

# Real Estate in Brazil: Tenancy and Culture

Prepared

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2007

## INTRODUCTION

This paper provides:

- an overview of the practices, law and culture surrounding real estate,
- a commentary on typical building and local infrastructure,
- an introduction to some business issues that may be encountered in Brazil.

When discussing commercial real estate in Brazil it is natural to focus attention on São Paulo, and secondly on Rio, since these are by far the largest markets. Greater São Paulo, with approximately 18 million inhabitants, answers for approximately 20% of Brazil's GNP and therefore has the largest real estate market. São Paulo's office stock is approximately 9.2 million square meters (99M sqft), whereas Rio's is approximately 5 million square meters. This said, it should be borne in mind that Brazil is a large country with varying cultures and business practices.

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## Occupying Property

### 1.1. Typical Building Characteristics and Quality of Stock

#### ***Building Classification***

Most international real estate firms in Brazil adopt some form of classification of buildings and sub-market definition. There is no single form of classification.

Ocupantes adopts the following criteria: a Class A buildings will be one delivered after 1985, with floor plates of over 700 m<sup>2</sup> leasable, central air-conditioning and high standard of specifications.

#### ***Quality of Stock***

Historically the real estate market in Brazil was landlord-favorable (one of the main reasons for legislation having weighed towards the tenant). Tenants normally had little choice and little say in terms of quality of space, and were normally expected to adapt a property to their needs. Additionally, developers were unconcerned about the final users of property so long as they were able to find sufficient equity investors or owner-occupiers to fund development (selling off-the-plan). Central air-conditioning, for example, only became a “must” as of the 1980s. Only in the late 90s, especially after the wave of privatizations and the entry of the technology and telecom companies, was there a clear sign of a tenant’s market, and developers began to compete to provide high quality space.

- São Paulo Class A stock: 1.4M m<sup>2</sup> approx.
- São Paulo Class B & C stock: 7.8M m<sup>2</sup> approx.

Large corporations normally occupy Class A offices. The following are typical characteristics of a Class A building in São Paulo, the main office market:

#### ***Specifications –Class A buildings***

- Design, Image and Layout

Most Class A buildings are designed by well-known and experienced architects, sometimes in conjunction with foreign architectural firms. They are designed to offer efficient use of space.

The buildings are designed to offer a good corporate image, including presence and visibility.

- Signage: not all buildings permit the installation of façade-top signage, limiting signage to a totem at the front of the building and a name-board in the reception. Recent legislation restricts external signage.

Entrance lobbies are often large, with double or even triple ceiling-height, or with atriums. Marble finishings are common, as are wood and granite.

- Elevators

Class A buildings will normally have spacious, well illuminated, good quality elevators, offered in sufficient numbers to attend standard office populations.

Thyssen-Sur and Atlas-Schindler are the main suppliers, present in the market for many years and holding above 90% of the market.

The majority of new Class A buildings offer Traction Elevators with VVVF (Variable Voltage Variable Frequency) drives providing smoother departures and stops. Only a handful of buildings offer the Miconic type elevators. Elevators will be equipped with CCTV. Traffic control will be located in the administration room.

- Air-conditioning types (note: there is no central heating)

All Class A buildings offer central air conditioning, although quality will vary. Most systems comprise typical rooftop cooling towers and compressors that supply cold water to each floor; each floor will have one or several fan-coils that will blow cold air through ceiling ducts. A typical floor designed to be divisible into four suites will have four fan-coil machines.

Most modern buildings have VAV systems (Variable Air Volume), which can provide numerous zones of comfort, as opposed to Constant Volume systems. VAV systems control room temperature by varying the amount of cold air delivered to a particular space.

What differs from building to building will be the number of zones, i.e. the number of volume controls on one floor; for dense layouts this will be an important issue.

Thermo-accumulation systems are only a few in the market. Systems that allow for under-floor distribution, or duct-less ceiling systems, are rare.

- Air-conditioning for data rooms

Some newer buildings offer a small separate cooling tower that will supply refrigerated water to autonomous units for data-rooms on a 24hr basis. Often the system will kick-in when the main system is switched off in the evening. This reduces the cost of extra-hour air conditioning.

- Ceilings

Ceiling heights in Class A buildings, with few exceptions, are normally greater than 2.70 m (8.8 ft), measured from raised-floor to lowered ceiling.

Ceilings are typically of lowered acoustic panels, with inset-fluorescent lighting. Several types are used, following a modulation of 0.625m x 1.25m.

- Raised flooring

The majority of Class A buildings offer raised flooring, except for a few older buildings where wide floor-channels are provided at a spacing of 2 m or 2.5 m. Raised flooring allows for ease in layout changes.

The raising may vary from 8 cm to 20 cm, although 15 cm is common.

- Service shafts

Modern buildings will offer good shaft-space for passing of cabling.

- Telecom

With a couple of exceptions, the occupier may choose the preferred telecom operator. Most will have VoIP capabilities.

Most buildings have access available to more than one optic fiber ring. Rooftop space may be available to lease for satellite and radio communication on a first-come first-served basis.

Cabling is installed by the occupier according to his needs, drawn from a distribution board normally located on the ground floor or basement.

- Power Supply Availability

Typical supply availability is of 23W – 25 W per m<sup>2</sup>. Distribution boards are installed in each suite.

- Generators

In 2001 Brazil suffered a major electricity blackout; since then buildings have allowed space for installing private generators or the use of one parking spot.

Only a couple of buildings on the market offer sufficient generator power to cover all private areas – most buildings only have generator power sufficient to cover common-area emergency needs. In these cases the occupier may install a generator (if permitted by the building). No-breaks are tenant's responsibility.

Generators are fueled either by diesel or by piped gas.

- Helipad

Many Class A buildings in São Paulo offer helipads, since the city has one of the heaviest helicopter fleets in the world. Prior to use, it must be ensured that the helipad is properly licensed to function.

- Parking

Class A buildings would be expected to offer together with the leased space a parking ratio between 1 space per 35m<sup>2</sup> to 1 space to every 40m<sup>2</sup>. For example, an office space of 3,000 m<sup>2</sup> in a multi-tenanted building may offer 100 parking spaces with the lease.

Outsourcing of the operation of the parking is usual, and it may be possible to negotiate additional parking spaces with the operator, on a monthly lease, depending on the availability. For this reason, new buildings are designed with an excess of spaces, and operators also count on a degree of usual vacancy.

The offer of parking to employees varies from company to company. If needed, additional parking is secured in nearby parking lots, often uncovered.

Visitors may use the parking area, upon an hourly rate. Many companies pay for visitor parking.

- Emergency Facilities

All Class A buildings meet high standards of fire-protection, that include emergency stairs (pressurized and/or with ante-chambers), hydrants, extinguishers, smoke detectors (not always) and sprinklers.

Fire drills occur every 6 months.

- Security Provisions

Security provisions in practically all buildings include:

- Access control (obligatory identification and turn-styles in the reception)
- CCTV
- Security guards, 24 hour presence in Class A buildings.

- Building Amenities and Support Facilities

There is no particular standard as to the additional facilities and services provided to occupiers. These can include from none to all of the following:

- ATM
- Restaurants and/or café
- Auditorium and/or meeting rooms (sometimes in an adjoining hotel)
- Gym

- Building Management

Class A buildings will have a centralized building management system and control room, from where the functioning of the building can be monitored, such as electricity consumption and

Class A buildings are expected to contract the services of recognized high standard building managers.

## 1.2. Local infrastructure, facilities and amenities

With a few exceptions, Class A buildings will be located in an area which will offer the following:

Parking – covered and uncovered, varying in supply and cost depending on location

Restaurants – good choice of cuisine, standard and cost

Banks – Brazilians normally bank with one of the few major Brazilian banks, most of which are likely to have a branch within a reasonable distance.

Hotels – proximity of hotels will depend on the office sub-market, but all office sub-markets will be within a reasonable driving distance from good hotels, of all standards. The south zone of São Paulo has, for example, a Hilton and a Hyatt.

Airports – São Paulo has two airports. Brazil's main international airport, Cumbica, is located in the suburb of Guarulhos; depending on the time of day and weather, it can take from 45 minutes up to 2 hours to reach. The busy in-town airport of Congonhas is easily accessible; local flights to Rio and many other Brazilian cities are available.

Buses – São Paulo has an extensive and busy low-cost bus network, attending a high proportion of the population. It suffers from lack of quality and over-crowding.

Metro – The São Paulo and Rio metros are limited in coverage, and do not reach many office locations.

## 1.3. Floor measurements for office rent negotiations

Brazilian leases (rent always established in local currency, the Real – R\$) establish the full amount of the monthly rent; the actual negotiations of top quality space with professional and institutional landlords is mostly undertaken on a per square meter basis, according to the leasable area of the property.

### **Leasable Area**

There are various floor measurements that could be adopted as the leasable/rentable area. The more developed markets in Brazil, and top quality offices in prime locations, adopt the *Private Area* (see definitions below). Some markets adopt *Gross Built Area*, for example parts of downtown São

Paulo and Rio, and many other smaller markets, as well as industrial leases. Since both Private and Gross area ignore floor-plate inefficiencies, it is recommended that, whenever possible, the “usable” or “carpet” areas be measured.

Whole office buildings are treated on a case-by-case basis, and leasable area may include lobbies and halls.

### **Measurement Norms**

Official measurement norms exist, and define “Private” and “Gross” areas, as well as others relevant to the building process and for calculating compliance to zoning laws. Brazilians find comfort in adopting anything “official”, therefore most markets will adopt Private or Gross area as the basis for rent calculation. Private Area is calculated by engineers during the planning stage, and the schedule of areas is required for registering buildings in the official Property Registries, and for defining Common Area Expense sharing. The engineer follows norms established by the Brazilian Association of Technical Norms; the full provisions of the norms are too detailed to be presented here.

### **Private Area**

Measurement of Private Area is established by official norm. Private area includes some wall thicknesses, columns, shafts, equipment rooms and others. It includes open terraces that are private to a particular floor. It is always larger than usable area and smaller than gross. It is smaller than BOMA, and does *not* include any share of the building’s common areas, such as common elevator lobbies and entrance halls. In some older low standard buildings it may be necessary to ensure that the quoted Private Area does not include parking.

Private Area is the most widely used basis for rent negotiations in major markets, however it is important to be aware of floor efficiencies when negotiating new space.

### **Usable Area**

The concept of “usable” area (*área útil*) was introduced to the office market in the 1970s by the first international real estate consulting firms, and is based on the English “Net Usable Area”. Usable area is measured from the inside of the walls and columns, and includes toilets, deposits and kitchenettes, but excludes shafts and other technical space and plant-rooms. Inexperienced professionals and landlords often confuse the terms Usable area and Private area.

### **Carpet Area**

Carpet Area, as the name suggests, is the space effectively used by offices, and excludes toilets and kitchenettes located in the building’s core.

### **Conversions**

Measurements in Brazil are in square meters (m<sup>2</sup>). One square meter is approximately 10.76 square feet.

## 1.4. Occupational Standards

### **Space Use**

*Ocupantes* has generally found that space use is less generous in Brazil than in the US. For many businesses in Brazil it is possible to adopt a general rule-of-thumb of 10 m<sup>2</sup> per person, already allowing for corridors and minimum meeting rooms. Naturally, depending on the company, this may vary considerably. A service company that receives many clients or conducts many interviews, or that has many training events, may require above average meeting space. A small office with a high ratio of front-office personnel to back-office may also need more area.

It is our experience that space use of above 20 m<sup>2</sup> per person is generous for the local market. Common excesses occur with: break-rooms, wide corridors, inefficient use of meeting rooms and training rooms, large offices for upper management.

### **Furniture**

There is a big range of local and international suppliers of good quality furniture with a large share of the market. The international suppliers work through local representatives. Main examples are:

- Local Suppliers – Giroflex, Voko, Escriba, Bortolini and Securit
- International with local presence: L'Atelier, Teperman
- Typically imported – Hayworth, Steelcase, Teperman, Knoll

Standard 90° workstation modulations are:

- 1.20m x 1.20m; 1.20m x 1.40m; 1.20m x 1.60m
- 1.40m x 1.20m; 1.40 m x 1.40; 1.40 m x 1.60m
- 1.60m x 1.60m
- Most common: 1.40 m x 1.60m

Partitions may have laminate finishes, textured laminates, plastic or cloth, as well as glass, with heights of 1.00m, 1.30m or 1.60m.

### **Project Management**

*Ocupantes* believes that there are several advantages in the use of a professional project manager, a practice not yet common in Brazil. The tradition in Brazil is for companies to hire the services of an architect, and leave in the hands of the architect the project, purchases and choice of contractor. Costs of this approach may appear initially low, but since it is traditional for an Architect to obtain part of his fee from suppliers, the end cost may be high. There are a number of Architects now beginning to operate as independent Project Managers or who at least offer an independent approach. By using a Project Manager there is greater control over costs, as well as an independent person responsible for quality. Advantages of a Project manager are:

- Single point of contact

- Independence from suppliers
- Independence from contractors
- Independence from designers / architects
- Quality and time control

*Ocupantes* provides project management service.

## 1.5. Costs: Real Estate, Operational and Build-out

Rent in Brazil is traditionally Triple Net, i.e. the rent paid does not cover any other costs, which are paid separately by the Tenant.

The following costs may be encountered, depending on the property:

### **Monthly fixed**

- Common Area Maintenance (CAM – commonly called “condominium” in Brazil) will occur in all multi-tenanted buildings, and will vary depending on the quality of the building from R\$7 per sqm to R\$20. A good standard multi-tenanted building in São Paulo is likely to have a condominium cost R\$10 and R\$15. The building manager levies the charge. The proportion of CAM is pre-established and cannot be negotiated.
- Other common charges – some building charge separately for some items, and the tenant must be alert to these situations.
- Property Tax – varies considerably depending on location and quality of property, from R\$2 per sqm to R\$ 4 per sqm. Property tax is paid in 10 installments, normally from February to November, inclusive, directly to the tax authority.
- Additional car-parking – depending on the tenant’s requirement, the lease may not provide sufficient spaces, or none at all (such as in most downtown buildings). In this case, where parking is available, cost can vary considerably from between R\$50 per space to R\$250, depending on location.

### **Yearly costs**

- Lease guarantee costs. Sometimes a landlord may waive the need for a guarantee if the tenant is a long-time tenant. There are various forms of lease guarantee, and there is no fast rule as to what a landlord might expect. This said, a bank-letter-of-credit or rent insurance tend to be the preferred alternative. The cost of a bank credit will be in the order of 5% to 15% of yearly expenses (i.e. rent, CAM, tax), and may depend on the Tenant’s relationship with the issuing bank.
- Rent insurance 0.75 to 1 month’s rent (will depend if lessee can prove if their monthly revenue is 10x real estate costs).
- Insurance – in Brazil the Tenant pays for building insurance related to the leased are, unless otherwise stated (rare). The cost of insurance depends on the replacement cost of the building. As a rough estimate adopt 0.5% of 100x month’s rent.

### ***Ad-hoc and one-off expenses***

- HVAC – In most condominiums HVAC systems function from 7am to 7pm. The use of additional HVAC is costly, since there is one set of cooling towers for the whole building. This cost can vary from R\$50 to R\$150 per hour. Note: heating is not provided in Brazil.
- Auditoriums – some buildings provide auditoriums, the use of which must be booked in advance and paid to the operator or administrators.
- Cost of shuttle service – operations distant from public transport and that have a large number of employees may provide a van service. This is not obligatory.
- Lease registration – for a lease to be enforceable to a new landlord it must be registered in the Property Registry. The cost is a percentage of total contract value.

### ***Tenant day-to-day expenses***

- Normally the tenant's electricity will be separately metered; the tenant will pay directly to the concessionaire.
- In condominiums, the cost of water is shared, and often this cost is included in the CAM.
- Tenants are responsible for the cleaning of all their private areas.
- Internal non-structural repairs are the tenant's responsibility.

### ***Capital Expenses***

- Tenant improvements – in Brazil it is very rare for landlords to pay for a tenant's fit-out. Normally a rent-free is offered, unless when the market is landlord favorable. The cost of tenant improvements varies considerably depending on standard sought and on how the property is delivered. The following is a broad view:
  - R\$500 per sqm for simple fit-out and no furniture
  - R\$1000 per sqm for an average standard fit-out and partial re-use of furniture
  - R\$2000 per sqm for high quality fit-out and new, high-quality furniture.
  - For the purpose of initial estimates for the installation of new offices, an estimate of R\$1500 is considered realistic. This amount includes a normal and reasonable amount of work to the property, new furniture, standard cabling, carpeting, and adaptations to air-conditioning ducting. It does not include the cost of a generator, raised flooring, lighting or suspended ceilings, neither additional air-conditioning equipment
- Space is often although not always delivered ready to receive carpeting and furniture, i.e. with suspended ceilings, lighting and air-conditioning ducts. Depending on layout, additional lighting may need to be provided. Raised flooring will be delivered only in the most prime buildings.
- Generator – if a tenant requires its own generator, not all buildings permit the use. Some buildings allow the use of one of the leased parking spaces, while others may have a dedicated space. The tenant must bear the cost of installation.
- Restoration of space – practically all leases require a tenant to return the space back in the same condition as delivered. This normally means that the tenant should remove all

partitions, replace/fix damaged ceiling tiles, re-paint walls and fix blinds. This cost will depend on the extent of the tenant's fit-out and can be between R\$150 and R\$250 per sqm.

## 2. Market practices and brokerage fees

### 2.1. Negotiation Etiquette

The larger cities in Brazil are very cosmopolitan and well developed, with advanced business practices. Business negotiations can therefore often be conducted as in any other large western environment. In real estate there can be exceptions where a landlord is not a professional landlord. For many such landlords, their property ownership is a matter of pride, and they can be quick to take offence.

Meetings often start late, but expectations for timeliness are becoming stricter. It is suggested to arrive on time, but expect to wait. 15-minute tardiness is common.

Small talk prior to negotiations is normal and expected, but not lengthy. In the negotiation itself one should not rush. Negotiation can be interrupted with asides. The other party will expect gentlemanly and humble treatment and will give it in return – establishing a good friendly relationship is essential. With some people you can expect interruptions such as the answering of a phone call, but avoid doing the same. Brazilians are good at reaching gentlemanly agreements, since legal recourse is slow and costly.

### 2.2. Timing in Negotiations

In Brazil, as with most countries, there is no fast rule as to the length of commercial and contractual negotiations. Generally, negotiations are influenced more by internal decision-making processes of the occupier than by those of the owner. The following times are indicative but not necessarily accurate in all cases, since much will depend on particularities of each deal:

#### ***Commercial negotiations:***

- 3 to 8 weeks

#### ***Contractual negotiations between lawyers:***

- a further 3 to 8 weeks – it is highly recommended that international firms delegate all legal reviews to local lawyers who are experienced in preparing leases in Brazil. The size of the document is alone a major difference between Brazilian leases and leases prepared under Anglican law. Since most relationships between parties are ruled by legislation, contracts, in particular lease documents, tend to be short in Brazil, sometimes only 5

pages. One major source of delay is therefore encountered when international lawyers raise questions regarding issues that are covered by legislation.

**Build-out:**

- Large office space of over 2,000 m<sup>2</sup> can take 3 months to fit out. This is the recommended minimum time to assume.

**Licenses:**

- *License for small works:* This should not be required when only light-weight partitions are to be installed; assume 30 days after Letter of Intent or Lease agreement is signed. Strictly speaking the license must be in hand prior to initiating works, however many firms initiate once the formal license request has been made.
- *License to Function:* in order to obtain the License to function, tenant must have the following property-related documents: Fire Brigade Certificate, City Council Approved Building Design work and the Building's Certificate of Occupation. There are other business documents that need to be presented by the tenant that are not related to Real Estate. The License to Function will typically take 30 to 45 days after all the documentation is presented, and strictly speaking operations should not begin prior to obtaining the license. Lawyers and accountants should be consulted as to the best procedure and as to the possibility of requesting the license prior to the end of fit-out works.

## 2.3. Brokerage Fees

Every country has its nuances and differences in brokerage practices, and Brazil is no exception. In fact, as a developing market, still with many market peaks and troughs, practices are constantly changing, and therefore in many cases there is no hard and fast rule relating to fees.

It can be clearly identified that there are two types of service providers:

- traditional “brokers” / real estate agents (*corretores*) acting merely as intermediaries and introducing agents
- consulting-oriented brokers, introduced to the Brazilian market by international real estate firms

Ocupantes has introduced a third type, by being the first firm dedicated solely to the interests of corporate occupiers.

It is clearly established by law that a landlord is to pay a fee (unless expressly agreed otherwise), and a broker may go to court if a fee is not properly paid. It is therefore highly recommended that all activities relating to the search of real estate be centralized, in order that not more than one broker is being spoken to. If two brokers approach one landlord, complications may arise.

The fee is payable upon lease signature<sup>1</sup>, and often the tenant is expected to pay the first rent in advance in order that the landlord can pay the fee.

Historically in Brazil, the traditional brokers have adopted a fee of 1 month's rent for a new lease. The level of service offered is not high – the broker acts merely as an introducing agent, joining the parties together. His allegiance is mainly to the deal, although, since his interest is to receive the highest possible fee, his loyalty lies more with the landlords. Such brokers do not get involved in rent-reviews or lease renewals, since, in the past, landlords and tenants were left to negotiate between themselves.

Consulting-oriented brokers, such as Ocupantes and other international firms provide a higher level of service, with detailed reporting, market analyses, financial analyses, etc. It is therefore common for fees to be higher than 1 month, sometimes as much as 2. Alternative forms of remuneration can be agreed with them, including deducing commissions that may be made available by the landlord.

### ***Tenant Representation***

In the past the Brazilian market had no concept that the broker could be a consultant acting for one of the parts. In fact this view remains today in many markets and with many Brazilians who see themselves as savvy negotiators. With more and more presence of international firms, the concept of Tenant Representation is evolving.

Care must be taken that this “evolution” does not bring with it too great a financial impact, neither conflicts of interest. The fee that a landlord must pay to the broker is, after all, somehow paid for by the tenant within the overall cost of the transaction; therefore if the tenant is to pay another full fee to a Tenant Representative, costs are being raised.

Ocupantes, always acting for the tenant, will seek to reduce the Tenant's burden by obtaining all or part of the fee from the landlord. The Tenant need only complement the fee to 1.5 months rent. If another broker is involved from the landlord's side, Ocupantes will claim half of the landlord's fee (normally half a months rent), and seek a complementation from the Tenant to the agreed fee. In this way the total fees of the transaction do not pass 2 months rent, and in many cases, where Ocupantes is dealing directly with the landlord, the total fees will be 1.5 month rent.

### ***Conflict of Interest***

Ocupantes' main approach to eliminate conflict of interest in Brazil has been to act solely for end-users / corporations. We do not act on behalf of institutional or professional landlords. Additionally, we believe that transparency with the client is crucial, as well as a long term relationship. As such, in order that the amount of fee obtained from the landlord is clear, it is established in writing in the early stages of the transaction, normally included on the first proposal to the landlord.

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<sup>1</sup> In case of a sale, fee is payable upon the signing of the sale contract (not upon deed transfer and registration).

### ***Alternative fee approaches***

Ocupantes is happy to analyze alternative approaches to the fee that include performance incentives. Such fee approaches are adopted by the international firms in Brazil, especially in rent review and lease renewal transactions.

## **3. Business issues**

There are numerous and complex business issues that can only be fully covered upon consultation with HR consultants, business consultants and tax experts. Below we present only a few common issues faced by businesses.

It must be noted that the cost of all benefits and social costs to an employee almost *doubles* the cost of a salary.

### **3.1. Social costs and Benefits**

#### ***Social Security***

11% of gross salary paid by employee (based on a maximum salary of R\$2,668.15) and 26.8% paid by employer (unlimited).

#### ***Income Tax***

27.5% of gross salary for salaries above R\$2,668.15. Below this it grows from 0% to 17.5%.

#### ***Dismissal Fund***

8% of gross monthly salary paid by the employer. In the event of dismissal without just cause, the employee may draw on the fund. The employer must also pay a fine of 50% of the fund (10% to the government and 40% to employee).

#### ***13<sup>th</sup> Salary***

At the end of every completed year employees have the right to a 13<sup>th</sup> salary, payable in December.

#### ***Holiday Bonus***

Employees are entitled to 30 days every completed year. In addition, they will receive a bonus of one-third of a month's salary.

#### ***Meal Tickets***

Not obligatory, but common way of subsidizing meals; the employer may deduct from income tax.

### ***Transport tickets***

A legal right of all employees. The employer may discount up to 6% of salary, therefore high earners do not exercise their right.

## **3.2. Taxes**

Brazil has a very complex tax structure, a subject that can only be superficially covered in this paper. While it is common to hire the services of tax experts, the understanding of the tax structure is a requirement of most in-house accountants and, to some degree, in-house lawyers. The time required dealing with tax issues and the added bureaucracy will impact headcount.

Brazil adopts traditional mechanisms for income tax and capital gains tax, but has another plethora of taxes that are hidden in the cost of products or charged on revenue, or even on the mere movement of funds.

Some taxes or part of them are paid at source, others not.

Depending on the business, different taxes rates may apply, as well as different revenue taxes.

- Property tax

There are two types of property tax, the ITR, for rural properties, and the IPTU – tax upon urban property, levied by each municipality. The IPTU has risen considerably over the last 4 years. It is normally payable in 10 installments or as one lump sum, averaging between R\$2 and R\$4 per square meter per month for offices in São Paulo.

There is also a transfer tax / stamp duty for properties sales, ranging from 2% to 5% depending on the city.

- The main business Value Added Taxes are:

IPI (Tax on Industrialized Products) – A federal tax; rates vary according to product. Being a VAT type tax, tax credits can be offset against future tax debts and even against other federal taxes.

ICMS (Tax on the Circulation of Materials and Services – a sales tax) – The main state tax; each state defines different measures and sets its *intrastate* rates depending on their needs for goods and services. These rates are 17% or 18% for most products, between 7% and 12% for essential products and 25% for non-essentials. The *interstate* rate is 12% in southeast Brazil. Being a VAT type tax, tax credits can be offset against future ICMS tax debts.

- The main non-VAT business revenue taxes are:

ISS (Tax on Services) – This is municipal tax. Each city produces its list of services and their respective tax levels. The maximum rate is 5%, the minimum 2%. There has been some confusion as to where the tax is collected: at the place the service is rendered or where the service provider is located. In São Paulo the general rate is 5%, and surrounding municipalities are adopting 2% to try to attract businesses. (ISS is paid on the gross revenue of the service, therefore, for example, if a fee of R\$100 is net of 5% ISS tax, the invoice is grossed up to R\$ 105.26, not R\$105).

PIS (Social Integration Tax) – this is a complicated tax with different forms of calculation; a part of it can be treated in a VAT manner. It can vary from 0.65% to 1.65%.

COFINS (Social Contribution Tax) – assessed on monthly gross revenues at a rate of 3% but recent rules have complicated the measure and in some cases may be 7.6%, parts of which are deductible from future debits.

Since these taxes are non-VAT type, sub-contracting of services can generate a double-taxation cost.

### 3.3. Regulatory Agencies

Companies producing pharmaceuticals, cosmetics and healthcare products must register with ANVISA. ANVISA monitors and may interfere in many issues relating to the industry, such as quality, advertising, border control, patents, price control etc. The procedure for registration is not yet properly regulated by law, no doubt an issue that all the industry has to work around.

## 4. Legal Issues

### 4.1. Landlord and Tenant Legal Overview

#### **General**

Brazilian Law, as with most Latin countries, has its routes in Roman and Napoleonic law, as opposed to Germanic law or the Anglican “Common Law”. The main difference resulting from this is that in Brazil it is attempted to have law written down by way of legislation rather than by the evolution of precedence, as occurs with Common Law. A disadvantage of the system is the lack of flexibility to allow for situations outside the written guidelines; an advantage is that many issues need not even be questioned, since the rules are already pre-established.

Since most relationships between parties are ruled by statute, contracts, in particular leases tend to be short. This is a major difference between Brazilian and American and English contracts. One major source of delay is therefore encountered when international lawyers raise questions regarding issues that are covered by local legislation. It is highly *recommended* that tenants and

purchasers of real estate defer to the advice of *local* lawyers, and where necessary tax experts. Legal review by a centralized legal team becomes unnecessary, and may even be resented by the other party.

Brazil has a detailed, written constitution; day-to-day business relationships are covered by the “Civil Code” and by other specific pieces of legislation.

Lease agreements in Brazil are governed by Federal Law Number 8245 of October 18, 1991. Build-to-suit leases and sale & leaseback transactions are normally structured to avoid this leasing law in order to be sufficiently attractive to investors.

The following is a summary of most office lease structures in Brazil:

### ***Lease Term***

Parties are free to sign a lease of any term. Most leases tend to range from 3 to 5 years. Sometimes shorter leases are signed, as short as one year for lease renewals. The parties are free to negotiate extension rights. Build-to-suit leases and sale & leaseback transactions normally require a 10-year lease or more. Renewal right and security of tenure are discussed further ahead.

### ***Lease end***

At lease end, if no party takes action, the lease becomes “indeterminate”, and will proceed on a month-to-month basis. Few leases contain a “holdover” fine. *It is important to emphasize that, as such, the lease remains valid and the tenant must pay rent irrespective of any request or invoice or lease amendment.* This occurs often in the local market, and in these cases landlords and tenants tend to negotiate the rent on a yearly basis. The lessor may terminate the lease upon 30 days notice. If the lessee remains on the property after this 30-day period, the lessor may file an eviction action in court to repossess the property.

### ***Security of Term – “Privity of Contract”***

In Brazilian law, as with Anglican law, a contract is private between the two parties that signed it. Therefore if the leased property is sold to a third party during the term of the lease, the purchaser is not necessarily obliged to abide by the lease agreement. In order *to protect the tenant’s position*, the following is required: i) the lease must have a clause stating that the lease will remain in effect even after the sale of the property (“validity clause”), and ii) the lease must be registered at the appropriate property registry office. It is the responsibility of the tenant to register the lease at the registry office and un-register at lease end.

### ***Early Termination***

One major advantage to the tenant is the right to terminate at any time (except for build-to-suit and sale & leaseback transactions). Such termination right is normally accompanied by a clause that defines a notice period and a fine, which, compared to Anglican practices, is a very reasonable fine. Historically the notice period is 30 days and the termination penalty three months rent, however in recent years commercial leases have tended to be stricter, with the sum of penalty plus fine adding up to 12 months in some cases. The amount of penalty payable is reduced in proportion to the

expired term of the lease, but since this is based on precedence, it is recommendable to state this in the lease.

### **Security of Tenure**

With a lease, or sum of leases, of 5 consecutive years or more, a tenant may earn security of tenure, assuming some conditions are met. The new lease must be negotiated before lease end; if no agreement is reached between the parties, the Tenant may resort to the courts between 12 and 6 months before lease end, so long as no later than 6 months before lease end. The court will decide on the rental amount to be paid based on an appraisal of the market value of the lease. This right cannot be waived but care is needed not to miss the dates.

### **Rent**

By law rent must be monthly, in arrears<sup>2</sup>, and must be in Brazilian currency (“Real”). Any lease providing for the payment of rent in another currency is null and void. Typically, payments are to be made on the fifth business day of the following month. Payment methods should be established in the lease. *The landlord is not obliged to send a reminder or invoice; the lease contract is itself sufficient documentation to obligate the tenant to pay rent.*

### **Indexation**

Although not obligatory, all leases provide that the rent is to be adjusted annually according to one of several possible CPI indexes. Current law only permits yearly adjustments (or longer). The most commonly used index is the IGP-M. Indexation to a foreign currency is not permitted.

### **Market Reviews**

While nothing impedes the parties to renegotiate at any time, the law allows either party to request a market review after 3 years after the last market negotiation. If no agreement is reached, either party can resort to court proceedings. Note, therefore, that, depending on market conditions, the rent can go up or down. This right cannot be waived, nor can an “upward-only” rent review clause be agreed.

### **Right of First Refusal to Purchase**

The tenant shall be entitled to the right of first refusal for the acquisition of the property in the event of a sale. In order to allow the tenant to exercise the right of first refusal, the landlord must provide the tenant with the pertinent information on a potential sale. The Tenant must express its interest in the acquisition of the property within thirty days of being given notice by the landlord of the terms reached with another buyer. Failure by the tenant to exercise the right allows the landlord to proceed with the sale. The tenant has the right of first refusal over the entire business proposal and not just over its respective leased area. Thus, in the case of a sale of the entire building, the tenant shall have the right of first refusal to purchase the entire building, not over the leased premises or its individual unit. The effectiveness of the right of first refusal will only be totally guaranteed if the lease agreement is registered at the relevant Property Registry. This right cannot be waived – a waiver clause is null and void.

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<sup>2</sup> Although unusual, the rent of an un-guaranteed lease may be charged in advance.

### ***Assignment and Subleasing***

Due to the right of a tenant to terminate a lease, subleases are rare. Assignments are practically non-existent. Most landlords do not allow assignments or subleases, except in large commercial transactions where it is possible to negotiate the freedom to sublet to a group company without approval by the landlord.

### ***Landlord's Obligations***

While law 8425/91 establishes many of the landlord's obligations, some of them are repeated in the lease document. Some examples are:

- To deliver the leased property in a condition relevant to the use for which it is designed, and not change such use;
- Pay all taxes and charges related to the property, unless the lease says otherwise; Leases in Brazil almost always require the tenant to pay these (equivalent to "Triple Net" leases);
- Permit peaceful use of the leased property;
- Responsibility for faults or defects existing prior to the lease;
- Pay "extraordinary condominium expenses", which are:
  - Expenses ("Extraordinary Expenses"<sup>3</sup>) that do not refer to routine expenses for building maintenance, especially:
  - Refurbishment works, repairs or additions which affect the structure of the property and/or add to its value; structure includes all columns, fixed solid walls, windows, roof among other items.
  - painting of outer walls;
  - works designed to restore the living conditions of the building;
  - installation of safety, fire, telephony, intercommunication, sports and recreation equipment;
  - expenses incurred with decoration and first-time landscaping of common use areas.
- Pay towards a reserve fund (= emergency fund).

### ***Tenant's Obligations***

While law establishes many of the tenant's obligations, some of them are repeated in the lease document. Some examples are:

The tenant shall:

- Pay the rent and other charges ("Ordinary Expenses") required by law or the agreement on the established due dates, or if this is not established, up to the sixth business day of the month following the month of reference;
- use the property for the agreed or intended purpose;

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<sup>3</sup> Common Area expenses are, by law, divided into Extraordinary Expenses, payable by the property owner, and Ordinary Expenses (normal day-to-day maintenance expenses), payable by the tenants.

- treat it with the same care as if it were the lessee's property;
- restore the property, upon expiry of the lease, to the condition in which it was received, except for normal wear and tear;
- immediately inform the lessor of any damage or defect that is the lessor's responsibility to repair, as well as of any third party disturbances;
- immediately repair any damages to the property or its installations, caused by the lessee, his/her dependents, relatives, guests or contractors;
- refrain from changing the property internally or externally without the prior written consent of the lessor (leases often allow a certain amount of adaptations so long as removable);
- deliver immediately to lessor the billing documents for taxes and condominium charges, as well as any notice, fine or public authority requirement, even if addressed to the lessee;
- pay telephone and electricity, gas, water and sewage expenses;
- insure the leased portion of the property, naming the lessor as beneficiary;
- allow the property to be inspected by the lessor or his/her representative on a previously established date and time;
- allow the property to be inspected and verified by third parties in the event of a sale;
- fully comply with the condominium convention and internal regulations;
- pay ordinary common area maintenance charges (commonly referred to as the "condominium"); these are, for example:
  - expenses required for the ongoing management, such as
  - wages, labor, social security and payroll charges for the condominium employees;
  - water, sewage, gas and electricity expenses related to the common use areas;
  - cleaning, upkeep and painting of common use installations and premises;
  - maintenance and upkeep of the common use installations and hydraulic, electric, mechanical and safety equipment;
  - maintenance and upkeep of common use installations and equipment designed for sports and leisure;
  - maintenance and upkeep of elevators, electronic gate and collective antenna;
  - small repairs in the commonly used premises and electric and hydraulic installations;
  - account differences upon reconciliation;
  - replacement of the reserve fund (see below), totally or partially used in the funding or supplementation of the expenses referred to in the preceding items, unless these expenses are incurred before the lease.
- The tenant shall pay the expenses mentioned in the preceding paragraph provided the budget and monthly apportionment are submitted, and may at any time require that these expenses be evidenced. (Apportionment is defined in the condominium convention and is non-negotiable).
- These expenses can be charged in arrears or in advance based on pre-determined budgets. Most good standard buildings with professional building managers use the latter.
- Since the lessee is held liable for the payment of taxes, charges and ordinary condominium expenses, the lessor may charge such sums together with the respective rent, or it may be agreed that the tenant pay such expenses direct to the supplier.
- In the event the property needs urgent repair to be carried out by the lessor, the lessee must allow it. If the repairs take more than ten days, the lessee will be entitled to a rent

deduction proportional to the exceeding period; if the repairs take more than thirty days the lease agreement may be terminated.

### **Improvements**

Unless otherwise established in the agreement, any “*necessary* improvements” introduced by the lessee (even if not authorized by the lessor) and any “*useful* improvements” (so long as previously authorized) will be subject to indemnification and allow for the exercise of the right of retention. (“*Necessary* improvements” and “*useful* improvements” are expressions defined in law<sup>4</sup>). It is common for the parties to agree to exclude useful improvements from the above, although tenants it should be insisted that necessary improvements be subject to indemnification. The issue is more sensitive in wholly leased stand-alone facilities.

Other improvements and amenities will not be subject to indemnification and may be removed by the lessee upon termination of the lease, provided this removal does not affect the property structure.

The custom in Brazil is for tenants to pay their own tenant improvements. Landlords deliver the space with minimal existing improvements although high standard offices are generally delivered with suspended ceilings, central air-conditioning and raised flooring in place.

Tenants are also responsible for the cost of restoring the demise to its original condition at lease end.

### **Lease Guarantees**

Guarantees are not obligatory but are the market norm. The parties may agree to only one of the following:

- deposit;
- private individual as guarantor (will need to own property);
- another company as guarantor, including parent company;
- rent insurance;
- bank letter-of-credit;
- collateral.

In large transactions some “professional” landlords may accept a parent company guarantee.

### **Reserve Fund**

By law, all owners in a building condominium must maintain a Reserve Fund. This Reserve Fund can be used to cover both operating and capital expenses. Normally the Reserve Fund is used in emergencies or to cover the any deficits where tenant reimbursements are received after expenses.

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<sup>4</sup> Necessary Improvements: improvements that seek to maintain the leased object and avoid its deterioration  
Useful Improvements: improvements that increase or make easier the use of the leased object  
Voluptuary Improvements: improvements done for mere comfort

## 4.2. Other Real Estate legal issues

### ***Strata-ownership (“Condominium”).***

Brazilian condominium laws allow for strata-ownership. This means that one building may have several owners. In fact one floor in one building, if divided into suites, may have several owners.

The result is that large space requirements may require signing leases with more than one landlord. This is a frequent occurrence.

In the last few years, institutional and professional landlords have maintained ownership of whole buildings, although mostly of top quality buildings in prime locations.

While strata-ownership may allow a tenant to obtain a good transaction by placing one floor owner in competition with another, the issue changes if a large floor area is required. Dealing with more than one landlord is naturally more complicated than dealing with one. It is possible, if agreed by all parties, for one document to be signed with all the landlords although the drafting of such a lease requires care. The advantage is to establish equal rules for each landlord, which will be beneficial at review and renewal. One advantage of signing individual leases with each landlord is to have better flexibility to surrender part of the space.

### ***Dispute Resolution***

Most leases state that unresolved disputes will be taken to the courts, normally in the jurisdiction where the property lies. Due to cost and time delays of actions through the courts, it is slowly becoming more common for leases to allow for disputes to be resolved by arbitration. Arbitration is relatively new practice in Brazil, and due to the cost and delay of the courts, Brazilians businesses have become relatively efficient at resolving disputes on a personal “gentlemanly” level.

### ***Zoning Laws***

Most large cities in Brazil have some sort of zoning laws, building codes and property-use regulations – the laws differ from city to city. They become a particular issue when leasing stand-alone properties or when an unusual activity will be undertaken. Each type of activity will have different building restrictions.

In São Paulo most office buildings are built to permit standard office occupation; if any unusual activity will be undertaken within the same space, such as laboratories, care will be needed to check whether such use is permissible. Stand-alone buildings may have been built for one type of activity and not allow for a different use, and often such a problem is discovered too late – care is needed.

The zoning laws in São Paulo have recently been changed, and are very complex – it is said that not even officers of the local planning authority fully understand the new regulations. It is therefore important, when looking for a stand-alone facility, to retain the early services of an architect who will be responsible for verifying with the local authorities that the site can accommodate a particular use.

Rio de Janeiro also has a complex zoning law that calls for care when leasing stand-alone properties.

We hope that the information contained in this document is sufficient and informative, and we look forward to assisting you in your real estate needs.