MAYER • BROWN

March 2018

Real Estate Newsletter

Recent Developments, Topics and Decisions

Triple Net Leases – Possibilities of Implementation under German Law

Dr. Jörg Michael Lang
Notary
Partner, Frankfurt
T +49 69 7941 1761
jlang@mayerbrown.com

INTRODUCTION

Triple net leases are lease agreements whereby all operating and administration costs, including maintenance costs for roof and walls, are passed on to the tenant. For the landlord, this offers the opportunity to be able to calculate income from the tenancy with certainty. For the tenant, the advantage is that he only has to pay rent that is significantly reduced in part and can take over the entire management of the building efficiently himself.

In the English-speaking world, triple net leases are widespread, but in Germany they are currently rather limited. This lies primarily in the uncertainty about whether they are lawful under German law in the first place. Due to the increasing number of investors originating from the Anglo-Saxon law world, there is also an increasing interest in the German real estate industry for this form of contract. This applies in particular for single-tenant properties, for which the property is ceded to the tenant for use as a whole.

TRIPLE NET AGREEMENTS IN GT&C

In German law governing lease agreements, maintenance of the leased property is generally the landlord's duty. Transferring maintenance to the tenant by way of contractual agreement is therefore a deviation from the statutory guideline. In order to be valid – if the clause is not individually negotiated, but put in by the landlord – it must meet the requirements of the test of reasonableness of General Terms & Conditions (GT&C).

A triple net agreement is not a surprise clause within the meaning of Section 305 (1) German Civil Code (*BGB*), which would be invalid from the outset. However, agreements which impose maintenance obligations for the roof and walls on the tenant will be viewed as an inappropriate disadvantage for the tenant pursuant to Section 307 (1), (2) BGB. Such an agreement put in by the landlord therefore breaches GT&C law and thus is invalid. The result of this is that the maintenance obligation remains with the landlord as per the statutory guidelines, while the tenant would still only have to pay the reduced rent.

It would be different if the tenant himself had put in the triple net agreement in a draft of the tenancy agreement to the landlord. In this case, the protection provisions of the law on GT&C would not act in favour of the tenant.

INDIVIDUALLY NEGOTIATED TRIPLE NET AGREEMENTS

If a triple net agreement was not included in the contract as a preconceived wording, but rather due to an individually negotiated agreement, the problems mentioned above do not arise in the course of the GT&C test. The Regensburg regional court decided that the agreement of a triple net rent is not generally improper pursuant to Section 138 (1) BGB. A decision by the supreme court about whether the triple net leases are lawful under German law is still pending, but there are good reasons to think that these are not generally unlawful in the case of individually negotiated contracts.

It is however problematic that the conclusion of individually negotiated contracts creates difficulties. In order for an agreement to be deemed individually negotiated, it is not sufficient that one side offered the other to waive the clause "pro forma". It must rather be clearly recognisable that it would have also been possible to conclude a contract without the triple net agreement. If the landlord cannot prove that the clause was negotiated individually, it is deemed a GT&C and the problems indicated above arise as a result.

CHOICE OF LAW AS A WAY OUT?

One possible way to counter the uncertainties around the legality can be the choice of a foreign law.

In the case of commercial leases where there is a foreign element, the parties can generally freely choose the applicable law. For there to be a foreign element, it is sufficient that one of the parties is resident abroad. Since in many cases foreign companies are involved as parties to a lease, it is generally possible to select a foreign law. In doing so, the parties can choose the law which appears to them to be the most suitable. The chosen law does not need to have any relation to the transaction or the states in which the contracting parties are resident. In the context of interest here, it is of vital importance that the parties select a law which recognises triple net leases. This is the case in Anglo-American law.

Provided there is a sufficient foreign element, not only contracting parties based in the USA or the UK may effectively agree on Anglo-Saxon law for their commercial lease, other foreign parties may do so as well, e.g. a S.à r.l. resident in Luxembourg.

There are restrictions on the choice of law insofar as mandatory provisions of another legal system enjoy priority. This is assumed to some extent for the law on residential leasing, in particular for mandatory provisions of German law to protect tenants, including protection against eviction. As far as can be seen, this priority of German tenancy law should not apply to commercial leases.

Should the opportunity to validly conclude a triple net lease with choice of law be used, consequential problems arise under certain circumstances: If it comes to court proceedings regarding the lease, then these would necessarily have to be held before a German court (in the municipality where the premises are located) on the basis of Section 29a (1) German Code of Civil Procedure (*ZPO*). This so-called exclusive court of jurisdiction is binding on the parties. This court would however have to apply foreign law, which would frequently require expensive work by experts due to the lack of the judges' own knowledge in the matter. Lawyers who are familiar with the applicable law would also have to be found. Besides that, there is the risk that the chosen law is unfamiliar to at least one of the parties, with the result that any assertion of rights would be made more difficult.

It is therefore concluded that the opportunity to choose the law does not represent an ideal solution.

CONCLUSION

Triple net agreements made in GT&C will be considered invalid in the course of the GT&C test as a rule, meaning that an agreement on triple net leases is not possible using standard form contracts in Germany. In terms of individual contracts, these are lawful according to the prevailing view, but it is difficult to bring before the court evidence that an agreement was individually negotiated. The cases in which the tenant himself suggests the conclusion of a triple net lease should not be critical, because then the critical situation of the "provision" of the lease by the landlord does not exist.

If the lease is related to a foreign legal system, it should be possible to validly conclude triple net leases by choosing a foreign law. However, time and cost disadvantages as well as potential legal risks which are difficult to calculate arise in proceedings concerning the lease agreements.

Therefore, triple net leases can be validly concluded by way of individual agreements or choice of law, but both possibilities have disadvantages and risks which are to be observed when making the arrangement.

Obligation of Notarisation for Amendments to Property Purchase Agreements despite declared Conveyance

Elmar Günther, Maître en Droit
Notary
Of Counsel, Frankfurt
T +49 69 7941 1141
eguenther@mayerbrown.com

Any subsequent amendment to a property purchase agreement with conveyance requires the notarial form before transfer of ownership, in any case if the transfer of ownership should not be carried out until after payment of the purchase price.

(OLG Stuttgart, judgement of 26 September 2017 – 10 U 140/16)

INTRODUCTION: For a contract which has as its object the obligation to transfer or to purchase a real property, the German Civil Code (*BGB*) prescribes that the contract must have the form of notarial certification. Form defects can be remedied through (i) the so-called conveyance (the in rem agreement to transfer) and in addition (ii) the registration of the transfer of ownership in the land register. It is always questionable whether and to what extent subsequent changes to the purchase agreement also require notarisation prior to the transfer of ownership. For the case group where the conveyance has already been declared, the German Federal Court of Justice (*BGH*) judged in 1971 and fundamentally again in 1984, following old decisions from the imperial court (*Reichsgericht*), that a later amendment does not require the notarial form. It stated that the obligation triggering the form requirement is satisfied in full and therefore no longer exists. The Federal Court of Justice subsequently maintained this case law, contrary to the almost unanimous dogmatic critique in the literature. The Stuttgart Higher Regional Court has now explicitly positioned itself with the opinion in the literature and against the Federal Court of Justice.

THE DECISION: Ultimately, the decision was based on an agreement on the reduction of the purchase price through a countersigned exchange of letters within the framework of a property developer (purchase) agreement. The purchase agreement contained the conveyance as well as the instruction to the notary to first arrange the transfer of ownership in the land register with the purchase agreement upon evidence of the payment of the purchase price. The seller demanded the remainder of the purchase price based on the invalidity of the agreement as a result of it not having been notarised; the purchaser held the agreement to be possible without form and therefore valid. The Higher Regional Court decided in favour of the seller. In doing so, it embraced the dogmatic critique in the literature, according to which the fulfilment of the obligation under the law of obligations to acquire title requires two elements: The declaration of conveyance and, secondly, the registration in the land register that ownership has transferred. The Federal Court of Justice's opinion is based on an out-dated understanding that the conveyance is carried out as a factual last stage in the processing of the purchase agreement and therefore the protective functions of the obligation of notarisation are no longer relevant. Since then, however, conveyance regularly takes place upon conclusion of the agreement, which requires further protections for the additional execution stages up to the instigation of the transfer of ownership. Otherwise, the functions of the obligation of notarisation, in particular the warning, protection and evidence function, would be effectively cancelled if the notarised agreement could be changed without form in almost all matters.

IMPACT IN PRACTICE: Permission to appeal on points of law against the judgement was granted by the Federal Court of Justice. It remains to be seen if and how the Federal Court of Justice will rule. In the meantime, there is no longer a uniform case law. In practice to date, material amendments in the framework of obligations of the parties have to a great extent been notarised as a precaution, but in future it is recommended to always have amendments notarised to be on the safe side.

Benjamin Schulz
Associate, Frankfurt
T +49 69 7941 1139
bschulz@mayerbrown.com

Neighbours' legal Claims for Compensation for Nuisance caused by the Employment of Craftsmen on own Property

An owner of property is liable to his neighbour for nuisance attributable to the fact that he employs craftsmen on his property. He must pay financial compensation to the neighbour irrespective of fault for the damages resulting from the hiring.

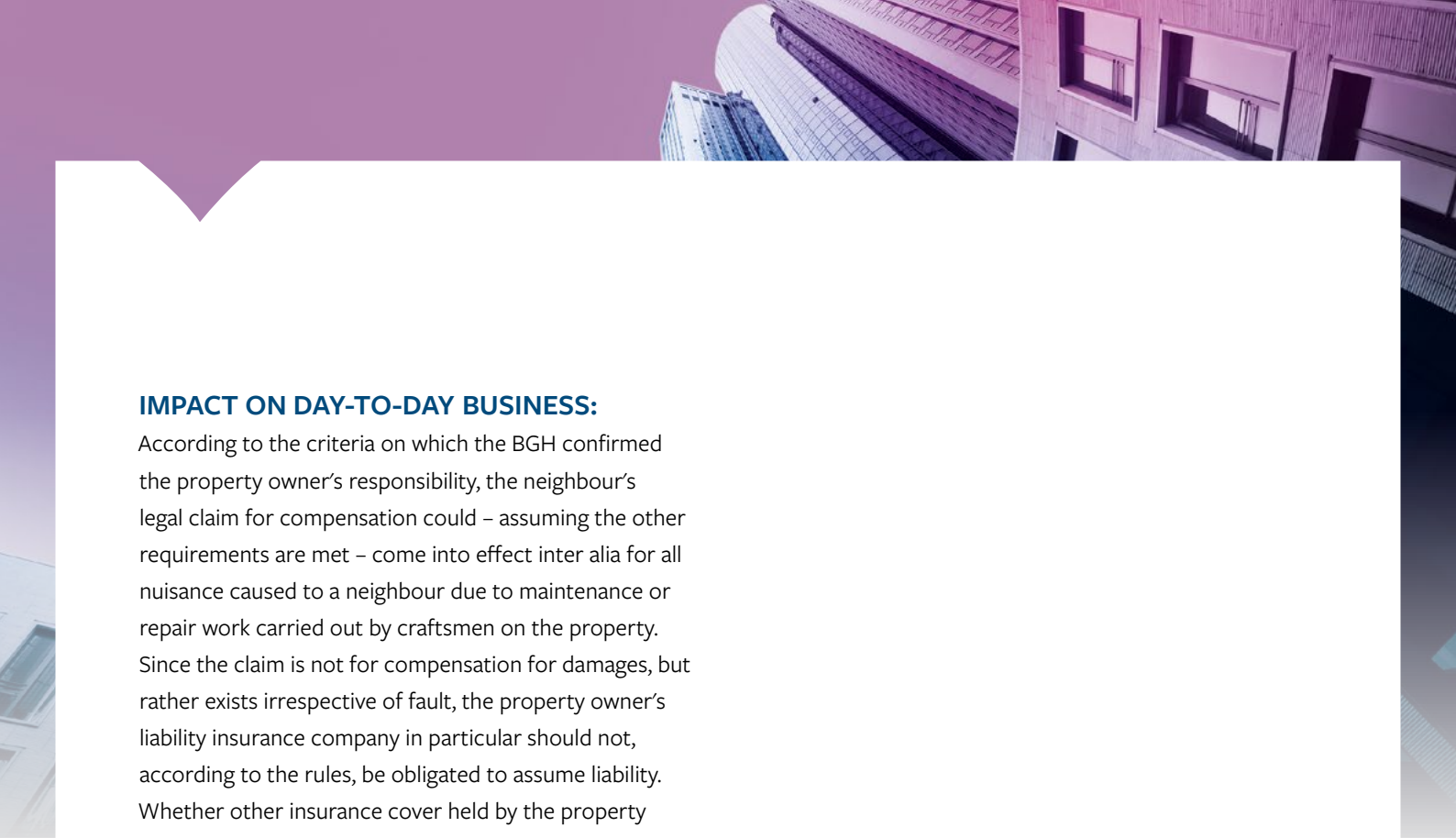
(BGH, judgement of 9 February 2018 – V ZR 311/16)

INTRODUCTION: The law envisages claims for abatement or removal and claims to cease and desist due to nuisance on private property, such as from emissions. There are however barriers in place for these claims, otherwise any practical use of neighbouring properties would not be possible. There are therefore no claims for abatement or removal and claims to cease and desist due to "insignificant" nuisance to the property. But even in the case of "significant" nuisance it is conceivable that it cannot be prevented, can no longer be prevented or else cannot be prevented with economically justifiable expense. Even then, the aforementioned claims do not exist. For these cases, the law stipulates a monetary claim for compensation against the party who is responsible for the nuisance as the so-called "creator of the nuisance". The Federal Court of Justice (*BGH*) has now decided that this financial claim for compensation takes effect if a craftsman employed by the owner of the property causes a fire which extends to the neighbouring house.

THE DECISION: A property owner hired a roofer to carry out repair works on a flat roof. In doing so, the craftsman culpably caused a fire. The property owner noticed the fire and called the fire service. The building nevertheless burned to the ground. As a result of the fire and the fire-fighting operations, the neighbouring house sustained significant damage. The insurance company of the neighbour affected compensated the neighbour and sought recourse. The roofer was ordered to pay. However, insolvency proceedings were opened over his assets. The insurance company therefore turned to the property owner who had hired the roofer.

Contrary to the previous instance, the BGH conceded to the financial claim for compensation of the neighbour's insurer. This is settled case law if, in the course of commercial use of a property, illegal actions emanate onto another property, which the owner or possessor of this property need not tolerate but is also unable to prevent, provided he suffers disadvantages which go beyond what is reasonable. In the case of a fire which extends to a third-party property, these requirements are met because the neighbour could not generally identify or repel the risk in good time.

In addition, the property owner is also responsible for the nuisance as the "creator of the nuisance" because the property owner awarded the contract and intended to profit from it. Also, in principle he could have influenced the type and scope of the craftsman's activity at any time. The nuisance for the neighbour resulting from the fire was therefore based on circumstances which are attributable to the property owner's sphere of influence. It is sufficient that these circumstances stem indirectly from his will. The fact that a third party, the roofer, caused the fire is as irrelevant as the fact that the craftsman was carefully selected and that no specific manner of performance was stipulated to him.



IMPACT ON DAY-TO-DAY BUSINESS:

According to the criteria on which the BGH confirmed the property owner's responsibility, the neighbour's legal claim for compensation could – assuming the other requirements are met – come into effect inter alia for all nuisance caused to a neighbour due to maintenance or repair work carried out by craftsmen on the property. Since the claim is not for compensation for damages, but rather exists irrespective of fault, the property owner's liability insurance company in particular should not, according to the rules, be obligated to assume liability. Whether other insurance cover held by the property owner would take effect must be determined separately in each case. In this regard, the craftsman should be obligated within the framework of his commission to maintain business liability insurance with sufficient cover. Moreover, the property owner should in fact insist unconditionally on evidence of this insurance cover, which as a rule should be agreed by contract.

The BGH referred the claim back to the higher regional court (*Oberlandesgericht*) for a decision due to the amount of the claim. The neighbour's claim for compensation does not, unlike a claim for compensation for damages, aim for full compensation of actual loss. Instead, the neighbour may claim "appropriate compensation". The law explicitly mentions the negative effect on "income". Rental income possibly lost by the neighbour is therefore generally compensable. In addition, the neighbour's claim for compensation also includes purely non-pecuniary damages, e.g. the mere impairment of potential use. The claim can therefore reach a considerable sum.

Overview Real Estate Transfer Tax Rates

Tax

Susan Günther
Counsel, Frankfurt
T +49 69 7941 1293
sguenther@mayerbrown.com

The following table provides an overview of the current status of the real estate transfer tax rates in the individual federal states (27 March 2018).

Baden-Württemberg	5.0 %
Bavaria	3.5 %
Berlin	6.0 %
Brandenburg	6.5 %
Bremen	5.0 %
Hamburg	4.5 %
Hessen	6.0 %
Mecklenburg-Western Pomerania	5.0 %
Lower Saxony	5.0 %
North Rhine Westphalia	6.5 %
Rhineland-Palatinate	5.0 %
Saarland	6.5 %
Saxony	3.5 %
Saxony-Anhalt	5.0 %
Schleswig-Holstein	6.5 %
Thuringia	6.5 %

About Mayer Brown

OUR GLOBAL REAL ESTATE MARKETS PRACTICE – a core practice for Mayer Brown comprised of over 200 lawyers – offers international and local knowledge from established teams in real estate markets throughout the world. We manage deals from all sides, and are able to leverage that experience on behalf of our clients. We anticipate shifts in the industry and respond to market conditions with an approach that is both sophisticated and pragmatic. From formation of capital-raising vehicles to acquisitions and sales to transactions involving complex financing and joint-venture structures in multiple jurisdictions, our multidisciplinary team handles matters spanning the industry, including:

- Real estate funds and investment management
- Private equity real estate
- REIT structuring and compliance
- Joint ventures and strategic alliances
- Fund finance and real estate finance
- Development and construction
- Portfolio leasing and ancillary asset management services
- Corporate real estate services
- Distressed real estate
- Transfer tax, property tax and assessment challenges
- Real estate litigation

THE MAYER BROWN PRACTICES COMPRISE MORE THAN 1,600 LAWYERS – among the largest law firm workforces in the world. We operate in the world's principal financial centers in the Americas, Europe, Asia and the Middle East.

IN OUR GERMAN OFFICES, more than 70 lawyers advise German and international clients in all areas of commercial law.

OUR CLIENTS include real estate institutional investors; pension funds and advisers; private equity funds; opportunity funds; real estate investment trusts; commercial, investment and industrial banks; governments; statutory bodies; insurance companies; real estate holding companies; developers; and multinational corporations.

The German Real Estate Coreteam

Head of the German Real Estate Practice

Dr. Fabian Hartwich, LLM
Partner, Frankfurt
T +49 69 7941 1115
fhartwich@mayerbrown.com

Dr. Joachim J. Modlich
Partner, Düsseldorf
T +49 211 86224 203
jmodlich@mayerbrown.com

Elmar Günther, Maître en Droit
Notary
Of Counsel, Frankfurt
T +49 69 7941 1141
eguenther@mayerbrown.com

Dr. Philipp Schaefer, Mag. iur.
Counsel, Frankfurt
T +49 69 7941 1065
pschaefer@mayerbrown.com

Annika Bautz
Senior Associate, Frankfurt
T +49 69 7941 1891
abautz@mayerbrown.com

Benjamin Schulz
Associate, Frankfurt
T +49 69 7941 1139
bschulz@mayerbrown.com

Dr. Jörg Michael Lang
Notary
Partner, Frankfurt
T +49 69 7941 1761
jlang@mayerbrown.com

Andreas Hilfrich
Counsel, Frankfurt
T +49 69 7941 1761
ahilfrich@mayerbrown.com

Dr. Jürgen Streng
Counsel, Düsseldorf
T +49 211 8622 4216
jstreng@mayerbrown.com

Anja Giesen, LLM
Senior Associate, Düsseldorf
T +49 211 86224 240
agiesen@mayerbrown.com

Sabine Krause
Associate, Düsseldorf
T +49 211 8622 4119
skrause@mayerbrown.com

Real Estate Finance

Dr. Martin Heuber, LLM
Partner, Frankfurt
T +49 69 7941 1128
mheuber@mayerbrown.com

Selected Experience 2017/2018

Real Estate team has "business sense and industry knowledge"

Legal 500 Deutschland 2018

Advised the open real estate fund **BERENBERG Real Estate Berlin**, which was set-up by Berenberg Bank as real estate manager and Universal-Investment, on the acquisition of the shopping and district center "Neumann Forum" in Perlin-Pankow from the Hamburg real esate company RI Partners. The "Neumann Forum" has a lettable area of around 26,500 sqm with more than 270 parking. Tenants of the almost fully let property are large retail chains, a privately-owned school, a kinder-garden as well as a retirement home.

In its advisory role for the BVK-Deutschland I-Immobilien-fonds – FMZ fund managed by **Universal-Investment Luxembourg,** the largest independent investment company in german-speaking Europe, the asset and property manager **GPEP** has acquired the Lion 2.0 portfolio. **Bayerische Versorgungskammer** (BVK – Bavarian pension fund for professional groups) is the fund's investor. The portfolio comprises 34 retail properties (16 discount stores, 9 supermarkets and 9 retail parks) was purchased from Habona Invest.

Credit Suisse Asset Management Immobilien KAG on disposal of the shopping centers "Rathaus-Galerie", Leverkusen (approx. 37,000 sqm), "Mercado-Center", Nuremberg (approx. 43,500 sqm) and "Le Befane", Rimini as the so-called "Melody Portfolio" to Union Investment. The transaction is considered one of the largest shopping center transactions in Germany in 2017.

Universal-Investment with GPEP GmbH as portfolio manager on the acquisition of 32 retail stores with a gross lettable area of around 40,000 sqm. Annual rental revenue is around four million Euro. Seller was an institutional fund.

Advised **LaSalle Investment** on the acquisition of a 16,000 sqm commercial building "Am Friedensplatz" in Bonn by way of sale-and-leaseback for a club of investors from Sparkasse Koeln/Bonn. The property serves as local headquarter of Sparkasse Koeln/Bonn.

BNP Paribas on the sale of real estate properties to La Francaise. The properties are located on a construction site in the town of Leutkirch im Allgäu. The project includes 250 luxury cottages covering 25,000 sqm as well as a property with a spa, restaurants, shops and play grounds with around 2,500 sqm.

About Mayer Brown

Mayer Brown is a global legal services organization advising clients across the Americas, Asia, Europe and the Middle East. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit our web site for comprehensive contact information for all Mayer Brown offices. www.mayerbrown.com