

## The “collective leasehold” – does it fix your lease renewal problem? – Part 1

You may have read a recent **Article** in a Thailand news publication which stated:

*“Collective leasehold structures provide owners in villa developments the legal means to have a greater say in their villa projects. Importantly, this means that owners have increased control over the renewal of their leases, thus mitigating a major risk associated with long-term leases in villa developments.”*

The so-called “collective leasehold” structure is quite commonly marketed to foreigners wishing to invest in a villa or apartment here in Thailand. However, the Article’s main assertion—that the structure mitigates the risk that your 30-year lease may not be renewed should be treated with extreme caution. Furthermore, the Article contained several errors with regard to applicable Thai law. Accordingly, in part one of this two part article, we will first address and correct the Article’s incorrect statements regarding applicable Thai law. In the second part we will explain why the Article’s contention that “collective leasehold” structures “mitigate a major risk associated with long-term leases” is misleading at best—or is simply incorrect.

Long-term leaseholds are a popular mode of investing in Thai real estate. This is due largely to the fact that Thai law, with some limited exceptions, prohibits foreign freehold ownership of real estate in Thailand. However, under current Thai law, the maximum lease term is a mere 30 years. Thus, it has become rather common for developers who are marketing to foreigners to offer a long-term lease of 30 years with two additional successive 30-year terms. Furthermore, as provided by Section 540 of the Civil and Commercial Code (“CCC”) any such additional term is not an “extension” of the lease—rather it is merely a “renewal” of the lease. This means the new term is essentially a new contract. The result is that if the owner of the property changes during the first lease term, the new owner will *not* be obliged to honor the renewal of the lease, *even If* the lessee has already pre-paid the original owner for the

renewal term. This is because the new owner never offered to renew the lease and the law does not oblige the new owner to honor an offer made by the original owner and lessor.

As mentioned above, in an effort to address this insecurity many developers offer a “secured leasehold” structure or as the Article referred to it, a “collective leasehold” structure. We will look into what that is and why it usually does not succeed in doing so in part two of this article. However, in order to understand the legal issues surrounding this lease structure we first need to address some fundamental legal errors in the Article.

The Article states that a “lease may be renewed together by the lessor (the landowner) and lessee (the buyer). . .” That is correct. However, the Article completes that same sentence by saying “but such a renewal agreement is by contract only not pre-registration at the land office.” The Article then concludes that this means that your lease may not be renewed because the lessor may not honor its contract. The implication—that if you had pre-registered your renewal term “at the land office” you would have something more than a mere contract with your lessor and your renewal term would then be enforceable regardless of your agreement with the lessor—misunderstands the law and is, therefore, incorrect. We have explained why this is so in an earlier article, which you can find here: (<http://www.thephuketnews.com/jfcc-drive-for-longer-leases-going-down-the-wrong-road-29916.php>). In summary, if your original owner changes during your first lease term, the new owner is not bound by the original owner’s promise to renew your lease—registration of that promise does not contractually bind the new owner to a promise the new owner never made.

The Article’s second legal fallacy regarding leases is contained in its following statement:

*“The likelihood of a lessor breaking a contractual promise to renew a lease increases when the land is transferred to a third party, as is likely during a 30-year term, since such a third party may (incorrectly) conclude that it is not under the same obligations as its predecessor.”*

It is true that a lease contract is not terminated by a change in lessor as provided by Section 568 of the CCC. However, an *option to renew* the lease is legally a one-sided promise, or “offer”, to renew the lease upon expiration of the prior term; it does not form a new lease *contract* for the additional term. Thus, the original lessor’s promise does *not* bind the new owner. Again, this is the main insecurity issue with regard to

lease renewals in Thailand. Accordingly, the Articles' new owner would *correctly— not incorrectly—* conclude that he is not under any obligation to honor his predecessor lessor's promise to renew the lease.

You will find the last major legal fallacy contained in the Article's following statement:

*"What is more, a lessee's remedies are limited in the event of a lessor's breach of a contractual obligation to renew a lease term. To compel renewal, a court action must be initiated. However, the damages that are available regarding a breach of a renewal clause are restricted to damages, and a lessee cannot "force" a renewal."*

The Article states that if your contractual lessor fails to honor you renewal option, your only remedy would be to obtain monetary compensation for this damage in court. This is incorrect. Under Section 213 of the CCC such a lessee can request the court to order "compulsory performance" of such obligation. And, in fact, our firm has sought and received such orders for our clients. Thus, we can confirm that not only as a legal matter, but also as a "practical matter" this remedy is available under Thai law.

*Unfortunately* the reality is that the "collective leasehold" does little if anything to address the very real insecurity that your long-term lease will not be renewed—we will explain why in part two of this article. *Fortunately*, however, there are far better legal means than the "collective leasehold" that do provide *actual* long-term lease *security* and without any downside to the developer. This can be achieved by securing the pre-paid renewal terms with a mortgage over the land plot in question. It is a simple and straightforward legal structure that provides security for the investor and, therefore, a marketing opportunity for the developer. But, you should first engage competent legal and tax counsel in order to successfully implement this long-term leasehold security structure.

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