

Real Estate 2020

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Published by

Law Business Research Ltd
Meridian House, 34-35 Farringdon Street
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First published 2007
Thirteenth edition
ISBN 978-1-83862-185-8

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



Real Estate 2020

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Lexology Getting The Deal Through is delighted to publish the thirteenth edition of *Real Estate*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, Chile, Cyprus, Germany, the Netherlands and Turkey.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Joseph Philip Forte of Sullivan & Worcester LLP, for his continued assistance with this volume.



London
November 2019

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This article was first published in December 2019
For further information please contact editorial@gettingthedealthrough.com

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GENERAL

Legal system

1 | How would you explain your jurisdiction's legal system to an investor?

Germany has a civil law system, where the law is predominantly based on a series of separate statutes, which are interpreted and supplemented by case law.

The most important statute in German civil law is the German Civil Code, which contains, inter alia, the basic rules for sale and purchase agreements, lease agreements and all other forms of agreements as well as rules on the acquisition, use and encumbrance of (real) property. Although the German Civil Code and various other regulations contain the most important provisions on German real estate law, the interpretation of these provisions in the jurisprudence of the German Federal Court of Justice is practically very important in some areas of real estate law (eg, the law of commercial tenancy). Contract law in Germany is governed by the principle of freedom of contract. However, several rules are binding for the parties to a contract, which means that a deviation through a contractual provision is void. Oral contracts are possible and valid; however, as regards real estate law, some transactions require a specific form. For example, any agreement governing the purchase and sale of real estate must be notarised by a public notary in order to be valid.

German courts can grant a preliminary injunction within a very short time frame, if the plaintiff can substantiate that this is required in order to avert significant disadvantages.

The acquisition and sale of real estate is mainly governed by federal law through the German Civil Code. However, there is state law of the German federal states and local law of the relevant municipalities that governs important aspects of real estate law, including real estate transfer tax, zoning and construction, environmental issues, monument protection, public safety.

Land records

2 | Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Germany has a well-established system of land registers that are managed by the local courts. Each property is registered with the competent land register. The transfer of ownership of real estate as well as the creation and assignment of any encumbrance of real estate must be registered with the land register. This rule applies to all forms of encumbrances of a property, including mortgages and land charges, hereditary building rights as well as other forms of encumbrances.

Unless an objection to the accuracy is registered with the land register or the inaccuracy is known to the acquirer, the acquirer of real

estate may assume that the content of the land register is correct (ie, the acquirer may generally rely on the content of the land register). Practically, in real estate transactions, the ownership of the seller and the encumbrances of a property are therefore in most cases evidenced by a (certified) land register excerpt with no need to conduct a detailed chain-of-title review. All encumbrances registered in the land register are ranked.

Condominium ownership is also registered in the land register (condominium land register). The same applies to hereditary building rights (hereditary building right land registers). Hereditary building rights are a form of in rem leaseholds that grant the right to own a building located on or under a property of a third party for a certain period of time (often 99 years).

Registration and recording

3 | What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The registration of conveyances and encumbrances, including the creation of security interests, requires the application to the land register filed by the owner or the respective other party (eg, the purchaser) as well as the approval of the party whose registered rights are affected by the registration (eg, in case of the registration of encumbrances, the owner of the property). This approval must be presented to the land register in publicly certified form (ie, the signatures must be certified by a public notary or other competent public authority). In the case of foreign public notaries, depending on the jurisdiction, a legalisation or apostille may be required.

Lease agreements are not registered with the land register or any other public register.

In connection with the acquisition of real estate, fees will be triggered for the public notary and the land register. Both types of fees are determined by statute. The exact amount of fees depends on the purchase price for the relevant property.

Furthermore, the transfer of real estate is taxed by all German federal states. The tax rate differs between the individual states (currently rates range from 3.5 to 6.5 per cent of the purchase price).

The aforementioned fees and taxes are to be paid by the purchaser, but the parties may agree otherwise (which is quite uncommon). The seller typically pays those fees that are triggered by the deletion of encumbrances granted in favour of the seller's financing banks.

Fees and taxes may be avoided in the case of a share deal in which the purchaser or several purchasers jointly do not directly acquire the relevant property, but all or a certain portion of the shares of the property holding company. As regards real estate transfer tax, the German legislator is currently discussing amendments to the real estate transfer tax regime for share deals. Parties considering a real estate share deal should therefore closely analyse the legal situation during the next months.

Foreign owners and tenants

- 4 | What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no general restrictions for non-resident entities or individuals to own or lease real estate in Germany. Foreign investors should, however, practically be aware of the requirements to present all documents to the land register in publicly certified form (ie, certified by either a public notary or other competent authority in Germany or a foreign equivalent with a legalisation or apostille).

Pursuant to the German Foreign Trade Act, the federal government can also prohibit the acquisition of more than 25 per cent of the share capital of a company domiciled in Germany, if the investor is domiciled outside the European Union and the acquisition could, in the government's opinion, result in a threat to public security in Germany. For companies active in the infrastructure sector, the aforementioned threshold was recently lowered from 25 to 10 per cent of the share capital.

This rule is practically only relevant for real estate share deal transactions in the defence, infrastructure and technology sector.

Exchange control

- 5 | If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Apart from the specific restrictions for (real estate) share deals mentioned above, there are no exchange control issues in connection with the investment in real estate in Germany. Cross-border money transfers exceeding certain thresholds are subject to a reporting obligation under the German Foreign Trade Act.

Legal liability

- 6 | What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

There are different types of liability that are relevant for real estate owners.

As regards liability towards third parties, the owner is liable to ensure public safety of the property and its buildings. The owner is obliged to compensate any damages suffered by a third party because of a violation of this duty.

Furthermore, the owner is liable for discovery and clean up measures on its property under the Federal Soil Protection Act and similar acts of the federal German states in case of any contaminations of the soil of the property. The owner is liable regardless of any fault for the contamination. Any potential contaminations of the soil and the associated liability risk should therefore be carefully reviewed in real estate transactions. Tenants can also be liable in case of contaminations under the Federal Soil Protection Act and similar acts of the federal states. In addition, tenant's liability is usually governed by the lease agreement in which property owners often delegate the obligation to ensure public safety of the property to the tenant.

The owner is further liable towards public authorities for payment of land tax and other taxes as well as public charges. This liability is attached to the property and can therefore be relevant for a purchaser of a property. Adequate provisions regarding indemnity from such liability are customarily included in the purchase agreement.

Lenders do typically not face the aforementioned liability risks.

Protection against liability

- 7 | How can owners protect themselves from liability and what types of insurance can they obtain?

Investors should protect themselves from liability when acquiring real estate in Germany by way of careful due diligence and adequate representations and warranties as well as indemnities in the purchase agreement.

Property owners typically take out property insurance covering damages to the property and the building. Moreover, liability insurance covers damages to third parties caused by the building or the property. Specific insurances covering certain risks resulting from potential soil contaminations are also available on the market in individual cases.

Real estate investors in Germany also customarily ring-fence risks from property investments through adequate non-recourse corporate structures (ie, separate special purpose vehicles for a specific investment).

Choice of law

- 8 | How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Real estate located in Germany is subject to German law. German law must therefore govern the conveyance of title as well as encumbrances. All other contractual terms in a real estate transaction may, however, be governed by the law of another country if the parties agree to a choice of law provision. For real estate portfolios located in various countries including Germany, it is possible to use a joint framework agreement governed by the law of one of the jurisdictions involved and separate transfer agreement that are governed by local law, which contain the conveyance of title.

In share deal structures and depending on the type of target entity involved, it is possible to (indirectly) acquire German real estate under contracts that are not governed by German law at all.

Jurisdiction

- 9 | Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

For real estate-related disputes, ordinary (civil) courts and administrative courts can have subject-matter jurisdiction. While the ordinary courts are competent for all types of civil-law disputes (eg, lease issues or issues resulting from purchase agreements or other agreements), the administrative courts are responsible for disputes between the property owner or tenant and public authorities, for example in zoning and construction law cases or environmental law cases.

Necessary parties to a claim include the plaintiff and the defendant; there is no general obligation to include third parties in the claim.

The exact requirement for out-of-jurisdiction service depends on the countries that are involved. Out-of-jurisdiction service within the European Union is (with certain exceptions) standardised via EU law.

Parties do not have to be qualified to do business in Germany to enforce remedies.

Commercial versus residential property

- 10 How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Laws regarding real estate ownership do not generally differentiate between commercial and residential properties.

However, tenancy law differs between commercial and residential properties. For residential properties, German tenancy law provides for a rather high level of tenant protection. In contrast to lease agreements for residential space, individual contractual rules that deviate from statutory law are largely permissible in lease agreements for commercial properties. Furthermore, statutory law differs in some aspects, for example, termination of a lease agreement by the landlord or the conclusion of a lease agreement for a fixed term is only permitted in extraordinary circumstances with respect to residential leases.

As regards financing, there is no general difference between residential and commercial property. However, contents of loan agreements depend very much on the specific property that is being financed.

Planning and land use

- 11 How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

There is a rather high level of regulation regarding zoning law in Germany. For inner city areas, zoning plans adopted by municipalities often stipulate the permitted type and scope of use of the properties within the zoning plan. In areas for which no zoning plan has been adopted, a new development must, generally, blend in with the type of buildings of the surrounding area.

In unplanned areas outside cities, zoning law differentiates between privileged projects (eg, farms) and other projects. The former are generally permissible if the public interest does not conflict, the latter are only permissible in individual cases and only if the public interest is not impaired.

In general the erection, alteration, change of use or demolition of a building requires a building permit. However, there are some kinds of building or construction that do not need a building permit (eg, certain small buildings). In order to obtain a building permit a building application is necessary. The application has to contain a detailed plan of the building, supporting documents (eg, site plan, construction drawings, building specifications) and, if necessary, documentation regarding heating, noise prevention and fire protection law. All the documents have to be submitted to the local building authority, which assesses whether the construction project complies with zoning and building regulation law as well as other applicable laws, such as laws concerning the protection of monuments or environmental regulations. If the building application is rejected it is possible to file an objection against the decision of the building authorities. If the objection is rejected as well, it is possible to file an action with the competent administrative court. In the building permit, the building authorities can also grant an exception from zoning law or impose additional instructions regarding the building.

If a building is not compliant with applicable laws the competent authority may request the owner to stop construction, to completely remove the building, or both.

Government appropriation of real estate

- 12 Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Expropriation of real estate is only permitted in very exceptional cases, if this is strictly required for the common good. In the context of an expropriation, the former owner has to be compensated for an adequate amount.

Forfeiture

- 13 Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Courts may confiscate real estate that was used for illegal activities. Furthermore, courts may order confiscation of proceeds (including real estate) of an illegal act.

Bankruptcy and insolvency

- 14 Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Insolvency proceedings require that there is a reason for insolvency pursuant to statutory law. Reasons for insolvency are illiquidity, potential illiquidity and over-indebtedness. If the insolvency court determines (upon application of the company or a third party) that insolvency proceedings are to be opened, an insolvency administrator is appointed and the management of the company loses the authority to dispose over the company's assets. Creditors can no longer enforce their claims against the insolvent company. In standard proceedings, the insolvency administrator will then liquidate all assets of the company in order to obtain proceeds for satisfaction of the company's creditors.

In the case of insolvency of the landlord, the insolvency administrator has the right to sell the property. The acquirer of the property assumes all rights and obligations under the lease agreements concluded with respect to the property. However, the acquirer of the property may terminate the lease agreement subject to statutory notice periods. In case of insolvency of the tenant, the insolvency administrator also has an extraordinary termination right regarding the lease agreement concluded by the tenant.

As an alternative to standard insolvency proceedings, the company may prepare an insolvency plan under supervision of a court appointed trustee. The plan must finally be approved by the company's creditors. An insolvency plan typically provides for a restructuring and partial waiver of the company's debts in order to continue the business of the company.

INVESTMENT VEHICLES

Investment entities

- 15 What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Investors typically choose the legal form of a limited liability company (GmbH) or a limited partnership with a limited liability company as general partner (GmbH & Co KG) as investment vehicle for real estate investments. Limited partnerships are pass-through entities. Both legal forms allow owners to shield the ultimate owners from liability.

Foreign investors

16 | What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors customarily use limited liability companies when choosing a German-law governed investment vehicle. This is because these entities can be used for non-recourse structures, provide for a rather flexible corporate governance regime and can be incorporated with a statutory minimum liability capital of only €25,000.

Organisational formalities

17 | What are the organisational formalities for creating and maintaining the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Setting up a limited liability company requires a notarised deed of incorporation including the articles of association and the registration of the company with the competent commercial register. The entire process can usually be completed within approximately four weeks. The shareholders must appoint one or several managing directors. Only private individuals (and not legal entities) can be managing directors. Shelf companies are available on the market and can be acquired within a very short period. Tax consequences of the relevant structure very much depend on the individual case and the parties involved.

ACQUISITIONS AND LEASES

Ownership and occupancy

18 | Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Ownership can be categorised in full ownership and co-ownership. Co-ownership is in practice important for the creation of condominium ownership, which legally consists of a share in the co-ownership of the entire property combined with exclusive ownership of an individual apartment.

Apart from the aforementioned forms of ownership, hereditary building rights, a form of in rem leasehold, exist and are widely used in Germany. Hereditary building rights grant the right to own a building located on or under a property owned by a third party for a certain period (often 99 years). At the end of the term of the hereditary building right, the building erected on the basis of the hereditary building right accrues to the owner of the property. Depending on the provisions of the hereditary building right agreement, the owner of the property has to compensate the property owner at market value of the building or an agreed price at the end of the term. Hereditary building rights can be separately sold, transferred and encumbered. However, transfer and encumbrance often require the consent of the landowner (depending on the provisions of the hereditary building right agreement).

Lease agreements are used for residential and commercial properties. While lease agreements for commercial properties can be concluded for a fixed term (eg, 10 years or even more) or an indefinite term, lease agreements for residential properties are (with some exceptions) generally concluded for an indefinite term. For tenant protection reasons, there are only limited termination rights for the landlord in case of residential properties.

Encumbrances such as rights of way or rights for installation of electric cables and water pipelines are commonly used in Germany. The

creation of such rights requires a notarised deed and registration with the competent land register. Encumbrances registered in favour of the local building authorities for compliance with zoning and construction law (public building charges) are, in most German federal states, registered in separate public registers, which should therefore also be reviewed by an investor in case of real estate acquisitions.

Pre-contract

19 | What are the typical pre-contractual steps?

In larger real estate transactions in Germany, parties often conclude a letter of intent or term sheet before negotiating the details of the transaction. Both types of agreements are non-binding with respect to the obligation to purchase and sell the property. It is possible and customary to take the property off the market while the final agreement is negotiated. This is usually achieved by an exclusivity agreement or a binding exclusivity clause in the letter of intent.

In the acquisition, sale, leasing and financing of real estate, engaging a real estate broker is optional but very common both in commercial and residential property transactions. The broker can be involved on behalf of the seller or the purchaser or on behalf of both. Special education for brokers is not required. However, brokers have to register their business and need a licence issued by local public authorities. Nevertheless, the special licence does not certify any real estate experience.

In the case of real estate acquisitions, the amount of commission is not regulated by law and can therefore be determined by the parties.

Broker commissions for leasing residential properties are capped at a maximum amount equal to two net cold rents of the relevant property plus value added tax. It is regulated by law that the party engaging the broker pays the commission in such transactions.

Contract of sale

20 | What are typical provisions in a contract of sale?

Typical provisions in a real estate purchase agreement include:

- the description of the purchase object, including land register details and all encumbrances of the property;
- the purchase price and payment mechanism;
- closing conditions, in particular:
 - the registration of a priority notice of conveyance in the land register;
 - the waivers of any applicable pre-emption rights in favour of public authorities;
 - the deletion of any encumbrance that will not be assumed by the purchaser (eg, land charges in favour of seller's financing banks); and
 - in larger transactions, merger control clearance;
- provisions regarding transfer of possession and proration of rights and benefits, including transfer of any lease agreements and other property-related agreements;
- covenants for the period between signing and closing (eg, the obligation to manage the purchase object with due care);
- representations, warranties and indemnities for pre-closing taxes;
- limitations of liability for representations and warranties (eg, caps, de minimis thresholds);
- conveyance of title and land register formalities;
- termination rights in case of default;
- a power of attorney granted by the seller to the purchaser to encumber the property prior to closing with land charges for financing the purchase price; and
- miscellaneous provisions, (eg, regarding governing law, jurisdiction, costs and taxes, etc).

In the current market environment, typically only very limited sets of representations and warranties are given. Such representation and warranties differ depending on the size and nature of the transaction but typically include certain statements on:

- title and encumbrances;
- compliance with laws;
- encroachments;
- contaminations;
- lease agreements concluded with respect to the property;
- insurance;
- litigation; and
- payment of taxes and other public charges.

In terms of title, the purchaser usually reviews the land register excerpts and cadastral maps in its due diligence. Furthermore, the seller guarantees that the statements in the land register are true and correct as of closing of the transaction.

Down payments in the amount of 5 to 10 per cent of the purchase price are often requested by sellers in the current market. These amounts are usually paid to an escrow account held by the officiating notary.

Generally, risk of loss transfers upon closing. Most real estate purchase agreements for larger transactions contain detailed provisions regarding termination rights of the parties in case the building is partially or fully demolished prior to closing.

Environmental clean-up

21 Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Under statutory law, the landowner faces liability for environmental contamination pursuant to the Federal Soil Protection Act and applicable soil protection acts of the federal states. The same applies to the polluter, its legal successors and the tenant.

In standard real estate purchase agreements, the purchaser usually indemnifies the seller from any remaining liability for contamination based on statutory law. More specific provisions with detailed indemnification obligations and covenants are used for the sale of properties with specifically known contamination.

Lease covenants and representation

22 What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The scope and exact wording of representations regarding leases very much depend on the individual transaction and the parties involved. Typical representations include:

- valid existence of lease agreements;
- no terminations or reasons to terminate lease agreements;
- no reductions of rent or defaults on rent payments or payments of ancillary charges;
- landlord's compliance with payment obligations regarding tenant improvements;
- no disputes with tenants; and
- overall rent roll amount.

Covenants regarding lease agreements for the period between signing and closing typically include that the seller will not enter into new leases or amend or terminate existing leases without the consent of the buyer and that the seller will comply with its obligations under existing lease agreements.

Leases and real estate security instruments

23 Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

As a general rule, all rights and obligations under a lease agreement transfer to the new owner by operation of law upon transfer of title. This mechanism does also apply in a sale in foreclosure proceedings initiated by the lender.

However, there are statutory break clauses regarding the lease agreement for the acquirer, if the property is sold either in foreclosure proceedings or in insolvency proceedings regarding the landlord's assets. In these situations, the acquirer of the property is permitted to terminate the lease agreement subject to statutory notice periods.

As a result, tenants run a certain risk that the lease agreement may be terminated prematurely due to the landlord's default or insolvency. Certain tenants therefore request the registration of a tenant easement in the land register with a rank prior to the land charge or mortgage of the lender. A tenant easement is an in rem right of the tenant to use the property for a specific purpose (ie, the purpose of the lease agreement). In the case of a termination of the lease agreement owing to an insolvency of the landlord or foreclosure proceedings, the easement remains in place and grants the tenant the right to continue to use the property against payment of a compensation. To mitigate a potential conflict with land charges of the lender, German mortgage banks developed certain criteria for such tenant easements. Investors should carefully review compliance with these criteria if they wish to finance the property with a German mortgage bank.

Delivery of security deposits

24 What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Lease agreements in Germany typically stipulate the obligation of the tenant to provide a security deposit. Regarding residential lease agreements, the deposit must not exceed an amount three times the monthly rent. Payment of the first part of the security deposit is typically due upon handover of the premises.

In commercial lease agreements, however, the parties are free to agree the amount of security deposits, which may exceed the threshold of three monthly rents. Depending on the tenant and the asset, bank guarantees or parent guarantees are common in commercial lease agreement.

Rent reviews are restricted in residential lease agreements by statutory law. Increases are subject to the fulfilment of certain requirements (eg, rent increases in case of modernisation measures or rent increases up to the level of the market rent). Furthermore, a staggered rent or an indexation of the rent in accordance with the German consumer price index is possible but must comply with certain prerequisites pursuant to the German Civil Code.

In long-term commercial lease agreements, indexation clauses, which link the rent to the development of the German consumer price index, are widely used.

Due diligence

25 | What due diligence should be conducted before executing a contract? Is any due diligence customarily permitted or conducted after contract but before closing? What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain government confirmation, a zoning report or legal opinion regarding legal use and occupancy?

Buyers usually seek to protect themselves against bad title by way of due diligence and representations and warranties given by the seller. The scope of due diligence very much depends on the individual transaction target and transaction structure. Usually at least a legal, tax and technical or environmental due diligence is conducted by the buyer. In transactions that include the acquisition of the property holding company, buyers would also conduct a financial due diligence. Conducting due diligence after signing but before closing is rather unusual.

In large auction sale processes, the seller would typically also conduct a seller due diligence and provide the results in the form of a vendor due diligence report or – more often – a ‘fact book’ to the interested bidders.

Regarding title due diligence, each acquirer needs to review the land register. Unless an objection to the accuracy is registered with the land register or the inaccuracy is known to the acquirer, the acquirer of property may assume that the content of the land register is correct. Therefore, there is usually no additional title search done in Germany for real estate acquisitions.

All registered encumbrances of the property are ranked. The general concept of the land register is ‘first in time, first in rank’. However, it is possible to deviate from this concept and agree on (and register) changes of the rank with the consent of all affected parties.

As regards legal use and occupancy, the parties usually review the zoning law situation, any applicable zoning plan and the building permit of the property as part of their due diligence.

Structural and environmental reviews

26 | Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Engineering and environmental issues are usually covered by a technical due diligence conducted by civil engineers. As part of the legal due diligence, registers of contaminated sites are checked.

In most transactions, representations and warranties regarding structural and environmental issues are limited. In transactions involving real estate with known contamination, the parties usually extensively negotiate the exact liability regime for the contamination. Specific insurance solutions covering risks resulting from environmental issues are also available on the market in individual cases.

Review of leases

27 | Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are typically reviewed both from the legal and the business side. The review on the business side usually focuses on key commercial terms. The lawyer’s review also comprises, among other things, compliance of the lease agreement with statutory law (eg, regarding indexation clauses or recoverability of operating expenses), identification of break clauses and change-of-control clauses, sublease and assignment provisions as well as a general review regarding all kinds of unusual (payments) obligations.

Furthermore, lease agreements for commercial properties must be concluded in written form in order to provide for a fixed term of more than one year. The German Federal Court of Justice has developed a specific interpretation regarding this written form requirement. If the parties violate this requirement, the agreement can be terminated by either party with the statutory notice period (ie, for commercial lease agreements with a notice period of six months). Lawyers therefore typically also check compliance with the written form requirement as part of the legal due diligence exercise.

Other agreements

28 | What other agreements does a lawyer customarily review?

Apart from the lease agreements, the legal due diligence usually includes the review of service agreements pertaining to the property (eg, asset management or property management agreements), finance agreements and insurance agreements if the transaction is either structured as a share deal or if these agreements are explicitly transferred to the purchaser in an asset deal. In share deal structures, the scope of review also comprises all corporate documents (articles of association, shareholders’ agreements, etc) of the relevant property holding company.

Brokerage agreements are typically not within the scope of the review.

Closing preparations

29 | How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers typically prepare the fulfilment of all closing conditions and any documents that have to be signed at closing. The exact set of preparations depend on the specific structure of the transaction (eg, for share deals or forward deals often more complex closing preparations are required compared to asset deals regarding existing buildings). For asset deals, the public notary is usually responsible for the fulfilment of certain closing conditions (eg, waiver of statutory pre-emption rights and registration of priority notices in the land register).

The usual timing between signing and closing also depends on the specific project. Simple transaction for which no merger clearance is required can often be closed four weeks after signing or even simultaneously with signing. In forward deals (ie, projects in which a building is sold that is still under construction), the period between signing and closing can be several years.

For closing of a financing, lenders require that the loan documentation is duly signed and all conditions precedent are fulfilled, including, for example, all security documents and legal opinions by lawyers.

Closing formalities

30 | Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Signing of a real estate purchase agreement must occur in front of a public notary with all parties present (either in person or represented by a proxy). Upon fulfilment of all closing conditions, the public notary issues a payment notification to all parties and the purchaser pays the purchase price on this basis. Closing is effected by payment of the purchase price to the seller's account. Afterwards, the notary will procure registration of the change of ownership with the land register.

In more complex transactions and usually in share deal transactions, all parties meet in person to verify the completion of all closing conditions, the existence of all closing deliverables and the due execution of the agreements that have to be signed at closing. Depending on the deal structure and closing deliverables, a public notary may also be required for notarisation at closing.

Closing of financing agreements usually occurs upon fulfilment of all conditions precedent and, in particular, the signing of security documents. Usually, no in person meeting is required.

For lease agreements, the parties usually agree on a formal handover of the property upon the start of the lease term. Lawyers are only in exceptional cases involved in this handover process.

Contract breach

31 | What are the remedies for breach of a contract to sell or finance real estate?

In the event of default of either party to consummate a real estate purchase agreement, seller and purchaser have the possibility to sue the other party for specific performance and request damage compensation.

Purchasers further typically have to agree on a submission to immediate enforcement in real estate purchase agreements. Therefore, if the purchaser fails to close, the seller can also directly enforce its purchase price claim. Furthermore, in case of non-payment of the purchaser at closing, the seller typically has the right to terminate the agreement and retain a potential down payment of the purchaser.

In the event of breaches of a loan agreement, each party can also sue the respective other party for specific performance and request damage compensation.

Breach of lease terms

32 | What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply? Are the remedies available to landlords different for commercial and residential leases?

The consequences of a breach of the lease terms are governed in the specific lease agreement and the lease related provisions of the German Civil Code.

In case of severe breaches, either party may terminate the agreement for cause. Lease agreements for commercial premises customarily specify under which circumstances the parties may terminate for cause. For residential lease agreements, the landlord's termination rights are restricted to the circumstances listed in the German Civil Code. These circumstances include, in particular:

- default with rent payment or a substantial portion of rent on two successive payment dates;

- default of payment for a time period of more than two payment dates of the rent in an amount equal to the amount of rent for two months; and
- substantial violation of the lease agreement.

After a termination, the property owner may file an action for eviction with the competent court.

In the event of a breach of lease terms by the landlord (eg, defects of the property), the tenant may sue for specific performance and request damage compensation, rent reduction or both.

FINANCING

Secured lending

33 | Discuss the types of real estate security instruments available to lenders in your jurisdiction. Who are the typical providers of real estate financing in your country? Are there any restrictions on who may provide financing?

The most common form of collateral in real estate financing in Germany are land charges that are registered with the land register of the financed property. Land charges encumber the property but do not constitute a conveyance of the real estate to the lender. Other forms of security instruments are mortgages, which are less frequently used as they are less flexible, for example, in case of assignments to third parties or refinancing.

In commercial real estate financings, lenders usually also request additional securities, including security assignment of rent, share pledges of the relevant property holding company and bank account pledges.

Typical providers of real estate financing in Germany are banks, insurance companies or building societies. Real estate financing can be obtained for both the purchase of existing buildings and for development projects. In general, lenders require a German or EU passported banking licence.

Leasehold financing

34 | Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is also available for hereditary building rights (German law leaseholds), which may also be encumbered with land charges. Under many hereditary building right agreements, the property owner's consent is required in order to grant land charges regarding hereditary building rights. The remaining term of the hereditary building right is taken into account by financing banks in their valuation of the security. Priority issues may arise between the land charge of the lender and the registered rights of the property owner (eg, regarding payment of hereditary building right interest). These issues can typically be mitigated by careful drafting of the financing documents and the hereditary building right agreement.

Form of security

35 | What is the method of creating and perfecting a security interest in real estate?

A land charge requires a notarised deed and registration with the land register.

Valuation

36 Are third-party real estate appraisals required by lenders for their underwriting of loans? Are there government or industry standards for appraisals? Must appraisers have specific qualifications or required government or industry certifications? Who is required to order the appraisal?

Lenders of large financings typically conduct an internal and external appraisal of the property. In particular, lenders require a third-party appraisal in case they want to refinance the loan via German law covered bonds. Specific rules apply for appraisals of acquisitions by real estate funds. Appraisers need to have the necessary expertise and experience for the transaction and property in question. Banks are required to order the appraisal. Furthermore, capital requirement provisions under banking law require banks to evaluate the value of collateral granted to them.

Legal requirements

37 What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Lenders who want to offer financings to borrowers in Germany on a recurring basis must hold a German or EU passported banking licence.

Typical liens used for real estate financings are land charges. Creating land charges requires a notarised deed and registration with the land register. Both the notary and the land register request fees under statutory law. Assignments of land charges are possible, but (depending on the exact type of land charges) may also have to be registered in the land register.

Loan interest rates

38 How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates for real estate financings are commonly calculated as the sum of reference rate plus margin. EURIBOR is often used as reference rate. In addition to the interest, borrowers usually also have to pay certain costs and fees of the lender.

Interest rates that are unreasonably high may be regarded as a violation of statutory law and are thus prohibited. Permissible interest rates depend very much on the individual circumstances. Limitations on interest rates do not differ between various types of lenders.

Loan default and enforcement

39 How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

As a general rule, enforcement of claims in Germany requires a successful court ruling.

However, in connection with granting a land charge as security for real estate financings, debtors are usually requested to agree to immediate enforcement into the property and all other assets of the debtor. Therefore, in case of a payment default, lenders do not have to

obtain a court ruling but can directly enforce their claims, in particular by requesting a forced sale of the property. There are no restrictions on the types of legal actions that may be brought by the lenders. Lenders may enforce under all security documents granted to them.

Loan deficiency claims

40 Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders may recover the difference between their claim (in particular, outstanding loan plus interest) and the amount recovered in the foreclosure proceedings. General time limitation rules for claims under the German Civil Code apply. If the debtor or guarantor has filed for insolvency and insolvency proceedings have been opened, the individual enforcement of claims is no longer allowed.

Protection of collateral

41 What actions can a lender take to protect its collateral until it has possession of the property?

Protection of collateral is usually achieved by property-related covenants in the loan and security agreements.

Furthermore, forced administration is recognised as a type of foreclosure proceeding regarding real estate. In forced administration, the property is not sold to a third party, but management of the property is transferred to a forced administrator and creditors receive rent payments.

In addition, rents may be collected during foreclosure proceedings in case of a security assignment of rent to the lender.

Recourse

42 May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

In connection with granting a land charge as security for real estate financings, debtors are usually requested to agree to immediate enforcement not only into the property but also into all of the debtor's assets. Furthermore, in case of a successful court ruling against the debtor, lenders can also enforce their claims with recourse to all of the assets of the debtor. Personal recourse to guarantors is usually not limited.

Cash management and reserves

43 Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Depending on the specific property and the credit of the borrowers, lenders may ask for blocked reserve accounts. Such accounts can, for example, include reserve accounts for taxes and other public charges, ancillary costs or capex/tenant improvement measures.

Credit enhancements

44 | What other types of credit enhancements are common? What about forms of guarantee?

Reserve accounts are common to enhance a borrower's credit. Furthermore, letters of credit and parent guarantees are also customarily used. For construction or project development loans, holdbacks as well as third party payment and completion guarantees are often requested by lenders.

Loan covenants

45 | What covenants are commonly required by the lender in loan documents?

The exact set of loan covenants depends on the type of property and transaction. However, typical covenants include the following:

- information and reporting covenants;
- covenants regarding proper insurance of the property;
- property related covenants (eg, regarding maintenance and repair of the property); and
- negative pledge covenants.

Financial covenants

46 | What are typical financial covenants required by lenders?

Typical financial covenants in German real estate financings are loan to value covenants, debt service coverage ratio covenants, interest coverage ratio covenants and loan to cost covenants. Furthermore, most commercial loan agreements contain financial reporting requirements for the borrower. Lenders usually reserve the right to request appraisals of the property under certain conditions.

Secured movable (personal) property

47 | What are the requirements for creation and perfection of a security interest in movable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

A security interest in movable property is usually created by contract resulting in a security transfer of ownership of the secured assets.

Single purpose entity (SPE)

48 | Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Lenders do usually not require each borrower to be an SPE. However, investors often choose to shield liability and prepare for a clean exit by using SPEs for their real estate investments in Germany. To the extent the SPE is a German law-governed company, general German corporate law applies, as there are no specific rules for SPEs.



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UPDATE AND TRENDS**International and national regulation**

49 | Are there any emerging trends, international regulatory schemes, national government or regulatory changes, or other hot topics in real estate regulation in your jurisdiction?

The German legislature is currently preparing amendments to the real estate transfer tax (RETT) regime for share deals. These amendments are aimed to reduce the number of share deal transactions in which no real estate transfer tax becomes due. In particular, under the current draft legislative proposal, it is foreseen that real estate transfer tax will become due if 90 per cent of the shares of a property holding company are acquired (currently the threshold is 95 per cent). Furthermore, holding periods after which shares or interests may be transferred without RETT becoming due will probably be extended from five to 10 years. Finally, according to the draft legislative proposal, co-investment structures in which two separate buyers together acquire all shares of a property holding company would no longer be exempted from RETT. Investors should carefully analyse the next steps of these proposed amendments, which are expected to come into effect in January 2020.

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