mandatory provisions of the current RAU will now be freely defined by the parties. For example, contrary to what happens under the RAU, that provides for mandatory rules regarding duration and termination of commercial leases, when non housing leases are at stake the NRAU allows these aspects (duration, termination or prevention of renewal of the leases) to be freely agreed upon by the parties.

Major changes will also be introduced in what concerns the termination of the lease agreement; these will contribute for the aforementioned reinstatement of the balance between both parties.

Differently from what happens with the RAU, which lists the situations whereby the landlord may terminate the lease[4], the future article 1083 of the Civil Code will end this limitation, permitting the landlord to terminate the lease whenever there is a situation of infringement of the contract by the tenant that, due to its gravity or consequences, renders the subsistence of the lease non-demandable.

Another of the NRAU's innovations in this regard is that, in some cases, it will no longer be necessary to resort to eviction proceedings – often too long and expensive – for purposes of terminating the lease. This will for example be the case whenever there is a delay of more than three months regarding the payment of the rent, charges or expenses and whenever the tenant rejects the execution of mandatory works determined by the public authoritie[s]. In these two situations the landlord will be able to terminate the lease by simple communication.

The landlord's opposition to the renewal of the lease will also be simplified as, with the NRAU's entry into force, it can be made by simple registered mail with acknowledgement of receipt[6].

On the other hand, the terms for the prior notice for the opposition to the renewal and for the termination of the housing lease by the tenant will be increased from 90 to 120 days.

As to the innovations introduced in respect of the termination of the lease, we have to refer future article 1101 c) of the Civil Code, providing for the landlord's right to terminate the undetermined duration lease with, at least, 5 years notice. Pursuant to article 26 of the NRAU this type of termination by the landlord will not be applicable to leases executed prior to the date of entry into force of the law; however, number 6 of said article establishes that this exclusion will end when, after the NRAU's entry into force, the business installed at the premises is sold or rented; this exclusion will also cease if, the tenant being a company, a transference of its share capital resulting in a modification of more than 50% of its ownership vis-à-vis the existing situation upon entry into force of the act occurs. It is thus likely that upon entry into force of the NRAU a relevant reduction of this type of operations (sale of business, lease of business and sale of shares of tenants) occurs.

In view of the above, the landlord is the party that will benefit the most with the entry into force of the NRAU, as it will no longer be restricted by some of the limitations existing in the RAU and that still presuppose that in a lease relationship the tenant is always the weaker party and therefore deserves to be more protected. This does not mean, however, that the tenant will be in a weakened position. In practice, it will all depend of the negotiation strength of each party and of the rules determined by the lease market.

The amendments that this reform will introduce **at a procedural level** will also result in important advantages for the landlord and hopefully will reduce the number of eviction proceedings pending in our courts. The increase of the number of cases in which court proceedings are not required as a pre-condition for enforcement proceedings will also allow that, in many situations, the landlord demands the immediate vacancy of the premises without needing to first obtain a court decision that decrees the rescission of the agreement (see the text "Judicial Proceedings in the New Urban Lease Regime").

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[1] Roughly translated, a "binding character"; "vinculismo" is a very exacerbated form of protective tenancy that includes rent control and a tendency for perpetuity of lease agreements.

[2] Approved by Decree-Law nr. 321-B/90, of 15 October 1990.

[3] This Decree-Law nr. 257/95, of September 30th, permitted that leases for commerce or industry, for the exercise of liberal professions and other non-housing licit purposes, be entered into for a limited term.

[4] This termination can only be determined by a Court at the end of eviction proceedings.

[5] If however the tenant, within the next 3 months, ceases to be in default or to oppose the execution of works, the termination by simple communication will be ineffective. Although the wording of the NRAU is not clear as to this point, we believe that this three months deadline will start running as of the moment in which the tenant receives the communication terminating the lease.

[6] While article 100 n. 2 of the RAU determines that the termination of the limited duration lease by the landlord must be served judicially, when reading future article 1097 of the CC together with article 9 of the NRAU it is clear that the landlord's "opposition to the renewal" can be made by simple communication (registered mail with acknowledgement of receipt) to the tenant.

In what regards the so-called **transitional provisions**, which concern essentially the updating of the rents in force in the older leases, we have many doubts as to the role to be played by them in the attainment of the goals of this reform.

In effect, the updating of the rents foreseen by these provisions, which can be demanded for housing leases executed prior to the entry into force of the RAU and for non housing leases executed prior to the entry into force of the Decree-Law n. 257/95, of 30 September 1995, will always require a previous evaluation of the premises further to the CIMI. This evaluation will in all probability result in a considerable increase of the tax value of the premises and, consequently, of the amount of the Municipal Tax over Real Estate ("Imposto Municipal sobre Imóveis" - IMI) to be paid by their owner[7].

In addition to the increase of the respective tax liabilities, the landlord intending to update the rents may have other expenses. This will for instance be the case whenever it is necessary to have works executed in the premises so as to guarantee that the corresponding maintenance coefficient will allow the updating of the rents[8].

These are just some of the aspects that bring the institutions representing the landlords to criticise this reform, alleging that the rent increases arising out of the transitional provisions are insufficient to meet the additional costs that the landlords will have to bear[9].

Criticism to this reform and, particularly, to the regime of increase of the rents in the older leases are not however exclusive to the landlords. Associations representing tenants have also severally criticised this aspect, claiming that the financial situation of a large number of tenants will not permit them to bear the foreseen rent increases.

In this sense, and although it is still difficult to evaluate the practical effects of this regime of updating of the rents, we have to consider the possibility, that may be confirmed in several cases, that the landlords will not take the initiative to update the rents in view of their belief that the maximum limit of that increase will not allow them to meet, within a reasonable period, the corresponding tax charges and the costs of the works they will have to execute. Another possibility is that the tenants will not summon the landlords to execute works in the premises with fear of the respective repercussions in what concerns the maintenance coefficient and, consequently, the amount of the new rent[10].

Although this reform gives a good contribution for improving the functioning of the urban lease market, we believe that, in practice, the alterations that it introduces do not meet the expectations generated during the discussion of the act. We now need to wait for the publication and entry into force of the NRAU in order to assess whether or not this new legal regime will contribute in a relevant manner to the accomplishment of the goals established by the Government.

It should be noted, however, that there are many aspects of the approved act that could and should still be improved. The Government may take the opportunity to introduce such improvements in the several implementing regulations which, further to articles 62 and 63 of the NRAU, have to be approved within the next few months. These two provisions foresee the approval of legislation regarding the following subjects: mandatory works; notion of vacant premises for purposes of tax law; determination of the annual gross corrected income; determination and verification of the maintenance coefficient; attribution of the rent subsidy; urban real estate pertaining to the state and leases involving public entities, as well as the respective rents; intervention of real estate funds and of pension funds in urban renovation and re-qualification programs; creation of the housing and urban rehabilitation observatory, as well as of the housing data base; utilisation of spaces in shopping centres. ▪

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[7]Although Decree-Law n. 287/2003, of 12 November 2003, provides that a general evaluation of urban real estate is to be made within 10 years as of the date of entry into force of the CIMI, the truth is that, at this moment, said general evaluation is far from concluded and the great majority of real estate in Portugal continues to have a tax value substantially inferior to the respective market value. Hence, this regime of updating of the rents may accelerate the revaluation for tax purposes of many of the older real estate with the corresponding increase of the State's income arising out of the IMI.

[8]Pursuant to the NRAU, a maintenance coefficient will apply to real estate with more than 10 years; this coefficient may vary between 0,5 (corresponding to a "poor" maintenance status) and 1,2 (corresponding to an "excellent" maintenance status). Pursuant to article 35 of the NRAU the landlord will only be allowed to increase the rent when the maintenance status of the premises is considered "medium", "good" or "excellent". If the maintenance status is "bad" or "poor" the landlord will only be able to increase the rent after the execution of works leading to the improvement of the maintenance status to at least medium level. The criteria to be used for the determination of these levels and of the maintenance coefficients will be defined in subsequent legislation.

[9]Another aspect that has been severely criticised by real estate owners is the worsening of the IMI applicable to vacant premises. Pursuant to the future wording of article 112 of the CIMI, IMI rates foreseen for urban real estate will be doubled for real estate that has been vacant for more than one year.

[10]There is a higher probability of occurrence of this type of situation in housing leases due the fact that in non housing leases the rent can be increased irrespectively of the maintenance status of the premises.

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The New Substantive Urban Lease Regime

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The NRAU differs in several aspects both from the RAU and from the regime that was proposed by the previous Government. One of these aspects regards the classification of leases according to their purpose: whilst in the RAU this classification is four-tiered (depending on whether the leases are for (i) housing purposes, (ii) commerce or industry, (iii) exercise of a liberal profession or (iv) any other licit purpose), the NRAU will introduce a two folded classification, differentiating only housing leases from non-housing leases.

The object of the present text is to briefly analyse the main general and special provisions – specific to each type of lease mentioned above –

that will be applicable to all lease agreements entered into after the entry into force of the NRAU, as well as, albeit with certain restrictions, to leases already in force on that date.

Such analysis will be made via cross references to the articles that the NRAU will incorporate in the Civil Code, considering that, with the entry into force of that legal instrument, a large part of the substantive urban lease regime will regain its place in this Code (from where it was removed in 1990).

Consequently, it is not our intention to describe the future substantive urban lease regime in detail – first and foremost because a text with the nature of this one would not be an adequate means for such an exercise –, but rather to analyse some of the main alterations to be brought forward by the NRAU taking into account the regime currently in force (the RAU).

I – General Provisions:

The Civil Code already includes several provisions directly applicable to urban leases. We are principally referring to Articles 1022 to 1063 thereof, which contain several provisions applicable to lease agreements in general.

With the NRAU, the legislator will add Articles 1064 to 1113 to the Civil Code. As referred above, these will be applicable to all urban lease agreements that are entered into after the NRAU's entry into force. Pursuant to Articles 26, 28 and 59 of the approved Act, these new articles of the Civil Code will also be applicable, albeit with certain restrictions, to leases entered into prior to the NRAU that still subsist on the date of its entry into force.

Via these new articles, the legislator will alter several aspects of the present regime, among which we would like to emphasize the following:

Agreement Form: The future Article 1069 of the Civil Code establishes that the urban lease agreement must be made in writing provided its duration exceeds 6 months.

This Article 1069 is thus different from the currently in force Article 7 of the RAU, further to which the written form is mandatory for all urban leases, it being nonetheless possible to remedy the non-compliance with this rule via the presentation of the relevant rent receipts.

Payment of Rents in Advance and Bond: The new Article 1076 of the Civil Code determines that the contracting parties may, on one side, agree that a maximum of three months' rent is paid in advance and, on the other side, fix a bond, by any of the forms legally foreseen, destined to guarantee the fulfilment of either party's obligations.

Consequently, said provision will increase the number of monthly rents that can be paid in advance. In effect, the present Article 21 of the RAU only allows the payment of one month's rent in advance. In our opinion, this new Article 1076 of the Civil Code will also put an end to the limitation resulting from Article 14 of the RAU's Preamble Decree, pursuant to which landlords who, upon execution of the lease agreement, receive deposit bonds which amount is superior to one month's rent are guilty of crime of speculation.

Updating of the Rent: The new Article 1077 of the Civil Code states that, irrespectively of the type of urban lease in question and of the period for which it has been entered into, the parties may establish, in writing, the possibility of updating the rent and the respective regime. If no such clause is included in the lease agreement, the rents will be annually updated in accordance with the coefficients published for those purposes.

With the entry into force of this provision, the limit resulting from the present Article 99, nr. 2, of the RAU will be eliminated. This article determines, for fixed term housing leases, that the parties are only free to provide for the updating of the rent if the agreement is entered into for an initial duration equal or superior to eight years.

Charges and Expenses: Further to the new Article 1078 of the Civil Code the parties are free to agree, in writing, as to who will be responsible for charges and expenses related with the leased premises. This article further establishes a subsidiary regime that will apply should the contracting parties fail to provide for this aspect.

As this issue is not ruled in the RAU, we believe that the future Article 1078 of the Civil Code may contribute to avoid some conflicts between landlord and tenant.

Termination of the Lease: The future Article 1079 of the Civil Code lists the same forms of termination of the lease as were already provided for in the RAU (that is: agreement between the parties, rescission, expiry of the lease, opposition to the renewal of the lease or other causes permitted by law), However, the regime of some of those forms of termination of the lease agreement will be the object of important alterations.

One of the main changes will precisely be introduced at the level of the rescission of lease agreements. Whilst the present Article 64 of the RAU lists all the grounds that may give cause to the rescission of the lease by the landlord, no other causes being admitted, the new Article 1083 of the Civil Code will permit that the landlord rescinds the lease agreement upon existence of a "breach which, due to its gravity or consequences, renders the subsistence of the lease non-demandable"[1].

Another innovation is that, under certain situations, it will not be necessary to resort to eviction proceedings to achieve the rescission of the lease. This will namely occur in case of lack of payment of rent, charges or expenses for a period exceeding three months and in case of opposition by the tenant to the carrying out of works ordered by a public authority (new Articles 1083, nr. 3, and 1084 of the Civil Code), in which the landlord may terminate the lease by simple communication to the tenant[2]. This is, without a doubt, one of the most important innovations of the NRAU and will presumably allow for a reduction of the number of eviction proceedings pending in our Courts.

Pre-emption Right of the Tenant in the Acquisition of the Leased Premises: Whilst the RAU determines that the tenant leasing the premises for more than one year has a pre-emption right in their purchase or if they are given as payment in kind, further to the NRAU only tenants leasing the premises for more than three years will have such right. Therefore, the NRAU will limit the number of situations in which the landlords are compelled to grant a pre-emption right to the tenants[3].

II – Housing Leases:

Analysing now the special rules that will constitute the subsection of housing leases (future Articles 1092 to 1107 of the Civil Code), it is important to point out the following aspects related with the duration, termination and transfer of housing leases:

i) Duration and Termination:

According to the new Article 1094 of the Civil Code, housing leases may, in what regards duration, be entered into for a fixed duration or for an undetermined duration.

a) In what regards **fixed duration agreements**, pursuant to the new Article 1095 of the Civil Code the lease will have to be entered into for an initial duration going from a minimum of 5 to a maximum of 30 years[4].

At the end of the referred initial term, the agreements entered into for a fixed duration shall be automatically renewed, except if any of the parties opposes to their renewal[5].

The opposition to the renewal by the landlord must be made by means of a communication (registered letter with notice of receipt) sent to the tenant with a minimum prior notice of 1 year in relation to the term of the lease (Article 1097 of the Civil Code). The NRAU will consequently simplify the procedure presently foreseen by Article 100, nr. 2 of the RAU, further to which the "notice of termination" of the lease by the landlord has to be served judicially.

The tenant may also cause the lease to terminate at the end of its initial term or of any of its renewals and should, for that purpose, communicate to the landlord his opposition to the renewal of the lease, with a minimum prior notice of 120 days. Consequently, the 90 days prior notice period presently provided for in Article 100, nr. 4, of the RAU for the cases of "notice of termination" by the tenant will be increased.

Furthermore, after six months of effective duration of the lease, the tenant will have the possibility to serve notice of termination[6] of the lease at any time and must communicate his intention to the landlord with a minimum prior notice of 120 days. Also as regards this aspect, the NRAU presents certain changes in comparison with the regime of "unilateral revocation" provided for in the RAU, considering that, on one side, the period of prior notice will be increased from 90 to 120 days and, on the other side, with the entry into force of the NRAU, the notice of termination by the tenant will only be admissible after the lease has been in force for more than 6 months[7].

b) The **agreements of undetermined duration**, as the name itself indicates, are those agreements in which the parties do not determine the respective duration in advance. However, this does not mean that the parties are eternally bound by such agreements, notably because, by legal definition, the lease is a temporary agreement.

Besides the causes of termination that will be mentioned in Article 1079 of the Civil Code, these undetermined duration leases may also be terminated by notice of termination made by the tenant or by the landlord.

The tenant may serve notice of termination of this type of agreement at any time and without any justification in particular, provided that, for that purpose, he communicates his intention (by registered letter with notice of receipt) to the landlord with a prior notice of 120 days. This notice of termination shall always produce effects at the end of a calendar month.

In turn, the landlord may, in general terms, serve notice of termination of this type of agreement in the following situations (provided for in the future Article 1101 of the Civil Code)[8]:

a) In the event the landlord needs the leased premises for his own residence or that of his children[9];
b) In the event the landlord intends to carry out significant modification or restoration works at the leased premises;
c) Irrespectively of any reason, provided that the notice of termination is communicated (by registered letter with notice of receipt) to the tenant with a prior notice of five years in relation to the date on which the termination of the lease is to take place. In this case, the notice of termination must subsequently be confirmed by means of a new communication made within a maximum period of 15 months and a minimum period of 1 year in relation to the date on which it produces effects[10].

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[1] The legislator has opted to include, in nr. 2 of the referred Article 1083, as a matter of example some cases in which the landlord can rescind the lease.

[2] This communication must however be served judicially or through personal contact by a lawyer, paralegal or enforcement paralegal.

[3] It should be referred that, pursuant to Article 58 of the approved Act, the entry into force of the NRAU will not cause tenants who, pursuant to the RAU, already hold a pre-emption right to lose such right (that is, tenants who, on the date of entry into force of the NRAU, are already leasing the premises in question for more than 1 year).

[4] Except if entered for temporary housing purposes or for a special transitory purposes, in which case the lease may be entered into for a period inferior to 5 years.

[5] The concept of "opposition to renewal" used under the NRAU corresponds, in general terms, to the concept of "notice of termination" set forth in the RAU.

[6] In general terms, the concept of "notice of termination" used by the NRAU corresponds to the concept of "revocation" referred to in Article 100, nr. 4, of the RAU.

[7] Under the RAU, nothing prevents the tenant from unilaterally revoking the lease one day after its execution.

[8] The Civil Code will contain several rules destined to regulate both the requirements and the procedure to be followed in the notice of termination to be served by the landlord in this type of leases.

[9] The notice of termination based upon these grounds shall be subject to payment of compensation to the tenant and to the verification of certain requirements specified in the future Article 1102 of the Civil Code.

[10] It should be noted that, pursuant to Article 26 of the approved Act, the landlord will not be able to put an end to leases entered into prior to the NRAU. However, the landlord will be able to give notice of termination with a prior notice of five years in case any of the situations provided for in number 6 of that Article occurs (sale or rent of the business installed in the premises, or in case the tenant is a company, transfer of its share capital resulting in a modification of more than 50% of its ownership vis-à-vis the existing situation upon entry into force of the act).

ii) Transfer:

The NRAU will also alter some aspects related with the transfer of the lease due to the death of the tenant, which is presently ruled by Articles 85 and following of the RAU.

Pursuant to the new Article 1106 of the Civil Code, the housing lease will not expire due to the death of the tenant when he is survived by one of the following persons: (a) spouse residing in the leased premises or partner who lived with the tenant as man and wife for more than one year; or (b) person who lived with the tenant in joint economy for more than one year. Pursuant to number 2 of that Article 1106, the position of the tenant shall be transferred, successively and in identical circumstances to the surviving spouse or person who lived with the deceased as man and wife, to the closest relative or kin or among these to the eldest, or to the eldest among the remaining persons who lived with the tenant in joint economy for more than one year.

In general terms, it may be said that the leases entered into after the entry into force of the NRAU will benefit from a regime of transfer by death considerably more favourable (for the tenant-transferee) than the regime that will be applicable to prior leases, the transfer of which will be subject to larger restrictions, imposed by the transitory rule set forth by Article 57 of the Act.

III – Non-Housing Leases:

As for the future Articles 1108 to 1113 of the Civil Code, which will be included in a specific subsection regarding leases for non-housing purposes, we must refer at the outset that, in comparison with the regime set forth by the RAU, these will permit a greater freedom in the determination of the contents of the agreement.

For example, contrary to what occurs in the RAU, which contains mandatory provisions regulating the duration and notice of termination of commercial leases, the NRAU will permit that, in relation to non-housing leases, these aspects (duration, notice of termination and opposition to renewal) be freely agreed by the parties. However, in the absence of determination by the parties, and further to the future Article 1110, nr. 2, of the Civil Code the lease agreement for non-housing purposes shall be considered as having been entered into for a fixed term of ten years. In this case, a minimum prior notice of one year will apply to the notice of termination by the tenant.

Besides this alteration which will, undeniably, be the most relevant in what regards leases for non-housing purposes, the NRAU will also modify some specific aspects of the current regime. We are notably referring to the future Article 1112, nr. 4 of the Civil Code, which will henceforth provide for the possibility of the parties previously setting aside the pre-emption right of the landlord in the case of sale of the business installed in the leased premises.

IV – Final Considerations:

Notwithstanding the numerous criticisms that it has received from various sectors, we consider that, in general terms, the substantive regime to be (re)introduced in the Civil Code will contribute for the long-awaited "modernisation" of the urban lease legislation, mainly in what respects non-housing leases, regarding which the parties will now enjoy a greater contractual freedom. Contrarily to what occurs with the RAU currently in force, which is still based on the assumption that the tenant is always the weaker party and, therefore, deserves more protection (an assumption that, frequently, has no match in reality), the NRAU intends to establish a larger equilibrium between tenant and landlord.

However, we must also refer that some provisions concerning fundamental aspects of the lease relationship included in the Act under analysis are not quite clear, being susceptible of creating interpretative disputes and, consequently, some conflicts between landlords and tenants.

Considering that the legal security is a paramount element for the healthy development of the urban lease market, we hope these doubts are promptly clarified either by the legislation that will be enacted to elaborate on several aspects of the NRAU or, should that not be the case, through the judicial decisions rendered in this respect. ▪

[11] Pursuant to which limited duration commercial leases must be entered into, as a rule, for a minimum initial duration of 5 years; in case the landlord intends to prevent their renewal at the end of their initial duration or of the renewal period, he will have to serve a judicial notice for those purposes.

The End of "Vinculismo"[1] (the Binding Character) in the Urban (Housing) Lease?

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The RAU is characterised for having a binding character; in brief this means that there is a tendency for perpetuity[2] of leases entered into under the RAU. This binding character appeared in a phased manner, further to the introduction in the lease regime of several provisions which, in general terms, render the alteration - mainly when it concerns the rent - and/or the termination of lease agreements difficult when these harm, even if only in theory, the tenant[3]. Therefore, even if in a somewhat simplistic form, one can say that subjacent to "vinculismo", to this binding character, there is the presumption of the "good tenant" against the "bad landlord", which justifies the legal creation of a lack of balance between the contracting parties.

The binding regime has been identified, for a long time and consensually, as the origin of most of the known problems that affect the urban lease market[4].

Consequently and while we wait for the publication of the NRAU, it is pertinent to analyse the regime which will shortly govern

urban leases, comparing it with the present regime to see how this question will be addressed. Our goal with this analysis is to assess whether the NRAU continues to have a binding character or if, on the contrary, with its entry into force there will be a return, in what concerns this type of agreements and as is a rule in civil law, to the domain of contractual autonomy[5]. For these purposes we will therefore have to determine if the alterations to be introduced in the urban lease regime, mainly in what regards the termination of the lease and the updating of rents are or not sufficient to state that the NRAU will reverse the still existing tendency towards a binding character.

When comparing the NRAU with the RAU, the possibility for the landlord to rescind the lease agreement without having to resort to the courts appears, without a doubt, as one of the major innovations of the new regime[6]. However the range of this alteration is not as vast as the wording of the new Article 1047 of the Civil Code might suggest. In practice, the landlord will only have the possibility to rescind the lease without resorting to the Courts in two cases[7]. Even so, this alteration is an important step towards a non-binding regime, especially because one of the cases in which the rescission of the lease by mere communication to the tenant will be possible will be lack of payment of the rent, probably the reason most frequently invoked by landlords to justify that rescission. Consequently, there is a clear intention on the legislator's side to facilitate the rescission of the leases in these situations.

Without questioning however the good intentions of the legislator as to this aspect, we are compelled to note that it is shocking that this new regime admits that the tenant will only be effectively obligated to vacate the leased premises after six months of failure to pay the rent[8]. This is all the more so when one considers the circumstances - referred above - surrounding the drafting of this new regime and the fact that the respective explanatory memorandum implicitly acknowledges the need to put an end to the binding regime and to the existing inequality between landlord and tenant.

As a matter of fact and still in respect of the termination of the lease agreement, we consider that the most relevant alteration in terms notably of the dichotomy binding regime / contractual autonomy is that resulting from the transition from a regime further to which the landlord could only rescind the lease based upon one of the grounds expressly foreseen by the law to a regime in which he may terminate the lease whenever there is a “breach which, due to its gravity or consequences, renders the subsistence of the lease non-demandable of the other party”. In light of the letter of the law, this rule will henceforth also govern the termination of the agreement by the tenant[9].

Another relevant change for purposes of the subject under discussion corresponds to the future limitation of the possibility that the tenant has to cause the expiry of the right of the landlord to terminate the lease based on the lack of payment of the rents. In effect, the RAU permits that the tenant prevents the termination of the lease due to lack of payment of rents if, until the term for filing the answer in the declaratory phase of eviction proceedings, he pays or deposits the sums due plus 50% as indemnity. The tenant can resort to this possibility in a systematic manner and without limitation. With the entry into force of the NRAU, the tenant will only be allowed to use this possibility once per lease[10] (this alteration will thus considerably reduce the number of situations in which, without justification, the tenant in breach is favoured in detriment of a landlord who in many cases is complying with his obligations).

Still in what concerns the termination of the lease, we must refer that, with the entry into force of the NRAU, a new situation of expiry of the lease will be added to Article 1051 of the Civil Code. Pursuant to the new sub-paragraph g) of said article the lease will expire upon termination of the services which determined the occupation of the leased premises. On the other hand, the legislator will increase the period during which the tenant may continue to occupy the leased premises after the expiry of the agreement from three to six months. This is not only contrary to the general anti-binding character tendency but is also, at least in some cases of expiry of the lease, hardly justifiable.

In what concerns (housing) agreements entered into for a limited duration or with a fixed term, some timid steps are being taken towards a greater contractual autonomy of the parties. Thus, with the entry into force of the NRAU, and in view of the alterations introduced in the regime of opposition to the renewal by the landlord, the latter will no longer have to serve judicial notice to the tenant to put an end to the lease.

On the other hand, the prior notice to be given by the tenant in the case of opposition to the renewal was increased from ninety days to one hundred and twenty days, the same occurring with the notice of termination at any time of the agreement which, in addition, will now only be possible after six months have elapsed since the beginning of the lease[11].

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[1] Translator note: “*vinculismo”* is a very exacerbated form of protective lease that includes rent control and a tendency for perpetuity of lease agreements. For present purposes “vinculismo” will be (roughly) translated into “binding character” or “binding regime”.

[2] In notorious opposition to the originally temporary nature of this type of agreement.

[3] Examples of the binding character of the RAU are the rules preventing the termination of the agreement by the landlord without just cause, the rules restricting the situations in which evictions may occur due to breach of the tenant, the rules raising difficulties or preventing the updating of rents, etc.

[4] The explanatory memorandum of the NRAU, even if in a less obvious form than the previous proposal, is no exception, as may be seen on pages 8 to 10.

[5] It should be noted that considering the nature of the present text, it is not our intention to conduct a thorough exercise in this respect.

[6] Pursuant to the RAU, the termination of the lease based on the tenant's breach must be decreed by the Courts.

[7] The NRAU determines that “in the case of lack of payment of the rent, charges or expenses for a period exceeding three months and in the case of opposition by the tenant to the carrying out of works ordered by a public authority, the subsistence of the lease can not be demanded from the landlord…”.

[8] This is the practical result of the combination of the new Articles 1083, nr. 3, 1084, nr. 1 and 1086 of the Civil Code.

[9] The same will occur in what regards the one-year limit (as of the date of the breach) applicable to the rescission of the lease by the landlord which will from now on also apply to the rescission by the tenant. Although this alteration is not very relevant in view of the broader range of possibilities at the tenant's disposal to be freed from the lease, this levelling of landlord/tenant is interesting from a pedagogic point of view.

[10] Articles 1048, nr. 2, and 1041 of the Civil Code.

[11] From these alterations, we can see that although the binding character is usually associated with inequalities between the parties, the elimination or lessening of those inequalities does not always lead to a reduction of the binding character. In fact, in this case the discrepancy between the positions of the parties was lessened but paradoxically there was an increase of the binding character, at least in what concerns the tenant.

In what regards this type of leases, our main criticism stems from the fact that under the NRAU the minimum initial duration of 5 years continues to be mandatory, despite the fact that lease agreement are by definition temporary. Our disagreement with the maintenance of this rule is also related with the fact that this period is only fully binding for the landlord (as the tenant may be freed from the agreement long before the respective term). When it comes down to it, it seems that the legislator continues – without justification, in our opinion – to consider that the tenants are incapable of protecting their own interests…

As for the regime applicable to undetermined duration lease agreements (which, it should be said, will be applied should the parties fail to establish a duration for the lease in their agreement), it shows a greater propensity for the perpetuity of the lease than the regime applicable to limited duration leases.

However, the NRAU will also introduce a very significant alteration in what concerns this type of leases (for an undetermined period). Thus, and besides the situations already provided for in the RAU, the new legislation will allow the landlord to serve notice of termination of the lease to the tenant irrespective of motive, provided that, for that purpose, he gives the tenant a minimum prior notice of five years[12].

Therefore, and although an enormous discrepancy between landlord and tenant continues to exist regarding this aspect – in so far as the period for the latter to terminate the agreement, irrespectively of any justification, is of 120 days -, there will now be a form for the landlord to terminate the agreement outside the cases that are, at this point, expressly foreseen in the RAU. This is a large step in the opposite direction of a binding regime. As a matter of fact, landlords may begin resorting to this possibility even in those cases where they actually have the intention to use the leased premises for their own residence or that of their children or to carry out significant works therein. Effectively, the possibly of give notice of termination of the lease for these reasons will continue to require the compliance with certain tight requirements. Moreover, it will continue to obligate the landlord to resort to the Courts, involving a number of other additional costs for the landlord.

The regime applicable to the notice of termination of the agreement by the landlord based on any of the reasons provided for in the RAU (those referred in the preceding paragraph) will also undergo some alterations. Consequently and as an example, the amount of the indemnity due to the tenant in view of the ceasing of the lease due to the landlord's need to use the premises for his residence or that of his children will be reduced from two and a half years' to one-year's rent. On the other hand, if the notice of termination is determined by the carrying out of works at the premises, the landlord will now have to indemnify the tenant for all expenses and damages, patrimonial and otherwise, borne by the latter. Further to the NRAU this indemnity can never be inferior to two years' rent[13].

As for the alterations that will be introduced in regard to the rent, we must refer that the NRAU will now acknowledge as a rule the freedom of the parties to establish both the possibility of updating the rent and the rules applicable to it (differently from the present rule, pursuant to which the updating is only "permitted in those cases and in the form foreseen by the law"). However, the relevance of this alteration is mainly pedagogic, since, in practical terms, this freedom already exists in the majority of the leases entered into under the RAU.

With regard to the transfer of the lease due to the death of the original tenant, the NRAU will extend the number of situations in which such transfer may occur. However, weighing all the alterations that will be introduced in this respect, we believe that the anti-binding character will prevail. Effectively this extension will only be applicable to agreements that are entered into after the entry into force of the NRAU in which in principle the values of the rents will be close to the average market value. Therefore, it is expected that this new regime will put an end to the frauds that were frequent under the RAU and that were behind numerous situations in which landlord were forced to "accept" the transfer of the lease without being able to increase the rent (or, being able to increase it, but only up to the amount of the conditioned rent, which is almost always considerably inferior to the market value).

Where true equality between the parties is concerned, the major evolution appears, unsurprisingly, by reference to non-housing leases, in respect of which – something that can be considered historical – the same subsidiary periods to serve notice of termination will henceforth be applicable to landlord and tenant alike.

Ironically, a subsidiary initial duration of ten years was set forth for these agreements. This seems peculiar, especially when it is acknowledged that the perpetual nature of leases is not a value to be preserved[14].

Considering the above, it seems to us that although the new regime still presents many characteristics of a binding regime, fundamental steps were taken towards a greater contractual freedom of the parties. Moreover, there is an attempt to reinstate the temporary nature of the lease agreement. We stress, as fundamental in respect of the object of this text, the possibility now granted to the landlord to put an end to undetermined duration leases, irrespectively of any particular reason.

In a point that is intimately connected with the binding regime, we must emphasize that the NRAU will reduce the inequalities between landlord and tenant. However, there is still room for improvement in this regard as a number of discrepancies between landlord and tenant continue to exist, which - in our view - are unjustified.

It remains to be seen how the Courts will interpret and apply this new regime. We are notably anxious to see if the legislator's clear intention to diminish the binding character of the current regime will be respected by the judicial authorities or if, to the contrary, the tendency of protecting the tenant that has been a trait of judicial decisions regarding urban leases will prevail against the letter and spirit of the new law. ■

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[12] In addition, it is necessary to comply with some additional requirements set forth in the law.

[13] The NRAU provides for other alternatives to the payment of this indemnity. However, should the parties fail to reach an agreement as to the applicable alternative, the landlord will have to pay that indemnity.

[14] This is yet another example that binding character and inequality between the parties are not always synonyms.

Judicial Proceedings in the New Urban Lease Regime

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Under the RAU eviction proceedings have two phases: a declaratory phase which purpose is to obtain a judgement declaring the extinction of the lease agreement and ordering the tenant to vacate the leased premises, and an enforcement phase, aiming at the effective recovery of the leased premises by the landlord, through the enforcement of the eviction warrant obtained in the declaratory phase, in case the tenant refuses to comply with the Court order.

The slowness in the conclusion of declaratory lawsuits, compelling the landlord to wait several years before obtaining the above-referred judgement, has rendered urgent the adoption of measures that facilitate the proceedings aimed at the setting free of the leased premises. This is so not only to lessen the losses that the procedural pendency causes the landlord but also to relieve the Portuguese courts, which are swamped with eviction proceedings.

For these purposes, the NRAU will increase the number of cases in which enforcement proceedings can be filed based upon extrajudicial enforcement instruments (as opposed to judicial decisions, as is the rule under the RAU).

Pursuant to Article 15 of the NRAU Act, such extrajudicial enforcement instruments are the following:

a) The lease agreement together with the respective termination agreement, in case the lease was terminated by agreement of the parties;
b) The lease agreement entered into for non-permanent housing purposes or for a special transitory purpose, in case of expiry of such agreement due to the end of the respective duration;
c) The fixed duration lease agreement together with the registered letter with notice of receipt through which the landlord manifested his opposition to the renewal of the lease (it should be noted that the landlord's opposition to the renewal must, as a rule, be communicated to the tenant with a prior notice of at least one year in relation to the date on which the initial duration of the lease or any of its renewals ends);
d) The undetermined duration lease agreement accompanied by the letters of termination (it should be noted that, in these agreements, the notice of termination by the landlord must be communicated to the tenant with a prior notice of at least five years in relation to the date on which the termination is intended to take effect and has subsequently to be confirmed, under penalty of ineffectiveness, via a second notice to be made within fifteen months to one year prior to the date on which the termination is to become effective);
e) The lease agreement, accompanied by the independent judicial notice or the document evidencing the notice made through personal contact by a lawyer, paralegal or enforcement paralegal, in case the agreement was terminated due to lack of payment of the rent by the tenant for more than three months;
f) The lease agreement, the independent judicial notice or the document evidencing the notice made through personal contact by a lawyer, paralegal or enforcement paralegal and the document issued by the respective public authority, in case the agreement was terminated due to the opposition by the tenant to the carrying out of works ordered by public authority;
g) The document evidencing the landlord's communication for purposes of updating the rent accompanied by the tenant's reply, in case the latter takes the initiative to terminate the lease further to the receipt of the landlord's communication updating the rent as provided for in the transitory provisions of the approved Act.

In any of the situations referred to above, the landlord may immediately resort to enforcement proceedings for delivery of the leased premises, without having to previously go through the declaratory phase of eviction proceedings.

Although the NRAU will allow the landlord to obtain enforcement instruments more easily – in the majority of cases, a document evidencing the independent judicial notification or the notice of receipt will be required for these purposes – the truth is that this regime may originate some uncertainty for the tenants. In fact, the letter terminating the lease is considered to have been received even if it is returned due to the addressee's refusal to accept it or in view of the addressee's failure to collect it within the period set forth in the postal services regulations. Hence, it is possible that, in practice, situations arise in which the agreement terminates and the landlord obtains an extrajudicial enforcement instrument without the tenant having had a true opportunity to react against such termination. We believe that this aspect will create several conflicts between landlords and tenants.

However, the fact that the NRAU foresees an increase in the number of extrajudicial enforcement instruments this does not mean that the tenant will be completely unprotected against a landlord holding such an instrument because, as it is presently the case with the RAU, the NRAU, through the amendments to the Civil Procedure Code, also provides for several situations of suspension of the proceedings and / or of the enforcement measures.

In those cases where the enforcement for delivery of the leased premises is based upon an extrajudicial enforcement instrument, the proceedings will be suspended if the tenant submits an opposition to the enforcement.

If the opposition submitted by the tenant is admitted, the claimant (the landlord) will be liable for the damages wilfully caused to the defendant (the tenant) and will have to pay a fine corresponding to ten percent of the value of the enforcement proceedings, if he has not acted with normal care. This is without prejudice of the possibility of the claimant being also criminally liable. This is meant to impede that landlords take advantage of the facilitated eviction proceedings

in order to achieve the vacancy of the respective leased premises outside the situations where this is legally permitted.

The enforcement will also be suspended if the tenant in the housing lease, subsequently to the termination of the respective lease agreement, applies for the deferment of the vacancy of the leased premises. As a matter of fact, this is one of the most relevant procedural guarantees that the NRAU acknowledges to tenants, permitting that, within the period foreseen for the opposition to the enforcement, they apply for the deferment of the vacancy based on any of the following grounds:

a) That the immediate vacancy of the leased premises would cause the defendant (tenant) a much higher loss than the advantage thereby granted to the claimant (landlord);
b) That, when the cause for termination was failure to pay the rent, this is due to the lack of means of the tenant, there being a presumption that this is the case whenever the tenant is a beneficiary of unemployment subsidy or of social integration income;
c) That the tenant has a disability with a proven degree of incapacity exceeding 60%.

Such deferment, if granted by the Court, cannot exceed 10 months as of the date on which the judgment ordering it was finally rendered.

The approved act furthermore determines that, in case the leased premises are the main residence of the defendant (tenant), the enforcement official must suspend the enforcement measures upon presentation of a medical certificate stating that said measures risks the life of a person residing in the premises, due to serious illness. This medical certificate must indicate, in a justified manner, the period during which the suspension of the measures should be maintained.

It should however be noted that in the situation above-described the enforcement proceedings will only be suspended if the defendant (tenant), within ten days as of the date on which the enforcement official drew up the incident certificate, requests the Judge to confirm the suspension and attaches to the proceedings all available documents justifying that suspension. Pursuant to the future Article 390-B, nr. 5 of the Civil Procedure Code, the enforcement judge will have a period of fifteen days, after hearing the claimant (landlord), to decide whether he maintains the suspension or orders the immediate recommencement of the proceedings.

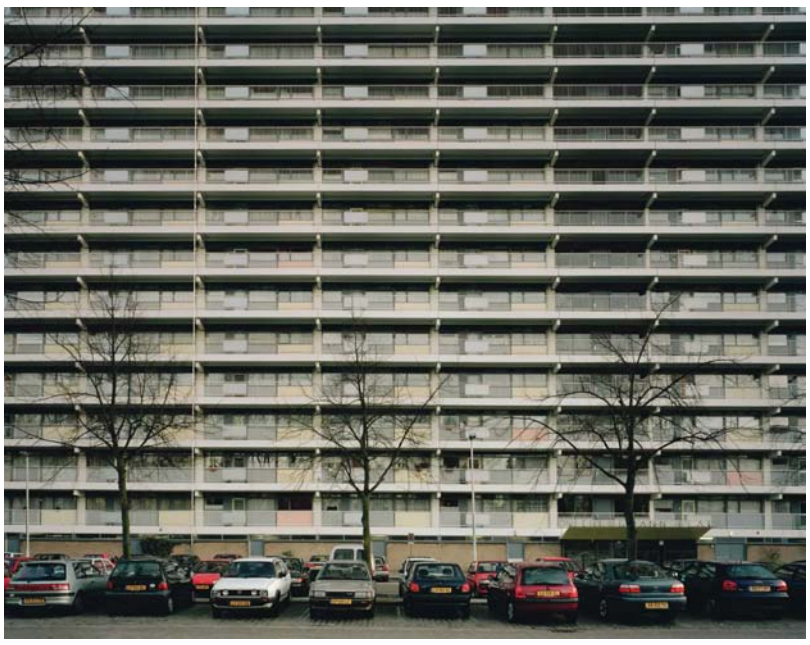
In case the landlord does not have an extrajudicial enforcement instrument, he may continue to resort to eviction proceedings, – which shall continue to adopt the form of a common declaratory process – in order to obtain a judgement that decrees the termination of the lease and orders the eviction.

As occurs under the regime presently in force, a judgement rendered at the end of eviction proceedings can always be the object of an appeal to the Court of Appeals, irrespectively of the value at stake. This appeal has a suspensive effect, the judge having nevertheless the possibility, upon application by the claimant (landlord), to determine that the appeal will not have a suspensive effect when:

a) The appeal is manifestly dilatory; and
b) The landlord gives a bond covering all damages arising out the execution of the eviction in case the latter is revoked.

In light of the above, it is unquestionable that this urban lease reform represents an important advance for the simplification of proceedings destined to obtain the vacancy of the leased premises, lessening the losses that presently arise for landlords from the slowness of eviction proceedings and the excessive guarantees given to tenants.

In spite of such innovations, the procedural rules to be introduced by the new regime can still be criticised, mainly due to the fact that those rules will continue to impose on landlords the charges resulting from certain social duties (of assuring housing) which, due to their own nature, should be assured by the State and not by private individuals. We are thinking for example of the cases of deferment of the vacancy of the leased premises due to illness or lack of means of the tenant. In these cases, notwithstanding the fact that the agreement has already terminated, the landlord is compelled to allow the permanence of the tenant in his property without being subsequently indemnified for having been prevented, for several months, of re-placing that property in the lease market. ▪



Paulo Catrica
Stressmann Flat, Ommord, Roterdão, 07-03-2001
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Transitory Provisions
Who will be the Winner?

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One of the most criticised aspects in the urban lease reform under analysis is the transitory regime determined in Articles 26 to 58 of the approved Act.

These Articles deal mainly with the updating of rents and with the transfer of **housing leases entered into before the entry into force of the RAU** and of **non-housing leases entered into before the entry into force of Decree-Law nr. 257/95, of 30 September 1995**. These are the aspects that we intend to analyse, even if briefly, in this article.

I – Updating of Rents:

In Housing Leases

Pursuant to Articles 30 and 31 of the approved Act, the landlord may update the rent in housing leases entered into prior to the RAU[1], up to a maximum annual amount corresponding to 4% of the "*value of the leased premises*". Article 32 of the approved Act determines that the "*value of the leased premises*" will be that resulting from the multiplication of the value determined further to an evaluation carried out pursuant to the CIMI – this evaluation can not be more than three years old - by a certain maintenance coefficient, which may vary between 1,2 (excellent) to 0,5 (bad)[2].

For example, if the Tax Authorities determine that a certain leased property has a tax value of € 100.000,00, following a tax evaluation made under the terms of the CIMI, and it is in an "Average" maintenance status (which is equivalent to a coefficient of 0,9), the maximum annual amount of the updated rent will be €3.600,00 (that is, € 300,00/month)[3].

In housing leases, the landlord can only update the rent after the leased premises have been evaluated pursuant to the CIMI[4] and provided that the maintenance coefficient is not inferior to 3 (this is, provided the premises are in an "excellent", "good" or "average" maintenance status). This will cause many landlords who want to update the rents to carry out the necessary works so that their properties will have the necessary conditions to be granted one of the above-mentioned maintenance levels.

In this type of leases (housing), the update of the rent may be implemented in a phased form, over a two, five or ten year period:

As a rule, the update will be made over a five year period[5].

However, if the landlord, in the communication sent to the tenant for purposes of the update of rent, invokes and demonstrates (*i*) that the family household of the tenant has an Adjusted Annual Gross Income ("*Rendimento Anual Bruto Corrigido*" - RABC)[6] exceeding fifteen Annual Minimum National Retributions ("*Retribuições Mínimas Nacionais Anuais*" - RMNA) and the tenant, in turn, does not invoke any of the situations that would give rise to the application of the 10 year phased period, or (*ii*) that the tenant does not have his permanent residence in the leased premises, the updating phased period will be reduced to two years[7].

On the other hand, if the tenant, in the reply to the communication for the update of rent sent by the landlord[8], invokes and demonstrates (*i*) that his family household earns a RABC inferior to five RMNA or *(ii)* that he is 65 years old or more or has a disability with a proven degree of incapacity exceeding 60%, the updating of the rent will take place over a ten year period[9].

In the event the update of the rent is to take place over a five or a ten year period, the maximum limit for the update of the rent will be 50,00 euros per month in the first year and 75,00 euros per month in the second to fourth or in the second to ninth years, as the case may be (except if those amounts are inferior to those resulting from the application of the annual updating coefficients published by the National Statistics Institute, in which case the latter will apply).

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[1] The approved Act contains several provisions establishing the terms to be complied with by the landlord's communication, should he wish to update the rent. It is important to note that if the communication does not contain all the references required by the law, it will be ineffective.

[2] The maintenance status of the leased premises is to be determined by an Architect or Engineer, duly registered in the respective professional Association. The criteria to be used in order to determine this maintenance status still lacks regulation. The chart set forth in the approved Act provides for the following maintenance coefficients: "Excellent" – 1,2; "Good" – 1,0; "Average" – 0,9; "Poor" – 0,7; e "Bad" – 0,5; it being in addition possible to apply intermediary coefficients if it is verified that works on the leased [3]premises have been carried out by the landlord and by the tenant.

[3] That is to say, (€ 100.000,00 x 0,9) x 4% = € 3.600,00.

[4] Article 36, nr. 3, of the approved Act determines that the opposition of the tenant to the accomplishment of the acts necessary for the tax evaluation or to the determination of the maintenance coefficient is valid grounds for termination of the lease by the landlord.

[5] Pursuant to Article 40 of the approved Act, between the first and the fourth years, the rent in force at the time of the communication will be increased, in each year, by a fourth of the difference between the amount of that rent (in force on the date of the communication) and the communicated rent. In the fifth year, the rent to be paid will correspond to the maximum rent communicated by the landlord, plus the updated coefficients that, in the meanwhile, were in force. Nr. 2 of that Article sets forth certain maximum limits for the update of the rent, determining that in the first year the rent cannot, in principle, be increased more than €50,00 per month and, in the second to fourth years, more than €75,00 per month.

[6] The rules for determining the RABC will be defined in legislation to be subsequently published.

[7] In the first year, to the rent in force at the time of the landlord's communication will be added half of the difference between that rent and the communicated rent and, in the second year, the rent communicated by the landlord will be applicable, updated pursuant to the updating coefficients that were in the meanwhile in force.

[8] Pursuant to Article 37 of the Act, the tenant's reply must be made within a period of 40 days as from the date of the communication for the update of the rent sent by the landlord.

[9] Further to Article 41 of the Act, between the first and the ninth years, the rent in force at the time of the communication will be increased, in each year, by a ninth of the difference between the amount of that rent (in force on the date of the communication) and the communicated rent. In the tenth year, the rent due will correspond to the maximum rent communicated by the landlord, plus the updated coefficients that, in the meanwhile, were in force. Nr. 2 of that Article establishes certain maximum limits for the update, determining that in the first year the rent cannot, in principle, be increased more than €50,00 per month and, in the second to ninth years, more than €75,00 per month.

[10] In this situation, the tenant will have the possibility to set off the costs of the works with the value of the rents.

It should be noted that, instead of sending a reply to the communication for the update of the rent invoking any of the situations referred to above (which would give rise to the phased update of the rent over a 10 year period), the tenant may opt, within the same period, for serving notice of termination of the lease to the landlord, in which case he must vacate the leased premises within a period of six months, during which the rent can not be updated; alternatively and within the same period the tenant can also make an application to the competent Tax Department for the carrying out of a new evaluation of the leased premises, informing the landlord of this fact.

Finally, we must refer that, if the landlord does not take the initiative to update the rent, the tenant may request the competent Municipal Arbitral Commission to proceed with the determination of the maintenance coefficient of the leased premises. If the maintenance level attributed to the leased premises is inferior to 3 (this is, considered "Poor" or "Bad"), the tenant may require that the landlord performs works at the premises. In this case, if the landlord fails to commence the works, the tenant may: (*i*) carry out the works himself, informing the landlord and the Municipal Arbitral Commission[10] of that fact; (*ii*) request the Municipality to carry out compulsory works; or (*iii*) purchase the leased premises for the value of the evaluation made under the terms of the CIMI, being in that case obliged to carry out the works, under penalty of return of the property to the landlord[11].

This possibility for the tenant to purchase the leased premises for their tax value is one of the aspects of the approved Act that has been most severally criticised. This is easy to understand given that, in our opinion, such rule is contradictory with the constitutional right to property.

In Non-Housing Leases

The procedure for update of the rent as described above will also be applicable, in general terms, to non-housing leases (that is, leases for commerce or industry, for the exercise of a liberal profession or for other non-housing licit purposes) entered into before the entry into force of Decree-Law nr. 257/95, of 30 September 1995[12]. However, contrary to what occurs in the case of housing leases, in leases for non-housing purposes, the update of the rent may be triggered by the landlord irrespectively of the premises' maintenance level/coefficient.

The update of the rent in non-housing leases may be implemented immediately or in a phased form, over a five or ten year period:

In these leases, the update of the rent is also, as a rule, made over a five year period.

However, (*i*) if the tenant maintains the leased premises closed or without a regular activity for more than one year, (*ii*) if after the entry into force of the NRAU, the business installed at the premises is sold or rented; (*iii*) or if, in the event the tenant is a company, there is a transfer of its share capital resulting in a modification of more than 50% of its ownership vis-à-vis the existing situation upon entry into force of the NRAU[13], the landlord will, in principle, be able to proceed to the immediate update of the rent.

On the other hand, (*i*) if there is a business open to the public installed in the leased premises and the tenant is a micro-company[14] or an individual person, (*ii*) if the tenant has purchased the business installed in the leased premises less than 5 years ago, (*iii*) if there is a business open to the public installed in the leased premises and these are located in a recuperation and urbanistic reconversion critical area, or (*iv*) if the business installed in the leased premises has been classified of national or municipal interest, the update of rent will have to take place over a ten year period[15].

The maximum annual update of the rent referred above will also apply to the situations of phased update of the rent in non-housing leases.

II – Transfer of Leases:

Articles 57 and 58 of the approved Act foresee certain rules in respect of the transfer of the leases due to the death of the tenant. When compared with the regime currently in force, these provisions limit the number of situations in which the transfer of the lease may take place, thus frustrating the expectations of many people who, under the RAU, would have the right to the transfer of the lease, a right they will cease to have upon entry into force of the NRAU.

For example, whilst Article 85 of the RAU determines that all descendents living with the original tenant for more than one year are potential assignees of the lease, Article 57 of the legal instrument that will approve the NRAU will restrict the transfer of the lease solely and exclusively: to children or step children less than one year old; to children or step children who have lived with the original tenant for more than one year and are under age; to children or step children who are under 26 years of age and attend the 11th or 12th grade at high school or an intermediary school or university; to children or step children of age who have lived with the original tenant for more than one year and have a disability with a proven degree of incapacity exceeding 60%.

As for non-housing leases, the legislator also intends to put an end to the perpetuity of said agreements and to their transfer from generation to generation.

Therefore, and differently from what is presently provided for in Article 112 of the RAU, pursuant to which the transfer of this type of leases is the rule, further to Article 58 of the approved Act leases for non-housing purposes will terminate with the death of the tenant, except if there is any successor who, for more than three years at the moment of the tenant's death, has been exploiting, jointly with the original tenant, the business installed in the leased premises. ▪

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[11] The right of the tenant to demand that the landlord carries out works and the consequences of the landlord's non-compliance are still to be regulated in a separate legal instrument.
[12] This Decree-Law permitted that this type of leases would be entered into for a limited term.
[13] In the case of companies by shares ("sociedades anónimas") which share capital is represented by bearer shares, it will be extremely difficult for landlords to be aware of this type of assignments.
[14] The approved Act defines micro-company as companies having less than ten employees and which turnover and total balance-sheet do not exceed two million euros each.
[15] It is the tenant that must invoke the verification of any of these circumstances in order to be able to benefit from the more extended updating period.
[16] Although it should be noted that the regime of conditioned rent will apply to some of the leases transferred pursuant to this article (this will occur, notably, in respect of the majority of transfers of leases benefiting descendents over 26 years of age and under 65 years of age). In addition, the RAU also provides for some exceptions to the right to transfer of the lease, as occurs, for example, in those cases where, on the date of the death of the original tenant, the potential assignee had residence in the districts of Lisbon and Porto and its suburbs (if the leased premises were located in any of those districts) or in the respective village, town, etc. in what regards the remaining part of the Country.

Other Legislative Changes

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In addition to the new provisions to be introduced in the Civil Code and to the transitory provisions which have already been addressed elsewhere in this ***NewsLextter,*** the law currently awaiting publication will also insert important changes in other legislation, to which reference has to be made.

This is principally the case of the changes to be made in Decree-Law n. 287/2003, of 12 November 2003, in the Code of Municipal Tax over Real Estate (CIMI) and in the Real Estate Registry Code.

I - Proportionality between the Phased Update of the Rents and the Increase of the IMI:

One of those changes will affect article 17 of Decree-Law n. 287/2003, of 12 November 2003 (the Decree-Law that approved the CIMI and the CIMT)[1].

Pursuant to the new number 2 of this article, once the owner/landlord has triggered the evaluation of the premises (this evaluation being an essential precondition for the update of the rent) the Municipal Real Estate Tax (IMI) will be calculated over the tax value established further to article 38 of the CIMI. If, however, the increase of the rent is made in a phased manner[2], said tax will be calculated over a percentage of the tax value. This percentage will be equal to the percentage of the updated rent currently being paid by the tenant[3].

The legislator's intention is thus that the increase of the tax to be paid is proportional to the increase of the rent resulting from the update foreseen in the new regime's transitory provisions. This will allow avoiding situations in which landlords promoting the evaluation for tax purposes of the premises further to the CIMI would be immediately obliged to pay taxes calculated over the total value arising out of that evaluation while having at the same time to wait several years before starting to receive the complete amount of the updated rent.

Hence, if there is a phased update, for example, made over a five year period, the owner/landlord will only pay tax calculated over the overall tax value of the premises as of the fourth year (i.e. the year in which the tenant will begin to pay the overall amount of the updated rent). If the update of the rent is made over a ten year period, the tax will only be calculated over the overall tax value of the premises as of the ninth year.

In order to ensure this correspondence between the amount of the IMI due and that of the rents perceived the landlord must, within thirty days as of the date in which the tax evaluation becomes definitive[4] or as of the end of the term for the tenant's answer[5], if the latter ends after that date, communicate to the competent tax authority[6] the number of years in which the update of the rent will take place, or the non update of the rent. Failure of the landlord to make such communication will be construed as an option for the phased update over a 5 year period[7].

Number 3 of the above-referred article 17 will also be changed. Pursuant to its new wording, whenever the landlord requires an evaluation of the premises for purposes of updating the rent, and said update is not possible in view of the maintenance status of the premises, the IMI will then be calculated over the total tax value established further to article 38 of the CIMI as of the third year after the evaluation.

The purpose of this alteration is consequently to penalize owners of real estate in a poor maintenance status.

As a matter of fact, and as referred elsewhere in this NewsLextter, in housing leases entered prior to 18 November 1990 the landlord will only be allowed to increase the rent when the maintenance status of the premises is considered "medium", "good" or "excellent". If the maintenance status is "bad" or "poor" the landlord will only be able to augment the rent after the execution of works leading to the improvement of the maintenance status. This impossibility of updating the rent notwithstanding, as of the third year following the evaluation of the premises, the landlord will begin to pay tax calculated over the overall tax value established further to said evaluation.

II - Penalization of Owners of Vacant Property:

The CIMI will also be altered. The most relevant of the alterations introduced therein is, undoubtedly, the introduction of a new number 3 in article 112, further to which the applicable IMI rates for urban real estate will be doubled in case of real estate that has been vacant for more than one year.

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[1] Code of the Municipal Tax over the Transfer of Real Estate.

[2] In housing leases entered into prior to the entry into force of the RAU the update can be made over a 5 year period or, in certain cases to be specified by the new law, over a 10 or a 2 year period. In what regards non housing leases entered into prior to the entry into force of Decree-law n. 257/95, of 30 September 1995, the phased update of the rent may be made over a 5 or 10 year period (in certain cases the update of the rent may even be made immediately).

[3] That is, if in a specific moment - and in virtue of the phased update - the rent being paid corresponds, for example, to 70% of the total amount of the updated rent (which, in principle, will be equivalent to 1/12 of 4% of the value of the premises), the real estate municipal tax will not be calculated over the total tax value established further to the evaluation requested by the owner but only over 70% of that value.

[4] Further to articles 75 and 76 of the CIMI.

[5] To be sent within 40 days as of the landlord's communication for the update of the rent.

[6] This communication will have to be made via a form which model is still to be approved by the Government.

[7] This presumption is without prejudice of the tax administration's powers of inspection and correction and of the application of penalties due to failure of presenting said declaration.

Despite the fact that the tax notion of "vacant property" still needs to be defined, which is set to happen via the publication of autonomous legislation to be approved by the Government within 120 days as of the publication of the NRAU, it is already known that:

i) Said legislation will in principle consider vacant the properties that remain unoccupied during one year;
ii) The inexistence of contracts in force with suppliers of essential public services, or of invoices regarding water, electricity, gas and telecommunications consumptions will be considered as a sign of vacancy;
iii) Premises destined to utilisation by their owner, to temporary leases and to short-term housing at beaches, the country, thermal zones and any other places of villeggiatura, among others, will not be considered vacant.

The legislator's goal with this provision is two folded: on one hand he wants to penalize the owners that do not ensure a social function for their properties; on the other hand, there is an intention to stimulate the increase of the offer of rentable property within the lease market.

III - Registry of the Lease:

The last of the changes regards the insertion of a new number 5 in article 5 of the Real Estate Registry Code, further to which leases with a duration superior to six years will only be opposable to third parties if registered[8].

Pursuant to this provision, which seeks to transfer to the letter of the law an understanding that has long since been sustained by legal authors, if a tenant enters into agreement for a period superior to 6 years and fails to register it at the competent Real Estate Registry, said lease will not be opposable to third parties acquiring the premises[9].

Thus, tenants entering into – or having already entered – leases for periods superior to 6 years should always register said leases; failure to do so will prevent them from successfully opposing the rights arising from them from said leases to third parties. ▪

Further to article 2, n. 1, m) of the Real Estate Registry Code the lease entered for more than six years, its assignment or sublease has to be registered, save in case of rural leases.

Pursuant to article 1057 of the Civil Code, this third party will be vested in the landlord's rights and obligations, the registry rules notwithstanding.

Luís Palma
Boring Postcards #2, S14 Trieste, 2003
Lambda print, 12 x 180 cm
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