



Selling off owner-occupied flats – What should sellers be aware of?



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In a challenging real estate market, developers, investors, and owners of residential rental properties may find it relevant to consider selling off of owner-occupied flats as part their business cases.

However, when selling off owner-occupied flats (in Danish: ejerlejligheder) to private individuals, a seller should be mindful of a number of matters relating to the seller's liability for defects as well as other related obligations.

This article outlines key matters relating to the seller's defects liability and other selected topics, including the possibility of a solvent liquidation of the property company during the defect liability period.

The article does not provide a complete review of all relevant topics relating to the sale of owner-occupied flats, such as handling of VAT-related matters.

Seller's 10-year liability for defects

The seller of real estate is liable for defects for a period of 10 years from the takeover date.

In case of a sale between two commercial parties, it is possible for the seller to exclude liability for physical defects in the sale- and purchase agreement, which is also the starting point in practice.

However, in case of a sale to private individuals, it is not possible for the seller to contract out of the liability for defects, except for the exemption from liability for physical defects under the so-called "house inspection scheme" (in Danish: *Huseftersynsordning*) by presentation of a property condition report (in Danish: *Tilstandsrapport*), and an electrical installation report (in Danish: *Elinstallationsrapport*) as well as a quote for a change-of-ownership insurance (in Danish: *ejerskifteforsikring*).

The house inspection scheme can, in principle, be used when selling off owner-occupied flats, but it is not commonly practiced as it requires a property condition report to be prepared for both the owner-occupied flat and for the building/common areas.

Requirement for building damage insurance

Construction of a new residential building, generally requires for a building damage insurance (in Danish: *Byggeskadeforsikring*) to be taken out under the Danish Building Act (In Danish: *Byggeloven*). The policy is taken out by the developer, and the eligible party under the policy will be the property owner at any time.

Properties constructed for rental purposes are exempt from the insurance requirement. In such cases, a time-limited restrictive easement must be registered on the property requiring for a building damage insurance to be taken out in the event of a sale of any owner-occupied flats in the property within a 10-year period after completion.

Consequently, in the event of a sale within this 10-year period, the seller must be aware of the obligation to take out a building damage insurance, as the insurance shall cover the entire building and not just the specific owner-occupied flats sold off.

Building damage insurance is only required to be taken out in the event of owner-occupied flats being sold off to a new owner for housing purposes. Building damage insurance is not required in the event of owner-occupied flats being sold to a new owner who continues to use the flats for rental purposes.

Handling of the owner's association

As soon as a part of a rental property is sold off as owner-occupied housing, it will have an impact on the value of the remaining portfolio of flats, as the remaining portfolio owner will become a member of a mandatory owners' association (in Danish: *ejerforening*) together with the other/new individual owners in the property.

When dividing a property into owner-occupied flats, the standard articles of association under the Danish Act on condominiums (In Danish: *Ejerlejlighedsloven*) will apply unless other articles have been validly adopted.

Prior to initiating selling off of flats, it is thus important to adopt bespoke articles of association.

One purpose is to set up an association complete with articles of association, budget, etc. that private individual owners will deem common. In cases where the seller may either retain or resell a remaining portfolio of flats to

one purchaser, it is also important to ensure the best possible (but still reasonable) rights for an owner of a remaining portfolio of flats, including in relation to voting rules and any veto rights, election of members of the board, appointment of property administrator, etc.

In addition, for properties constructed within 5 years it will be relevant to regulate the owner association's handling of claims regarding defects in cases where the construction contract and the related contractor's performance guarantee are assigned to the owners' association, as detailed below.

If the owners' association includes more than one building, another consideration may be the division of the common rights and obligations of the association, e.g., by setting up administrative sub-associations for each building to handle maintenance etc. relating to the relevant building.

Possible liquidation of the property company

In cases where all owner-occupied flats have been sold off from a property company without any other activity, it may be relevant to liquidate the property company prior to the expiry of the seller's 10-year defect liability period.

Liquidation of a company requires that all claims from creditors have been paid, and all contingent assets and liabilities have been settled. Any claims must be filed with the liquidator within a proclamation period of 3 months after the registration of the liquidation with the Danish Business Authority.

In that context, it is relevant to consider whether the seller's 10-year defect liability can block the liquidation or trigger a demand for withholding an appropriate amount of the liquidation proceeds.

It is established in legal practice that, unless there are current defect claims from buyers or any other indications that defects will appear in the property later on, a seller's potential defect liability will be deemed so remote and uncertain in nature that it should not be taken into account in the liquidation process.

In the event that defect claims or other circumstances indicating that defects may later appear are raised within the 3-month proclamation period, the liquidation cannot be finalised. Thus, the liquidator will be obligated to withhold an appropriate amount of the liquidation proceeds or ensure any other adequate security for payment.

Assignment of the construction contract

In case of a newly built property, the seller's 10-year defect liability is in contrast to the contractor's defect liability, which is generally limited to 5 years after handover in accordance with the Danish general conditions, ABT18/AB18.

When selling off newly built owner-occupied flats, the seller may have an interest in assigning the construction contract to the owners' association, allowing the association to raise claim for defects, on behalf of the owners, directly against the contractor. However, this will not release the seller from liability for defects towards the buyer.

Particularly where a developer or owner of a newly built property expects to liquidate the property company, it will be relevant, as part of the preparations of sale to ensure that the buyers have adequate alternative security for the remediation of defects. This is typically achieved by way of assignment of the construction contract and the related contractor's performance guarantee.

The general rule under ABT18/AB18 is that the parties are entitled to assign their rights under the construction contract without the consent of the other party, whereas obligations cannot be transferred without consent. As a result, the seller will have the option of assigning the right to raise claims for defects against the contractor, including the rights under the contractor's performance guarantee, unless otherwise agreed.

After handover of the construction works, the remaining obligations of the building owner will typically be limited to the duty to convene 1-year and 5-year inspections. Unless otherwise agreed, the contractor may thus, in theory, oppose the transfer of the duty to convene inspections. However, this is not of much significance, as any failure to call 1-year and/or 5-year inspections will not have an impact on the new assignee's right to raise a claim for defects provided that notice of defects is given within reasonable time after the defects were or ought to have been identified.

When entering into an agreement for the construction of a residential property where selling off of owner-occupied flats may become relevant at some point, it will, first of all, be essential to ensure that the construction contract does not restrict the possibilities for assignment of rights.

Moreover, it will be advisable to incorporate a provision in the construction agreement allowing for the seller/developer to assign both rights and obligations under the construction agreement after hand-over (and possibly after settlement of the contract sum including any withhold amounts). In some cases, it may also be relevant to ensure the right to partially assign the construction contract to the owners' association, including the division of the performance guarantee, e.g., if the seller intends to retain or sell a portfolio of remaining flats.

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