

FRAMEWORK ON THE INVESTMENT OPPORTUNITIES IN BULGARIAN INDUSTRIAL ZONES

By Petar Angov and Kaloyan Krumov

The current situation related to the COVID-19 pandemic caused global supply chain disruptions, increase in trade barriers, and shifting consumer mindset. From industrial perspective, these and other challenges will have an impact on geographical planning of production and warehouse facilities.

Bulgaria has been ascertaining its position over the recent years as a competitive investment destination in Southeast Europe in manufacturing and services sectors, among others. Bulgaria's advantageous geographic position as the European gate to Turkey and the Middle East, with several Pan-European transport corridors passing through the country, makes it an attractive investment destination also for industrial manufacturing and logistics services. Apart from that, as an EU member state the country benefits from all features of the European Single Market.

The efforts of the government and also the private investments in the industrial sector have formed two different groups of industrial zones in Bulgaria, respectively two possible investment opportunities:

- In certain industrial areas companies have developed independently their facilities in clusters. Thus, privately held industrial zones have formed. In such type of projects, the development of the adjacent infrastructure is made by the private companies with less involvement from the state.
- In 2009 the Bulgarian government has launched a programme for the formation of state-developed industrial zones, where the infrastructure is provided by the state and certain categories of investors are attracted to build or lease facilities for their own operations. These are the second type industrial zones, which benefit from certain state incentives and could be relevant for investors in industry sectors which are deemed as a priority for the Bulgarian state.

STRUCTURING CONSIDERATIONS

In industrial projects there are some key differences in the deal process compared to other real estate projects, due especially to the location of such developments, which typically are outside urban areas. There are different options for structuring of the investment and respectively different due diligence matters to be considered depending on whether it is a greenfield land acquisition and development or investment in a new facility in an existing industrial area.

In Bulgaria, the acquisition of the right to develop an industrial or warehouse property can be structured as:

- acquisition of land for development by the investor; or

- obtaining of right of construction (*superficies right*) over a land plot for a period of time or indefinitely.

The acquisition of full ownership of title to the land is the most common form of holding title to real estate in Bulgaria. It gives the owner:

- the maximum beneficial and legal entitlements, and is perpetual;
- the maximum power to dispose of, possess and use the real estate;
- the entitlement to become the owner of any and all permanent attachments to the land, known as the rule of accession (although alternative arrangements can be agreed).

However, obtaining right of construction (*superficies right*) on a land plot, as an alternative to acquisition of the land, could provide certain flexibility from business point of view. The *superficies right* is a right allowing separation of the title to a building from the title to the underlying land before the actual building is developed. The owner of a land plot may grant to a third party *superficies right* for construction of a building on the land and for becoming the owner of such building, when completed. A key characteristic of the *superficies right* is that it can be granted for a limited period of time. The default rule of law is that upon expiration of the agreed time period, the developed building becomes property of the landowner without any additional action or transaction and without consideration being due, unless it is otherwise agreed. If such a limitation period is not agreed, the *superficies right* (and ownership of the building developed in exercise thereof) is perpetual.

In either of the above two options of acquisition of title rights for a future real estate development, depending on the status of adjacent infrastructure, the investor may have to acquire easement rights for road and utilities infrastructure for its project. Easement rights can be critical from practical and legal perspective, as the close proximity of suitable infrastructure and the investment in interconnection from the nearby infrastructure to the project can significantly impact the timeframe and costs for completion of the project.

Investment in *private industrial zones* or *state industrial zones* will also affect the deal structure and the pre-transaction due diligence process.

PRIVATE INDUSTRIAL ZONES

There are a number of existing industrial zones which have been formed around a cluster of manufacturing and logistics businesses over time. Such industrial zones are developed naturally and depending on the geographical location of the available land for development with proximity to suitable transport infrastructure and availability of qualified staff. Investment in this type of industrial zones follows the general deal process of acquisition of real estate properties, obtaining of planning and building permits, etc.

Ownership Title Status

The territory of private industrial zones or land for private greenfield industrial development typically falls within one of the following categories:

- (a) former state-owned enterprises or plants which have ceased to exist, whereas the real estate has been either privatized or remained in state or municipal companies; or
- (b) real estate assets (land and/or buildings) which have been returned to the heirs of their former owners by the state after the end of communist regime. Such properties could include either former industrial properties or undeveloped agriculture land in the vicinity of cities and close to transport infrastructure.

The ownership title history of the real estate will determine the scope and complexity of the title due diligence which should be carried out in order to determine whether the current owner of the property holds clean and marketable legal ownership. Title due diligence is carried out primarily by searches of the real estate registry and is intended to be limited only to this search and review of the registered transactions. The seller has to be, and his/her predecessors must have been, owner(s) of the targeted real estate for at least 10 years in order to avoid any risk of the transaction being rescinded or annulled. However, where the state or a municipality is a former owner of the land, or in cases involving restitution, a number of additional searches are essential.

Zoning Status

Land plots located in former industrial areas are often already designated for industrial development. In this case the timeframe until commencement of construction is significantly shortened. Due diligence review of the zoning parameters is necessary in order to verify whether the land plot is located within the construction borders of a municipality and what the actual zoning parameters are. A new detailed zoning plan will be required, if the land plot is not designated for industrial development. The approval of appropriate zoning parameters, unless there are limitations under a general zoning plan or other environmental or agriculture limitation for the territory, could extend the timeframe to commencement of construction with at least 6-8 months.

Other considerations and administrative approvals will be relevant in case the targeted land for development is located outside urbanized territory. The time and costs for a possible environmental impact assessment or change of the designation of the land from agriculture land to development land should inevitably be considered in this scenario.

Infrastructure

The availability of suitable infrastructure with appropriate capacity and redundancy is an important factor. When an investor develops a project in an existing industrial zone, the owner(s) of the industrial zone infrastructure would provide access to the existing infrastructure within the industrial zone at cost. The benefit of the investor in such case will be the absence of the construction and other risks related to planning and construction of the required infrastructure. Nonetheless, even when investing in a project in an existing industrial zone, a proper due diligence of the existing infrastructure should be performed in order to ensure the availability of the required infrastructure. The matter of appropriate capacity and redundancy of services, such as power and water supply, wastewater treatment and ITC should be addressed also in the deal structure and the later on in the transaction documents.

For greenfield industrial developments special consideration should be given to the close proximity of infrastructure connection points, as well as the title and zoning status of the land which will be affected by the construction of infrastructure interconnects to the project. In greenfield developments the acquisition of easement rights and obtaining of zoning parameters for the required infrastructure interconnects could be viewed as a standalone project development. There are certain government support measures for development on infrastructure necessary for industrial developments in specific sectors of the economy or in specific municipalities.

STATE INDUSTRIAL ZONES

Another alternative for companies operating in certain sectors is the investment in a state industrial zone. The Bulgarian Government has incorporated a state-owned company - National Company for Industrial Zones. The purpose of the state company is to promote the creation of new industrial zones near several major Bulgarian cities. The company currently operates and develops 11 industrial parks – one near the capital city Sofia, one in each major city on the Black sea coast (Varna and Burgas), one in the major port cities along the Danube river (Rousse and Vidin) and 5 more near cities throughout the country.

Apart from developing and operating industrial zones, the National Company for Industrial Zones works closely with more than 10 municipalities for the purpose of promoting municipally owned industrial properties for sale or lease.

The National Company for Industrial Zones may offer to potential investors industrial properties which are not otherwise accessible through the free real estate market. The legal framework allows such assets to be sold to certified investors on prices even below market average.

Private investors with a certificate for priority investment (see below *GOVERNMENT INCENTIVES*) may be considered for projects in state industrial zones or can benefit from reduced red tape with the support of the National Company for Industrial Zones.

Ownership Title Status

The ownership title review for acquisition of land or a *superficies right* in a state supported industrial zone will be simplified as compared to due diligence on private property, because the ultimate owner is either the state or a municipality. Nonetheless, there are some specific points that should be reviewed from legal ownership perspective, such as any deficiencies in a transfer of ownership from the state or a municipality to a state or municipal company. Another matter for review in the due diligence process is the risk of potential unresolved restitution issues. However, as the time passes by the risks related to restitution have substantially diminished.

Zoning Status

Land plots in state supported industrial zones are already designated for industrial development under detailed zoning plans. In this case the timeframe until commencement of construction is significantly shortened since the due diligence review would be of confirmatory nature in most cases.

Infrastructure

One of the key incentives promoted by the government for investment in state supported industrial zones is that there is existing infrastructure which is available to the investors or the National Company for Industrial Zones could undertake to build the required infrastructure to support the investment in the particular industrial project.

GOVERNMENT INCENTIVES

The legal framework in Bulgaria provides for incentives which aim to foster investment and improve the business climate. Investments which fulfil certain criteria (such as duration, total investment amount, etc.) are entitled to specific advantageous measures under the Bulgarian Investment Promotion Act. While this certification is a prerequisite for obtaining assistance and acquiring industrial property from the National Company for Industrial Zones (*see above*), the measures under the Investment Promotion Act are generally applicable for any certified investment and those incentives could be applied also to investment in private industrial zones.

The incentives are applied towards projects which have been certified as *class A*, *class B* or are identified as a *priority investment project*. Depending on the desired certification class and supportive measures, potential investors may apply to the National Investment Agency for certification of the contemplated project (for *class A*, *class B* and *priority investment projects*) or or the mayor of a municipality (for *class B*). Once certified with a respective investment class the investors may benefit from the specific measures provided by the law. Below is a non-exhaustive list of such incentives with their key features:

➤ *Priority administrative assistance and services*

Certified investors have their applications and administrative procedures processed within shorter terms. Projects obtained certifications as *class A* or *priority investment project* are entitled to individual administrative assistance by officers acting as proxies.

➤ *Acquisition of state-owned real estate properties through simplified procedures – on market or below market price*

Properties owned by the state or a municipality generally need to undergo a tender procedure for sale to private investors. However, certified investors may acquire real estate properties or limited *in rem rights* over state or municipal properties without the need of a tender procedure.

Investors certified as *priority investment projects* may acquire real estate properties on prices even below market average. Examples for investments which could be certified as *priority investment projects* include the development of an industrial park or technological park with the necessary infrastructure for the purposes of attracting further investments in such parks.

The benefits of this special incentive come along with certain conditions related to deadline for completion of the project and exit restrictions for a certain period (3 or 5 years). There is also a limitation on the establishment of security over the acquired property, which should be considered when attracting financing for the project development.

➤ *Financial support for infrastructure development*

The Council of Ministers may grant financial support for building public infrastructure from the closest infrastructure grid to the boundaries of the investor's land plot. Such financial aid may be granted for an investment certified as *class A, priority investment project* or in connecting with the development of at least two *class B* projects within one industrial zone.

The amount of financial support is planned with the annual state budget each year. Applications for this measure shall be submitted to the Ministry of Economy and are then evaluated by a committee from the Ministry of Economy each calendar quarter provided that there are still non-distributed amounts for the respective year.

➤ *Financial support for qualification of employees*

The Council of Ministers may grant financial support for obtaining further qualification of the employees involved in a certified project. A prerequisite for this measure is that the investment project relates to high-tech services or, alternatively, that the project is developed within economically weaker areas of the country. Such training/education of the investor's employees may be carried out in an external educational institution or the employer may organize this further education within the company with the amounts provided.

➤ *Partial financial relief of the mandatory social security contributions*

The Council of Ministers may approve financial incentive for certified investments so that mandatory social security and health insurance contributions which have been paid by the certified company for its employees for a period of up to 24 months may be reimbursed to the employer. Necessary prerequisites include the requirement that the annual remuneration of the certified employer's employees be higher than the average annual remuneration for the respective field of business. The newly established employment positions shall be maintained for a certain time period (3 or 5 years depending on the scale of the project).

LEGAL REGULATION OF INDUSTRIAL PARKS

The lack of specific legislative framework regulating the development and maintenance of industrial parks in Bulgaria has been recognized by the authorities as an obstacle for the sustainable development of such parks. Specific legislative acts concerning the development and operation of industrial parks have been adopted in other European countries such as Romania, Ukraine, and others. The Bulgarian Government has taken steps to enact a specific law which shall regulate the establishment, development, and maintenance of industrial parks. A draft law was put for public discussion and it can be expected that an updated version will be submitted for parliamentary vote before the end of 2020.

Representatives of the work group concerned with preparation of the new law reveal that the new law aims to:

- give a clear legal framework for the relations between an industrial park operator and subsequent investors in the industrial park;
- improve the mechanisms of government incentives and support for investment in technical infrastructure for industrial parks; and
- facilitate the process of zoning and regulation of the land for the purpose of development of industrial parks.

The new legislative initiative is expected to improve the investment climate in Bulgaria as far as industrial projects and technological sectors are concerned and hence to increase the flow of foreign direct investments in the country.