

- CREN - Croatian Real Estate Newsletter

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CREN PATRONS



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**Branko Vukmir, Ph.D.
Zagreb**

CONSTRUCTION CONTRACTS AND FIDIC GENERAL CONDITIONS IN CROATIA



**Mr. Branko Kastelic, president of
the Management Board
IMOS**

IMOS – one of the leading Slovenian RE driving forces

1. INTERVIEW

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CONSTRUCTION CONTRACTS AND FIDIC GENERAL CONDITIONS IN CROATIA

Could you please introduce yourself to CREN readers?

I am a legal advisor with long-term experience in the field of construction contracts. For many years, I was the chief legal advisor to INGRA and as such I have participated in negotiating numerous construction contracts and equipment delivery contracts in many countries on all continents. This practice led me to study the construction contracts from a scholarly perspective, and as early as 1980 I wrote a book entitled **CONTRACTS ON PERFORMING INVESTMENT WORKS ABROAD**. At that time, the term “investment works” was the legal name for constructions works. This book had two parts. The first part dealt with the legal issues related to contracting construction works and delivery of equipment abroad, whereas the second part contained, among other things, translations of some of the more important FIDIC general conditions. At that time I was also the President of the Working Group of the Economic Commission for Europe, which developed a guide for drafting turnkey contracts and the consultant to UNCITRAL in Vienna, for the preparation of their guide for contracting construction of industrial facilities, entitled **LEGAL GUIDE ON DRAWING UP INTERNATIONAL CONTRACTS FOR CONSTRUCTION OF INDUSTRIAL WORKS** (edition

1988). For the past fifteen years, I have been teaching international law of payment security instruments and commercial contract law, and thus also construction contracts, as part of post-graduate studies at the Faculty of Law in Zagreb. Also, I occasionally teach contractual building law at the Faculty of Civil Engineering in Zagreb. In recent years, I have written two books in this field, one on bank guarantees and letters of credit (**INTERNATIONAL TRANSACTIONS LAW – PAYMENT SECURITY INSTRUMENTS**), and the second entitled **CONSTRUCTION CONTRACTS AND CONTRACTS ON SERVICES OF CONSULTING ENGINEERS**. The latter has more than 800 pages, and I believe it represents the most complete work on these contracts in Croatian legal literature. In recent years, I have also written a large number of articles on various aspects of building contracts and FIDIC General Conditions, published in the journal **PRAVO I POREZI (LAW AND TAXES)** (published by RRiF).

Can you explain to us why you dedicate so much attention to FIDIC General Conditions in your work?

When contracting construction works in various countries of the world, I noticed as early as the 1960’s that these works are always contracted applying FIDIC General Conditions. This motivated me

to study these conditions more closely, and then I established that they are an exact copy of the British general conditions. So, through the British general conditions, the law that prevailed in international building contracts was the British construction law. Studying this law from a comparative perspective awakened my enthusiasm because this was an excellently elaborated, logical and just system, which achieved a fair balance between the parties to such contracts. At the same time, I saw that British consulting engineers greatly benefited from their excellent knowledge of these general conditions, because investors from the whole world relied on their know-how in the management of these contracts. The contractors who were well familiarized with these general conditions also drew major benefits from that. Ever since then, I have been trying to encourage Croatian advisory engineers, contractors of building and construction works and exporters of equipment to become familiar with these conditions to the greatest possible extent. Namely, lack of knowledge of these general conditions prevents our designers, architects and other entities involved, to be competitive on foreign markets in comparison to companies from abroad. Today we can really say that without knowing the FIDIC General Conditions, it is not possible to be present on foreign markets in this field. I believe that my efforts so far have not been particularly successful, but I am still trying.

Is the British construction law still relevant today for regulating relationships in this type of contracts if the FIDIC General Conditions are used?

There have been significant changes in this field, particularly through the

amendments of the FIDIC General Conditions. Namely, some of the elements of the FIDIC General Conditions, which reflected the British understanding of relationships in the field of construction law, encountered resistance from European consultants, and also from European contractors and equipment suppliers. Just to mention one example of these changes (and there are numerous other examples as well): for European experts, there was always some controversy about the role of the supervisory engineer, or what is called the ENGINEER. In the British understanding, the central figure in such contracts is the ENGINEER, appointed by the EMPLOYER, and he has great powers with respect to contractors. Although the Engineer is paid by the EMPLOYER, it is assumed that he is independent and that he “is in the service of the work”, and that therefore he can be given the authority to make important decisions during the construction, which the contractors have to abide by. If the contractors were dissatisfied with some of his decisions, they can – within a certain deadline – file a complaint, but if they miss that deadline, they may not contest the decision later in any arbitral or court proceedings. In European construction contracts, supervisory engineers do not have such broad authorities, and for them it is always clear that they are just the representatives of the EMPLOYER and that whatever they say, it is always said on behalf of the EMPLOYER. In 1999, after almost 40 years of applying the earlier General Conditions, FIDIC adopted a completely new set of conditions, in which the role of the Engineer was significantly closer to the European understanding. This also happened to numerous other elements of the British law, which were abandoned in the new FIDIC

Conditions and replaced by elements from the European Civil law. However, the British law has still not completely lost its influence, and for some issues the answers can even today still be found in that legal system.

If the FIDIC General Conditions are so important for performing works abroad, are they also important for construction works in Croatia?

It is precisely that this issue for us is of a special importance. Everyone that has experience in contracting construction works in Croatia is aware that Croatia does not have standardized conditions for these type of works and that the contracts are – as a rule – drafted on a case-by-case basis. This has resulted in the fact that the disorder in contracting has become a source of concern. The investors often try to draw up terms that would burden the contractors with inappropriate obligations and that are far from the international practice of the division of responsibilities. When it comes to public companies, contractors have to apply to public tenders and they are not allowed to have reservations with respect to prescribed conditions, because the Investors could disqualify them. Therefore, they are often forced to agree even to unusual and often burdensome conditions. This leads the contractors to accept these conditions, as they do not want to lose the contract, hoping that they will improve their position and make up for the loss later on, by subsequent amendments to the contracts. Sometimes they succeed, and sometimes they don't. All this creates often disorder in contracting and leads to great uncertainty in the execution of works. The contracting entities often do not understand that it is not in their best interest to burden the contractors with

inappropriate conditions, because this could lead the contractors to bankruptcy or create insurmountable difficulties in the financing of works, and that is why Investors would not achieve their primary objective: fast and smooth completion of the facility they contracted.

If I understand you correctly, do you propose that the FIDIC General Conditions are also applied in Croatia?

The fact is that neither in the former Yugoslavia nor in Croatia did this profession succeed in drafting general conditions of contracts that public companies would be obliged to apply in contracting this type of works. In Croatia, the law regulating relationships from construction contracts is the Law of Obligations, then there are the Special Usances for Construction, which do not differ much from the Law of Obligations, and there is case law. If you consider, for example, the situation in Germany, you will find that they have the VOB rules, which are mandatory for public companies. The influence of VOB is so great that most private companies apply it as well. This situation has led to contracts where the “fair” division of obligations and responsibilities between the contracting parties are “well known”. Since we haven't succeeded in creating our own standard terms and conditions, I believe that it would be simplest to adopt the FIDIC General Conditions and prescribe that the public companies should be obliged to use one of the FIDIC General Conditions when they are contracting construction works in Croatia. This development would result in a double advantage: on the one hand, Croatian companies would get used to the FIDIC General Conditions, and they would learn those

rules and get familiar with the administration of contract management in line with those rules, whereas on the other hand they would become capable of working abroad, because they would gain experience in applying these General Conditions in Croatia.

How do you think this could be achieved?

This is a good question, which does not have a simple answer. From the practice so far, it is evident that Croatian consulting engineers and Croatian contractors, and their professional organisations, are either not sufficiently influential or not sufficiently aware of the current situation, and that therefore they have not succeeded in creating and imposing in practice their own set of contractual provisions. As far as I know, no effort has been made to achieve this at all. Knowing our internal circumstances, where the State Administration has the greatest influence on various developments, I believe that the initiative to adopt such general conditions should come from the competent Ministry. The Ministry should then attract all other participants in such work and induce them to support this development. However, in order to achieve this, the main prerequisite would be the existence of awareness of these institutions that this is really necessary, and as the second condition, all the stakeholders should show the will to change the current situation. I have no doubt that Croatian companies and eventually the entire Croatian economy would benefit from such a development. However, I am not at all sure that the awareness and will exist to do this.

Are there any examples abroad that other countries have used FIDIC

Conditions for their internal construction contracts?

First of all, one should know that the World Bank, and also other international financial organisations, often prescribe the application of the FIDIC General Conditions for public tenders for the construction of facilities in various states, which are financed through World Bank loans. So, Croatia is obliged to apply the FIDIC General Conditions every time a certain facility is financed from a World Bank loan. On the other hand, many countries have transposed the FIDIC General Conditions into their own prescribed conditions for works performed by foreign contractors. Some countries have slightly changed these conditions and adapted them to their own needs, but basically, in these countries, the FIDIC General Conditions have become the rules, according to which foreign contractors perform these works. From this situation, only a small step is needed to apply these conditions to contracts performed by domestic contractors for domestic public investors as well.

Can I ask you, what is it about these General Conditions that makes them so attractive to be applied internationally, and what would we gain if they were also applied to internal contractual relationships?

First of all, it should be emphasized that the FIDIC General Conditions have undergone 50 years of development, and during this time, precious experience has been gathered about contracting and managing contracts of this kind. The most recent FIDIC General Conditions date from 1999, and they are the result of long development. What is gained by applying the FIDIC General Conditions is primarily a balanced

relationship between the rights and obligations of the contractual parties. These General Conditions were drafted by experienced consulting engineers, and by experienced contractors, with the participation of investors. In the process points of view of all these stakeholders were taken into account. As a consequence, the interests of all the participants in the construction process are reflected in these conditions in a way that the international practice deems just or at least fair and balanced. Furthermore, the management of these contracts has been brought to a high level of organisation. One knows exactly the procedure related to individual steps in performing the works and there are strict deadlines for every procedure. Today, we have five sets of FIDIC's general conditions, and they are all mutually aligned and balanced, so that once you understand and become familiar with one of these sets, it will be simpler to find your way in the other sets of conditions as well. At the same time, the construction contracts are categorized according to the level and division of responsibilities of the participants in the works, which prevents unjustified burdening of one of the contractual parties.

From my experience, the experience of companies that turn to me when they encounter a problem with respect to performing construction contracts, I have often perceived an unbelievable lack of organisation in managing these contracts, both on the part of the investors, and on the part of the contractors and supervisory engineers. Most frequently, this is the consequence of the lack of clarity of the existing contracts, because they are often drafted from scratch. In such contracts, there are often no clear deadlines for individual steps, it is often not exactly known who the authorized

representatives of the parties are, what is their exact authority, there are often no prescribed procedures for amendments of these contract and for changes in the scope of works during the construction, and there are often no provisions regulating similar important issues. The delay penalties are often not calculated when we are entitled to them, while claims for damages are not filed even when a contract gives us the basis to do so. There are also numerous other omissions. The contractors mostly rely on their construction logs, which, in my opinion, is a very inefficient way for contractual parties to communicate during the construction stage and to preserve evidence of their claims. All this leads to uncertainty in the execution of the works, and it creates unnecessary conflicts between the contractual parties, finally leading to unnecessary disputes and losses. Instead of managing these contracts in an organized and orderly way, a kind of catch-as-catch-can relationship is formed between the contractual parties, while on the other hand money is lost, to which our contractors or contracting entities would be entitled to.

The final question: what do you intend to achieve by conducting a two-day seminar organised by the FILIPOVIĆ ADVISORY on the 28th and the 29th March in Zagreb?

The agenda of this seminar is published in this issue of your Newsletter. As you can see from the agenda, it was our intention to show the development, which led to the FIDIC General Conditions as they are today, to point to the existing weaknesses in Croatia, and to draw attention to the importance of these conditions for practice in Croatia. Besides, I intend to present a couple of

legal issues for discussion, which in my opinion are not well resolved in our legislation, and which have not yet been seriously objected to by this profession. At the same time, I would like to hear the experience of participants (domestic and foreign), and their problems in drafting and

performing contracts of this kind. I am especially interested in hearing of controversial cases from actual participants in construction contracts and from their lawyers. I hope that the seminar will be interesting to those who decide to participate in it.

2. INTERVIEW

**Mr. Branko Kastelic, president of the
Management Board
IMOS**



IMOS – one of the leading Slovenian RE driving forces

Can you present us IMOS and its vision?

The history of IMOS started almost 50 years ago in 1964. Today the parent company in IMOS Group is IMOS Holding. IMOS Group also included eight sister process or project companies. IMOS d.d. is the largest subsidiary company and employs the majority of highly educated experts and competent personnel. It is one of the leading companies in the field of integral engineering involving the construction of residential, business and industrial facilities.

The reason for the subsidiaries is more transparent management, especially in regards to bigger projects in Slovenia and also Croatia.

The Vision of the IMOS Group is excellence in the realization of investment ideas. The activities are being executed within the IMOS Group are project development, consultancy engineering during the planning stages, consultancy engineering during the implementation process and project supervision during the exploitation period.

For IMOS Group, the leading engineering company in Slovenia main

philosophy is that every project is important, be it big or small.

But if we talk about the biggest ones, these are Tobačna City, Litostroj, Črnuški bajer in Ljubljana, Podbreznik in Novo mesto and Savudrija in Croatia. We'll work on them for at least five years.

We are of the opinion that Tobačna city project is one of the biggest RE projects in Slovenia. Please, describe us in short the main features of this project!

Nowadays the Tobačna city is the project which we are totally focused. The area expands Ljubljana city center. Tobačna city will be a modern, multifunctional architecturally designed area based on spatial and programme where the living culture will be based on a complete business and residential center, including also the conversion of existing buildings.

Entire project will contain in subterranean part 131.000 m² of gross floor area with 3200 parking spaces and in superterranean part over 60.000 m² of the residential and storage areas, over 39.000 m² of net office areas and 650 apartments.

What are your other important development projects?

Besides Tobačna city ones mentioned, we have three or four more development projects. The total number of projects is almost 100. Some are in the final stage, some are stagnating because of clients' decisions. You are involved in a few projects that aim to revitalize an area. The most important reason we place so much focus on those project is that these are areas of greater size which means there are usually less competitors interested. Another thing is that these locations are really good and even though some may not believe it, our satisfaction when we carry out such projects is greater and we get the feeling that we did something good for the environment and for society.

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For example we own the biggest business and economic zone in Slovenia in Litoštroj area on northern side of Ljubljana which extent approximately 170.000 m². Litoštroj has historically represented innovativeness, new creative solutions and products, which has been successfully providing and still does so on the whole world market. In recent years, with changes in market conditions and the abandonment of non-profitable programmes the rehabilitation of degraded industrial areas within the framework of urbanization of the existing city structure has occurred. The demolition

of currently non-functional buildings and construction of new buildings, as well as the excellent location, with new municipal infrastructure provide a new opportunity to give administrative, business, trading and other activities a fresh impetus. At the end the Litoštroj area will provide over 150.000 m² new applicable business surface and possibilities to employ over 5000 people.

At this opportunity we like also to expose project Vila Savudrija in Croatia. This project rise in a charming tourist destination on the picturesque shores of Northern Istria and is marked by its Mediterranean climate, pine forests, evergreen plants, vineyards and olive groves. The area is near of the new top quality touristic resorts (Kempinski, Skipper) and provides the potential for development of quality hotels and Villas, Aqua Park and accompanying service programmes. We are already inviting interested parties to join the project of the construction of the Vila Savudrija resort as either partners of (co)investors and also hotel or tourism companies and other entities interested in investing in the tourism economy to join the project as partners. Surface area of the property is approximately 63.000 m² large.

How did you adapt to the global downturn in the construction industry?

Since the global downturn had a significant impact on the construction industry in IMOS Group adapted with organisational structure which has made our lives easier. The activities in the three firms offer us various opportunities. It's easier to set our priorities according to the projects due to our transparency. The crisis made us put greater emphasis on cost control. Relatively speaking, we have slowed down our projects, especially

those where we don't have customers yet. At the same time we have accelerated development of projects we believe will be the most interesting after the crisis ends.

When it comes to development projects we are sticking to our normal pace, working first towards obtaining building permits – which does not automatically mean we're going to continue with the process. In fact we conduct market research to find out if the project has a chance to be successful or not.

We are sure that you are preparing your business plans and strategies for 2011 and beyond. Can you tell us more about those?

For the moment, we're not thinking about new projects due to the crisis. In the next five years we wish to carry out projects according to our priorities: first is work on Tobačna City because it's a big, demanding and interesting project. We see our strength in excellence and we hope we will see the rewards in the strengthening of trust with all our business partners. These may just sound like nice words without any serious intentions behind them, especially in times when our branch has experienced a loss of trust due to

some short-sighted aims of some construction companies. Our strategy is to use our advantage. This is a priority of our development; however we have yet another goal – management of liquidity with the goal of carrying out what we agree upon with our partners. This is our special emphasis for 2011 – remaining true to our mission regardless of the events around us.

What can you tell us as a conclusion to your present business position?

Civil engineering is a branch which is based on trust. The reason for this is that we're selling something that does not even exist just yet. That's why we sometimes say that signing a contract with the customer is similar to marriage because this is the time when it all really begins. If it's going to work out depends on both partners. So here's where trust kicks in. There are five of us in the management of IMOS Group. All of us have been in civil engineering since sort of forever; we have two economists, two civil engineers and one architect. So we needn't fear the future at all since we have the continuity and the vision needed to succeed.

3. STATISTICS

Average Asking Prices of Real Estate Offered for Sale – February 2011

	average price EUR/m ²	price range EUR/m ²
ZAGREB		
Housing		
Apartments	1.842	558 – 6667
Houses	1.716	404 - 9.167
Commercial space		
Offices	1.809	1.300 – 3.333
Business premises	2.345	722 - 8.663
Office blocks	1.297	618 – 4.867
COAST		
Housing		
Apartments	1.934	611 - 6.383
Houses	1.721	300 - 10.000
Commercial space	1.689	240 - 8.298
Tourist facilities	2.651	651 – 4.605

Average is calculated on the basis of the currently quoted prices on the Burza nekretnina d.o.o. (*Real Estate Stock Market Ltd.*), which is available online: www.burza-nekretnina.com.

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It is our wish that the Croatian Real Estate Newsletter / CREN be a source of speedy and quality information for all who are active in the real estate sector – developers, planners, contractors, mediation agencies etc. Please send your comments, proposals and opinions to cren@filipovic-advisory.com to help us improve CREN and make it the leading medium on the Croatian real estate market.

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