

# Commercial real estate in Sri Lanka: overview

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A Q&A guide to corporate real estate law in Sri Lanka.

The Q&A gives a high level overview of the corporate real estate market; real estate investment structures, including REITs; title; tenure; sale of real estate; seller's liability; due diligence; warranties; real estate tax and mitigation, including VAT and stamp duty/transfer tax; climate change targets; restrictions on foreign ownership; real estate finance; leases; planning law; and proposals for reform.

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## The corporate real estate market

1. What have been the main trends in the real estate market in your jurisdiction over the last 12 months? What have been the most significant deals?

Over the last 12 months, the trend for multi storeyed high-rise apartment complexes/mixed developments has continued in Sri Lanka. Notable developments include Shangri-La, Altair, Astoria and Havelock City.

One of the most significant deals has been the Colombo Port City Development with provisions for commercial and residential businesses on reclaimed land.

## Real estate investment

2. What structures do investors typically use for real estate investment in your jurisdiction and what are the main advantages and disadvantages of each (for example, flexibility and tax transparency)?

Investors typically develop real estate through limited liability companies. The advantage is that the liability of a company is limited to its shareholders' equity. Foreign investors, mainly due to restrictions on foreign ownership of land, develop real estate through joint ventures with landowners (local investors). Typically, these joint ventures

involve a joint venture company/special purpose vehicle in which the foreign investor and the local investor hold shares up to legally permitted percentages in consideration of the equity/debt and land investment that will be made by the parties into the joint venture company.

3. What are the main sources of finance and types of investors for real estate investment in your jurisdiction? Does your government encourage overseas investment into real estate in your jurisdiction, for example through real estate investment legislation?

Typically, the main source of finance is debt/bank finance. Investors with expertise in property development are encouraged to invest in real estate in Sri Lanka. The Board of Investment of Sri Lanka was established to encourage foreign investors into the jurisdiction by offering various concessions in the form of customs duties and expatriate visas based on the quantum of investment to be made by the foreign investors.

### **Restrictions on foreign ownership or occupation**

4. Are there restrictions on foreign ownership or occupation of real estate (including foreign ownership of shares in companies holding real estate)? Are there restrictions on foreign guarantees or security for ownership or occupation and on lending for the purchase of real estate?

There are restrictions on foreign ownership of real estate, but not on foreign occupation of real estate. Foreign ownership of real estate is restricted under the Land (Restrictions on Alienation) Act, No. 38 of 2014 (as amended by Act No. 03 of 2017 and Act No. 21 of 2018) with effect from 1 January 2013, subject to certain exemptions. The Act prohibits transfer of ownership in real estate to a foreign national, foreign company or company incorporated in Sri Lanka with 50% or more foreign shareholding (either direct or indirect). One exemption is that such a transfer of ownership of real estate after 1 April 2018 is permitted to a company listed on the Colombo Stock Exchange.

Under the Land (Restrictions on Alienation) Act, any land transferred or leased to a foreign national, foreign company, or company incorporated in Sri Lanka with 50% or more foreign shareholding (either direct or indirect), cannot be pledged/mortgaged to any bank licensed under the Banking Act of Sri Lanka for five years after the date of the transfer/lease (effective from 29 October 2014). However, this provision is ambiguous since the Land (Restrictions on Alienation) Act prohibits the transfer of land to a foreign national, foreign company or company incorporated in Sri Lanka with 50% or more foreign shareholding (either direct or indirect). Therefore, this restriction only appears to apply in respect of land leased to such persons or entities.

From 1 January 2013, foreign ownership of shares in companies that hold real estate are subject to the same restrictions.

## Title to real estate

5. What constitutes real estate in your jurisdiction? Is land and any buildings on it (owned by the same entity) registered together in the same title, or do they have separate titles set out in different registers?

Real estate includes land, buildings on it, things attached to the earth or permanently fastened to anything attached to the earth, and any interest in or over land. Elements of real estate that relate to one property are registered together in the same title.

6. How is title to real estate evidenced? What is the name of the public register of title and the authorities responsible for managing it? Is electronic access and electronic conveyancing available?

Title to real estate is evidenced through deeds and public registers. The public registers are referred to as land registers and are maintained and managed by land registries located in each district. Electronic access and electronic conveyancing are not currently available.

7. What are the main information and documents registered in the public register of title? Can confidential information or documents be protected from disclosure in the public register of title?

The following information is registered in the public registers of title:

- A brief description of the transaction (transfer, gift, lease or mortgage).
- Particulars of the parties involved in the transaction.
- A brief description of the real estate.
- Particulars of the instrument through which the transaction was effected (deed number, date and notary public).
- Conditions attached to the transaction (if any).

Information in the public registers of title is accessible to the public, therefore confidentiality cannot be maintained.

8. Is there a state guarantee of title? Is the authority that manages the public register liable to pay compensation for any errors it makes in relation to title registration? Is title insurance available and is it commonly used?

There is no state guarantee of title for private land. Land registries that manage public registers are not liable to pay compensation for any errors they make in relation to title registration. Title insurance is available and is commonly used for lands with defective title.

9. How can real estate be held (that is, what types of tenure and other main ownership rights exist over land)?

Real estate can be held with either freehold or leasehold title.

## **Sale of real estate**

### **Preliminary agreements**

10. What types of preliminary agreements are typically used in the sale of real estate? Are they legally binding?

Sale agreements are typically used as preliminary agreements in the sale of real estate. They must comply with certain requirements to be legally binding (that is, offer and acceptance, consideration, intention, certainty, legality, and capacity) and be notarised.

Since sale agreements contain conditions precedent to any sale of real estate, they are commonly used in the early stages of marketing and commercial negotiation of a sale.

### **Sale contract**

11. Briefly outline the typical main provisions of a corporate real estate sale contract and main real estate provisions of a typical share purchase agreement.

The main provisions of a typical corporate real estate sale contract include obligations of the seller and buyer to sell/purchase the land subject to successful completion of the due diligence on the title/ownership to the land by the buyer within a set period of time. The main real estate provisions in a typical share purchase agreement include warranties of title.

### **Due diligence**

12. What real estate due diligence is typically carried out before an acquisition and what key areas does it cover? Which documents are typically reviewed? Which specialist advisers are usually involved and which reports do they typically produce?

Real estate due diligence is typically carried out on the pedigree of the title and planning and building approvals. Depending on the location and nature of the construction, the due diligence will also extend to other governmental approvals/licences (for example, environmental, coast conservation, and tourism). Deeds, plans, other title documents (testamentary proceedings), local authority documents (ownership, street line and building line, conformity, building plans and so on) are also reviewed.

The buyer's legal advisers are usually involved in the due diligence process and produce a due diligence report on their findings and recommendations.

### **Sellers' warranties**

13. What real estate warranties are typically given by a seller to a buyer in the sale of corporate real estate and what areas do they cover? What are the main limitations on warranties, for example are they typically qualified by disclosure?

The typical real estate warranty provided by the seller is to warrant and defend title to the real estate against any third parties. These warranties are not usually qualified by disclosure.

In a share sale, real estate warranties are typically ring-fenced.

## Liability

14. Does a seller have any statutory or other liability to the buyer in a disposal of real estate?

A seller has no statutory or other liability to a buyer to disclose real estate information (including title) in a disposal of real estate, except for any personal liability arising from any warranty provided by it (*see Question 13*).

15. Briefly outline the environmental legislation and potential liability for a buyer in a purchase of real estate. Is it common to carry out environmental surveys and searches and to obtain environmental insurance? How is environmental liability typically dealt with in the sale contract?

The National Environmental Act, No. 47 of 1980 (as amended) provides for environmental impact assessments to be carried out for prescribed large-scale development projects and environmentally sensitive projects.

Certain industries or activities set out in regulations under the National Environmental Act must obtain an environmental protection licence. Any person in contravention of the Act is guilty of an offence and punishable under it.

It is not common to secure environmental insurance. Environmental liability passes to the buyer on sale.

16. Can an owner or occupier inherit liability for other matters relating to the real estate even if they occurred before it bought or occupied it? Can a seller or occupier retain any other liability relating to the real estate after it has disposed of it?

An owner or occupier can inherit liability for matters relating to the real estate even though they occurred before it was bought or occupied. A seller or occupier retains liability to the buyer, buyer's heirs, executors, administrators and assignees, even after the property has been disposed of by the buyer.

## Completion arrangements

17. What are the typical arrangements and main documents required for completion of the sale? When does title transfer and what are the formal legal requirements to execute the sale documents, transfer the real estate and register the change of title? Is notarisation required?

The transfer deed must be executed by the seller in favour of the buyer on receipt of consideration in a way that is satisfactory to the seller. The main documents handed over by the seller at the time of the sale are:

- The original deed(s) through which the present owner acquired title to the real estate.
- The original survey plan(s) depicting the real estate as approved by the local authority.
- Other approvals requested by the buyer under the due diligence carried out by him/her.

Title transfers to the new buyer once the transfer deed is executed by the present owner. Once executed, the transfer deed will be stamped, notarised and registered at the relevant land registry.

## Real estate tax

18. Is stamp duty/transfer tax (or equivalent) payable on the purchase of real estate? Who pays, what are the rates and are there any exemptions? Does it apply to the transfer of shares in a company holding real estate and at what rate?

Stamp duty is payable on the purchase of real estate. It is paid by the buyer on the market value of the real estate at the time of purchase, calculated as follows:

- Where the market value of the property is LKR100,000 or less: LKR3 for every LKR100 or part of it (3%).
- On any balance over LKR100,000: LKR4 on every LKR100 or part of it (4%).

Exemptions are provided in regulations. There is no stamp duty payable on a transfer of shares.

19. Are any methods commonly used to mitigate real estate tax liability on acquisitions of large real estate portfolios? What is the general approach of the tax authorities in your jurisdiction to such schemes?

There are no methods used to mitigate stamp duty on acquisitions of large real estate portfolios, unless certain instruments are completely exempt from stamp duty (for example, state grants).

20. Is value added tax (VAT) (or equivalent) payable on the sale or purchase of real estate? Who pays? What are the rates? Are there any exemptions?

VAT is not payable on the sale or purchase of real estate.

21. Are municipal taxes paid on the occupation of business premises? Are there any exemptions?

Municipal taxes are payable on the occupation of business premises. Certain categories of property are exempt from payment of municipal taxes (such as buildings used for schools, property used for religious purposes, and buildings used by military sentries).

## **Climate change issues**

22. Are there targets or incentives to reduce greenhouse gas emissions from buildings in your jurisdiction? Is there legislation requiring buildings to meet certain minimum energy efficiency criteria?

There are incentives to reduce greenhouse gas emissions from buildings by substituting them with solar power. The Sustainable Energy Authority Act, No. 35 of 2007 provides that the management board of the Sri Lanka Sustainable Energy Authority is responsible for adopting and implementing measures to conserve energy and improve efficiency in the use of energy in all sectors. It also lays down regulations to establish specific energy consumption benchmarks to be complied with by all consumers.

23. Are provisions relating to the energy efficiency of buildings commonly included in contracts for the sale of real estate or in leases (for example, green leases)?

Provisions relating to the energy efficiency of buildings are not commonly included in contracts for the sale of real estate or in leases.

## Real estate finance

### Secured lending involving real estate

24. Briefly outline the typical security package required by lenders in relation to real estate lending. How are the most common forms of security interest relating to real estate created and perfected (that is, made valid and enforceable)?

A typical security package required by lenders includes the creation of a security interest over real estate in the form of a charge or mortgage. Other security interests include mortgages created over rental income, bank accounts, insurance policies, key agreements, and so on. A charge or mortgage is created by executing a mortgage bond, which must be notarised, stamped and registered with the relevant land registry and company registry (if the mortgagor is a company registered with the Department of the Registrar of Companies).

Mortgages are liable to stamp duty at the rate of 0.1% of the amount lent.

25. What other real estate related measures do lenders typically take to protect themselves against default by the borrower?

Lenders may sometimes obtain a power of attorney to act as the borrower's attorney to deal with the real estate in the event of default by the borrower. Recourse against guarantors is a measure adopted by most lending institutions to protect themselves against default by the borrower.

26. Can lenders incur environmental liability? What measures do lenders typically take to manage potential environmental liability?

Lenders cannot incur environmental liability.

27. Briefly outline the main remedies for lenders in relation to the secured real estate if the borrower defaults on the loan. What is the effect of the borrower's insolvency on the lender's remedies?

If the borrower defaults on the loan, the general remedy available is to obtain a court order declaring the mortgaged property to be bound for the money due and ordering a judicial sale of the property. However, under the Recovery of Loans by Banks (Special Provisions) Act, No. 04 of 1990, a licensed commercial bank within the meaning of the Banking Act, No. 30 of 1988, has the power to sell the property without recourse to the court. Based on case law, this remedy is not available against third party mortgagors. Lenders with secured interests over real estate will rank among the secured creditors in the borrower's insolvency proceedings.

28. Briefly outline key additional issues for lenders in relation to construction and development projects.

In certain construction and development projects, real estate is leased to the borrower to carry out development. In these circumstances, they can only create a security interest over their leasehold rights, which may not be a satisfactory form of security for lenders compared to security over freehold rights, where the lender can sell the real estate offered as security to recover the outstanding debt. In addition to real estate, lenders can obtain an assignment of rights under project contracts, which provides protection in the form of step-in-rights.

## **Other real estate financing techniques**

29. Are other real estate finance techniques commonly used in your jurisdiction? For example, real estate securitisation and sale and leasebacks.

Other real estate finance techniques, such as real estate securitisation and sale and leasebacks, are not commonly used in Sri Lanka.

## **Real estate leases**

### **Negotiation and execution of leases**

30. Are contractual lease provisions regulated or freely negotiable? Which legislation applies?

The Rent Act No. 7 of 1972 (as amended) applies to all premises except for business premises situated in certain areas if the annual value of the premises as specified in the rates assessment exceeds certain prescribed amounts, and premises where the landlord is a company registered under the Companies Act 1982. Therefore, most business leases and rents can be freely negotiated.

31. What are the formal legal requirements to execute a lease? Does the lease have to be executed by certain parties or as a deed? How do the formalities differ for a company, partnership and for individuals?

The lessee must ensure at the outset that the lessor has legitimate rights to lease the real estate and that it is free from encumbrances. The contractual terms of the lease must be recorded in an agreement executed by both the lessor and the lessee in the presence of a notary public and two witnesses. Formalities are the same for a company, partnership or individuals. Registration in the public registers is for priority only and is therefore not compulsory to ensure the validity of the lease.

### **Rent payments**

32. How are rent levels usually reviewed and are there restrictions on this? Is stamp duty and VAT (or equivalent) payable on rent? Is a rent security deposit required and does it have to be managed in a certain way?

Rent levels are reviewed according to the contractual terms agreed on and entered into in the lease. Stamp duty is payable at 1% of the total lease rental. VAT is payable on rent if the lessor is registered for VAT. A security deposit is typically retained by the lessor until the termination of the lease. It is generally not interest-bearing and will be refunded after deducting legitimate fees at the end of the lease term, in accordance with the contractual terms agreed on by the parties.

### **Length of term and security of occupation**

33. Is there a typical length of lease term and are there restrictions on it? Do tenants of business premises have security of occupation or rights to renew the lease at the end of the contractual lease term?

The lease term, renewal and security of occupation are subject to the contractual terms agreed on by the parties in the lease agreement. The situation is the same for tenants of business premises.

However, the maximum term of a lease granted to a foreign national, foreign company, or company incorporated in Sri Lanka with 50% or more foreign shareholding (either direct or indirect) is 99 years.

### **Disposal**

34. What restrictions typically apply to the disposal of the lease by the tenant? Can the tenant assign or sublet the lease with the landlord's consent? Can tenants share their premises with companies in the same group? What is the effect of a legal reorganisation or transfer/sale of the tenant on the lease and on a guarantee of the lease?

The tenant may be required to obtain the landlord's consent before disposing of the lease by assignment or sublet. If the lease agreement provides for it, the tenant can assign or sublet the lease without the landlord's consent. Whether the tenants can share their premises with companies in the same group depends on whether the terms of the lease agreement provide for it. In the event of a reorganisation or transfer/sale of the tenant, the new entity assumes the rights and obligations under the lease.

35. Does a landlord or tenant retain any liability under the lease after the lease is assigned?

A landlord or tenant does not retain any liability under the original lease after it has been assigned.

### **Repair and insurance**

36. Who is usually responsible for keeping the leased premises in good repair and for insuring the leased premises? Are there provisions for the ownership of lease improvements?

The lessee is responsible for keeping the leased premises in good repair unless the repairs are structural, in which case the lessor typically undertakes them. The leased premises are insured by the lessor with the exception of movable articles belonging to the lessee, which will be insured by the lessee.

Any improvements forming part of the land (immovable) will endure to the benefit of the lessor. However, compensation for improvements made with the consent of the landlord can be agreed on by the parties. It is also accepted that a lessee who makes necessary improvements can claim compensation from the landlord, whether the improvements were made with or without the landlord's consent.

### **Landlord's remedies and termination**

37. What remedies are available to a landlord for a breach of the lease by the tenant? On what grounds can the landlord usually terminate the lease and what restrictions and procedures apply? What is the effect of the tenant's insolvency under general contract terms and insolvency legislation?

Damages are available to a landlord for breach of the lease by the tenant by instituting court proceedings. Typically, the landlord can terminate the lease for non-payment of rent by the tenant or for material breach of condition. The lease will form part of the insolvency estate of the tenant.

38. Can the tenant withhold rent payments in certain circumstances, for example for serious damage to the leased premises? Can the tenant terminate the lease in certain circumstances?

Certain agreements provide for a reduction in the rent, or withholding of rent payments, in the event of serious damage to the leased premises caused by a force majeure event. Once an agreement is signed by parties, they are generally bound by the terms and conditions contained in it, including its termination provisions.

## Planning and development controls

39. In what circumstances can local or state authorities purchase business premises compulsorily? Is the purchase price market value?

Under the Revival of Underperforming Enterprises and Underutilised Assets Act, No. 43 of 2011, shares of certain identified enterprises and assets were acquired by the state. However, it has been proposed that this legislation be repealed. The state can also, on behalf of any state authority or local authority, acquire real estate for public purposes under the Land Acquisition Act, No. 9 of 1950 (as amended). In this instance, compensation is paid based on the market value as determined by the government agent.

40. What authorities regulate planning control and which legislation applies? Is there specific protection for special categories of buildings such as historic buildings?

Planning control is regulated by the relevant local authority and, in areas declared as urban development areas, by the Urban Development Authority of Sri Lanka (UDA). Planning regulations are issued by the relevant local authority or the UDA. The City of Colombo Development Plan 2008 was published by the UDA to regulate construction within Colombo's city limits.

There are specific protections for special categories of historic buildings provided in the Antiquities Ordinance No. 9 of 1940 (as amended). The regulatory body is the Department of Archaeology.

41. What planning consents are required for building works and the use of a building?

A development permit must be obtained from the local authority/UDA for building works and a certificate of conformity must be obtained for use and occupation of the building.

42. What are the main authorisation and consultation procedures in relation to planning consents?

Planning consents include approval of survey plans (including condominium plans), building plans and issuance of development permits.

### **Initial consents**

Planning consent is granted by the local/provincial authority or the UDA based on the location and the nature of the development. The initial decision time will vary based on each application.

### **Third party rights and appeals**

The applicant has a right to appeal a refusal to issue a preliminary planning clearance to the Minister of Megapolis and Western Development within 30 days of the decision.

### **Reform**

43. Are there proposals to reform real estate law and are they likely to come into force and, if so, when?

The Land (Restrictions on Alienation) (Amendment) Act, No. 21 of 2018 has removed restrictions on foreign nationals owning apartments below the fourth floor of a building.

### **Contributor profile**

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