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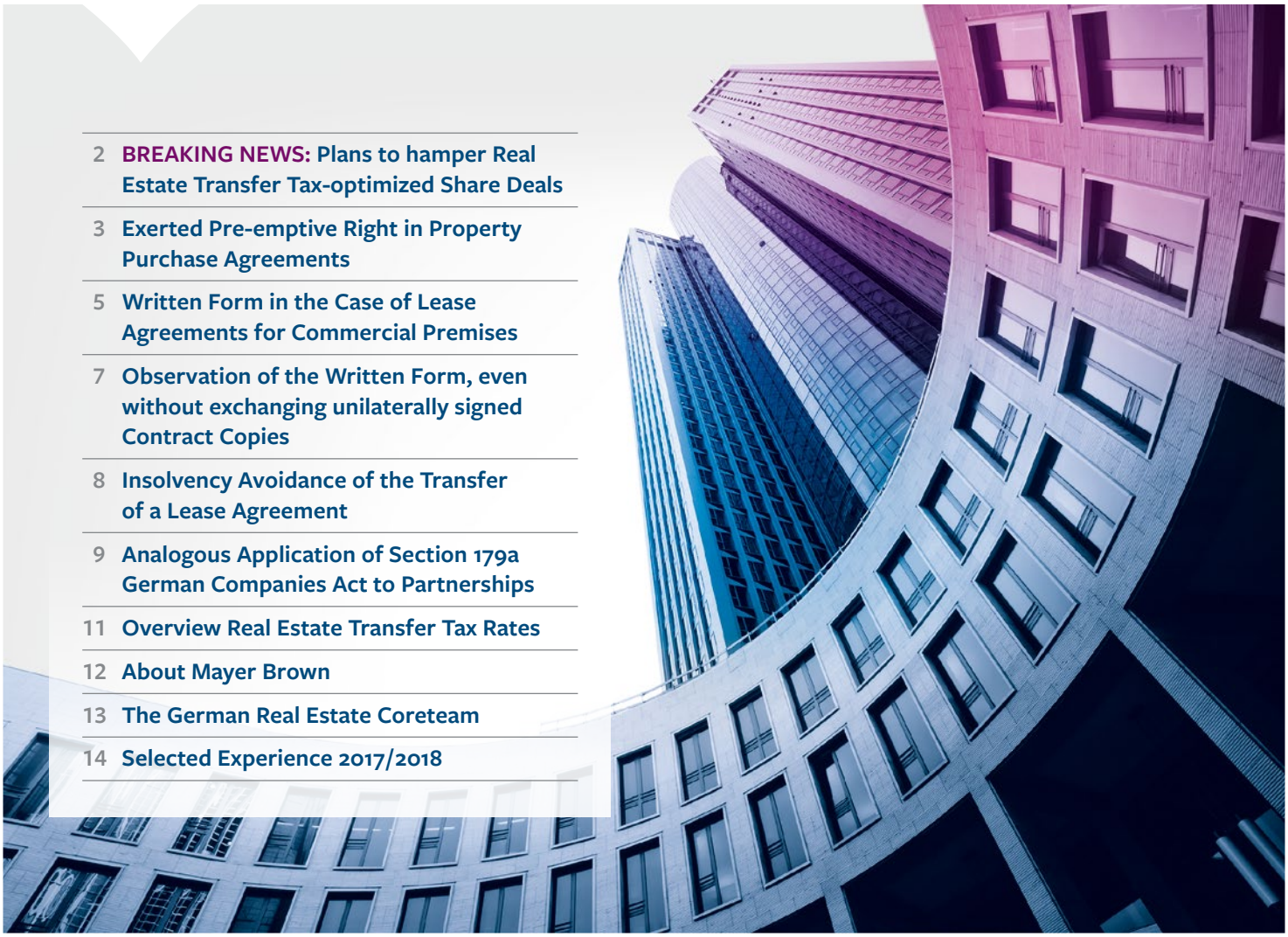
Real Estate Newsletter

Recent Developments, Topics and Decisions



BREAKING NEWS: Plans to hamper Real Estate Transfer Tax-optimized Share Deals

Tax

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On 21 June 2018, the Hessian Ministry of Finance issued a press release according to which the finance ministers of the Federal States agreed on several measures to aggravate the implementation of tax structures to avoid German real estate tax in case of share deal transactions. Pursuant to the press release, it is to be expected that, in particular, Sec. 1 Para. 2a, 3 and 3a German Real Estate Transfer Act ("RETT Act") will be amended in the near future to implement the following key measures:

Lowering the relevant participation threshold from 95% to 90%

The participation threshold relevant for all share deal transactions triggering real estate transfer tax under Sec. 1 Para. 2a, 3 and 3a RETT Act shall be reduced from at least 95% to at least 90%.

Lengthening of the monitoring periods from 5 to 10 years

The currently applicable monitoring periods shall be extended from 5 years to 10 years.

Introduction of a new real estate triggering event in case of a change in the shareholder structure of a corporation

Under current tax law, RETT is triggered if at least 95% of the partnership interests in a partnership owning German real estate are transferred, directly or indirectly, to new partners within a monitoring period (Sec. 1 Para. 2a RETT Act). Such provision shall now also apply to corporations and the threshold shall be reduced to 90% (which could be problematic for listed corporations). Consequently, a RETT optimized, complete purchase of a shareholding together with a co-investor shall be made impossible (i.e., an existing shareholder must continue to hold a significant minority participation).

It is to be expected, that the proposals of the finance ministers will be implemented in due course, whereby changes could still occur within the legislative process. It is currently unclear when the lowered threshold and the lengthened monitoring periods will become applicable and which effects the proposed changes will have on existing structures (e.g. structures including a put option exercisable after 5 years by the minority shareholder). In particular, the press release does not indicate whether there will be a grandfathering rule. It is not unlikely that the new rules will come into force as of the date on which a bill is submitted to the Parliament. Until then, there might be a short time window to adjust existing structures, if necessary.

Exerted Pre-emptive Right in Property Purchase Agreements

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THE SITUATION: The following example should illustrate the possible consequences if a purchase agreement contains no or only incomplete provisions in cases where a pre-emptive right is exercised:

A property which is encumbered with a pre-emptive right not registered in the land register is to be sold. The parties are aware of the pre-emptive right, and therefore the property purchase agreement stipulates that the purchase price falls due if the beneficiary of the pre-emptive right has declared that it will not exercise its right (so-called negative declaration) or the exercise period has expired. However, the parties missed agreeing in the purchase agreement a right of withdrawal in cases the pre-emptive right is exercised. Following conclusion of the purchase agreement, the public notary asks the beneficiary of the pre-emptive right for a negative declaration. The beneficiary instead exercises the pre-emptive right.

According to the contractual provision, the claim to payment of the purchase price can no longer become due and the purchase agreement can no longer be consumated. Through the exercise of the pre-emptive right, a second purchase agreement with the same content comes into existence between the seller and the beneficiary of the pre-emptive right. However, the seller has no contractual right to withdraw from the purchase agreement with the original buyer. At first, both purchaser and seller are stuck in the purchase agreement (pre-emptive rights whose exertion entails the lapse of the claim to transfer of ownership shall be disrgarded in this context). The seller is even bound towards two parties.

WHAT THE LAW REGULATES: Therefore, one has to ask whether the law helps the parties get out of this situation; in particular whether it provides for a right of withdrawal in these cases.

Firstly, a distinction is to be made whether the pre-emptive right is a right *in rem*, which means that it has been registered in the land register, or whether it was solely agreed in a contract under the law of obligations. In the case of pre-emptive rights *in rem*, the law (Section 1098 in connection with Section 883 para. 2 BGB [German Civil Code]) states that a transfer of the property contrary to the pre-emptive right is invalid towards the beneficiary of the pre-emptive right. The beneficiary has the right to demand the re-transfer of the property from the other purchaser. This also applies to the cancellation of a priority notice. Because it becomes impossible for the seller to transfer the property to the original buyer due to the strong legal position of the beneficiary of the pre-emptive right, the buyer has the right to withdraw from the purchase agreement under the prerequisites of the law (Sections 346 para. 1, 326 para. 5 BGB).

If, on the other hand, the pre-emptive right is not registered in the land register and if no priority notice in favour of the buyer has been granted, the situation is comparable with the case where the seller sells the same property to two different buyers (see below on the case of granting a priority notice to the buyer). The seller can indeed choose to which buyer it transfers the property. However, the seller is generally liable to pay compensation for damages for non-performance it can be accused of. In the case of non-performance of the seller, the other contract party may also be entitled to a statutory right of withdrawal.

Liability towards the original buyer as well as a statutory right of withdrawal should however be excluded if the buyer knew of the pre-emptive right at the time the purchase contract was concluded. This situation is described in our example. One, therefore, has to ask how seller and buyer can get out of the purchase agreement. According to a judgement of the German Federal Court of Justice

("*Bundesgerichtshof*", *BGH*) in 2009 the following applies: *"If the buyer knows of the existence of the pre-emptive right, in case of doubt it is to be assumed that the purchase agreement should, according to the will of the parties, be subject to the condition precedent* (*auflösende Bedingung*) *of the exercise of the pre-emptive right."* The case law therefore does not resolve the deadlock by use of a right of withdrawal. Rather, a purchase agreement with the original buyer generally terminates if the pre-emptive right is exercised through the occurrence of an unwritten condition precedent determined by way of interpretation of the purchase agreement. However, this does not apply in the exceptional case if the purchase agreement is to be interpreted in a way that the seller, in spite of both parties' knowledge of the pre-emptive right, warrants that the pre-emptive right will not be exercised by the beneficiary. If, however, the beneficiary exercises its pre-emptive right in contradiction of the seller's warranty, the seller should be liable to the original buyer.

If the original buyer is entitled to a priority notice, it has greater protection against the beneficiary of a contractual pre-emptive right. This legal priority position, however, only helps the buyer if it had no knowledge of the pre-emptive right at the time the purchase agreement was concluded. This is because, if the buyer had knowledge of the right, it must, according to the case law, be assumed in case of doubt that the purchase agreement is agreed subject to the condition precedent of the exercise of the pre-emptive right; the purchase agreement terminates when the pre-emptive right is exercised. A priority notice shares the fate of the right which it secures. If the purchase agreement then terminates with the claim to transfer the property ownership, the priority notice also terminates.

CONTRACTUAL AGREEMENTS: Ultimately, the buyer generally knows of pre-emptive rights from buyer due diligence and is therefore usually left with his transaction costs.

As standard, the parties agree on a provision within the framework of the requirements for maturity for the payment of the purchase price that the non-exercise of the pre-emptive right is a condition for the purchase price becoming due. Beneficiaries of a pre-emptive right are generally the municipality in which the object of the purchase is located; the beneficiary of the right can also be a tenant who operates his business on the object of the purchase or another third party. Pre-emptive rights, in particular of tenants, are to be identified in advance in the course of a buyer due diligence.

As a reflection of this maturity rule, the purchase agreement should then stipulate a right of withdrawal of the seller for the case where a pre-emptive right is exercised. If such a contractual right of withdrawal is missing, the parties only retain the statutory rules as set out above.

In order to also govern the fate of the usually granted priority notice for the original buyer if a pre-emptive right is exercised, the officiating notary should be instructed and e.g. authorised declare the consent to the deletion of the priority notice in these cases, or – prior to registration – to rescind the corresponding application for registration. This instruction to the notary is usually generally agreed for the case where one of the parties withdraws. If the exercise of a pre-emptive right triggers a right of withdrawal, the general instruction for cases of withdrawal is therefore also sufficient.

In the frequent cases, in which a part of the purchase price has already been deposited as down payment beforehand or into a notary escrow account at the time of the conclusion of the purchase agreement, the purchase agreement should also include an instruction to the notary for this amount to refund the down payment to the buyer if a pre-emptive right is exercised.

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Written Form in the Case of Lease Agreements for Commercial Premises

A change to the rent, which is based on a contract clause, according to which one contract party can request a new determination if there is a particular change in the index, must be agreed on in an addendum to the lease agreement which satisfies the written form requirement of Section 550 Sentence 1 German Civil Code *(Bürgerliches Gesetzbuch - BGB)*.

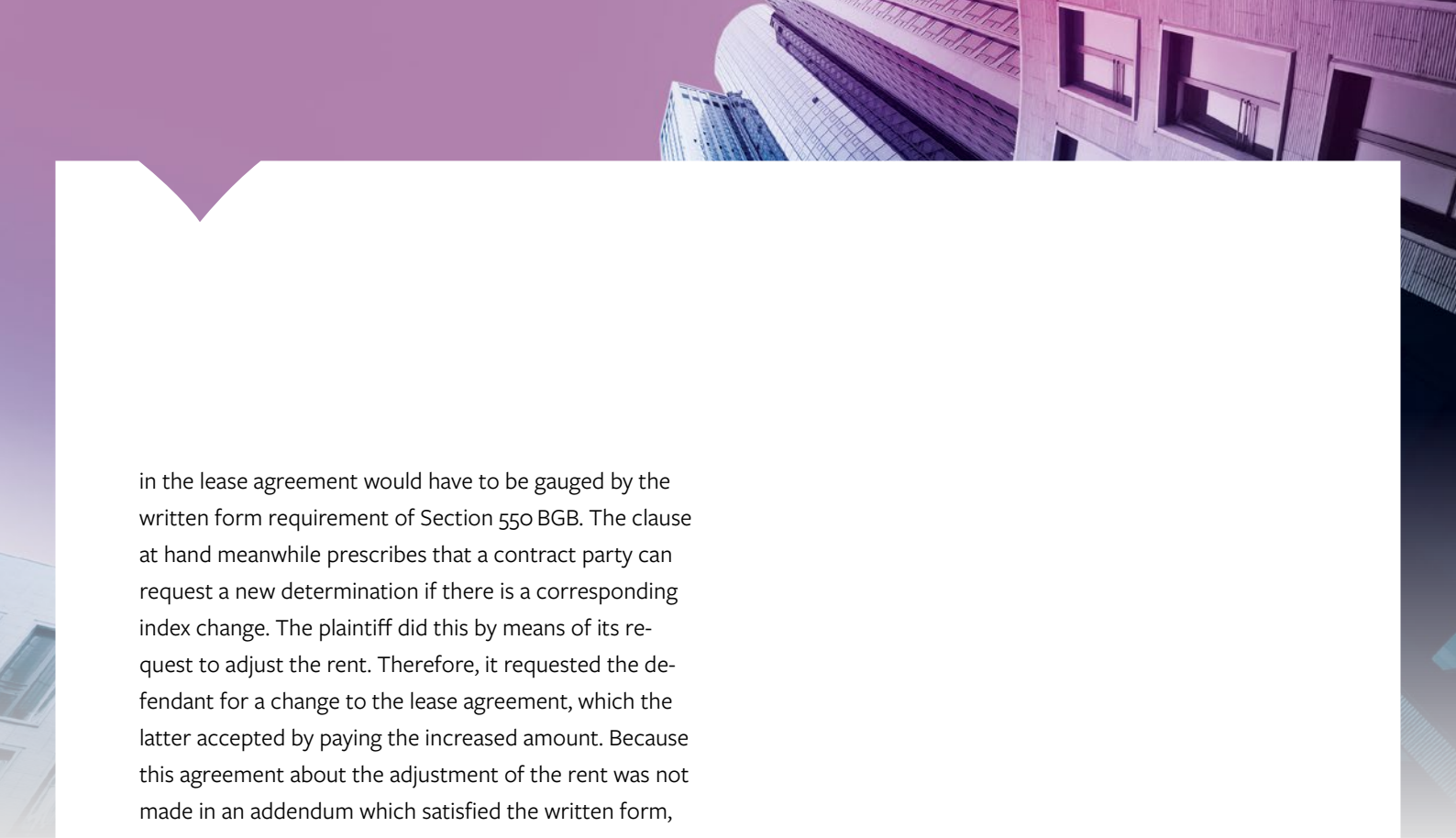
(BGH, judgement of 11 April 2018 – XII ZR 43/17)

INTRODUCTION: Lease agreements which are concluded for a duration of more than one year require the written form, Section 550 Sentence 1 BGB. The written form is only observed if there is an agreement regarding all material contract conditions required for the conclusion of the contract arising from one of the documents signed by the parties or from identical documents signed by one of each of the parties. This equally applies for amendments to the original contract. In the opinion of the German Federal Court of Justice (*Bundesgerichtshof – BGH*), the rent concerns a circumstance which is material to the contract. Therefore, changes to the agreed rent must generally satisfy the written form requirement of Section 550 BGB. The BGH has now decided that the change to the rent, which is based on a contract clause, according to which one contract party can request a new determination if there is a particular change in the index, is subject to the written form requirement of Section 550 Sentence 1 BGB, unlike in the case of an automatic adjustment or a unilateral right to make an amendment.

THE DECISION: In 2006 the plaintiff leased commercial premises to the defendant, limited until 31 December 2017 for use as office premises. The contract included a provision, according to which each party can request a new determination of the last basic rent owed if the consumer price index for Germany increases or decreases by more than 4 per cent as against the time of the conclusion of the lease or the last rent amendment. If the parties cannot agree on a rent within 6 weeks after the index increase occurs, the rent was to be set by a sworn expert to be appointed by the chamber of commerce and industry.

In a letter dated 27 December 2012, the plaintiff informed the defendant that the consumer price index had changed by more than four per cent since the last rent increase, and requested to adjust the monthly basic rent from 1 April 2013 to EUR 2,273.60. The defendant complied. It paid the higher rent from April 2013. In 2013, the defendant moved out of the rental premises. It sub-leased the premises. The plaintiff refused to consent to this sub-lease. The defendant thereupon terminated the contract without notice with a letter dated 12 February 2014 and suspended payment of the rent. The plaintiff deemed the termination to be invalid.

The German Federal Court of Justice decided that the extraordinary termination by the defendant did not result in the termination of the contract. This is, however, to be re-interpreted as an ordinary termination, which had terminated the tenancy. An ordinary termination is possible on the basis of a breach of the legal written form requirement of Section 550 BGB. There is a fundamental difference between the index clause under discussion here on the one hand and a clause with automatic adjustment or a unilateral performance determination right of one party on the other. In the latter cases too, the respective provisions



in the lease agreement would have to be gauged by the written form requirement of Section 550 BGB. The clause at hand meanwhile prescribes that a contract party can request a new determination if there is a corresponding index change. The plaintiff did this by means of its request to adjust the rent. Therefore, it requested the defendant for a change to the lease agreement, which the latter accepted by paying the increased amount. Because this agreement about the adjustment of the rent was not made in an addendum which satisfied the written form, the lease agreement is considered to have been concluded for an indefinite period, and can therefore be terminated at any time with the statutory period of notice. The performance determination right of the expert – being only stipulated as a substitute for an agreement – would not change the regulatory content of the clause in a way that it would include a right of the contract parties to make amendments by way of a unilateral declaration.

IMPACT ON DAY-TO-DAY BUSINESS: It is not an uncommon linguistic design of index clauses in commercial lease agreements that a party "*can request*" an adjustment in the case of corresponding index changes. This request for an adjustment is just as often expressed in a simple letter and the corresponding adjusted rent subsequently paid. If a rent is adjusted in this form, the lease agreement no longer complies with the written form and can be terminated at any time. With regard to this, the index clauses in existing lease agreements and the method according to which the adjustments are to be made should be reviewed. Where applicable, the amended rent is to be recorded in an addendum which complies with the statutory written form requirement. For new contracts, index clauses with automatic adjustment or an unilateral right to make adjustments should be used.

Observation of the Written Form, even without exchanging unilaterally signed Contract Copies

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The written form as required for long-term lease agreements is already observed if the lease agreement is documented in two (identical) written copies, which are each signed by only one of the parties, even if the copies are subsequently not sent to the respective other party.

(BGH, judgement of 7 March 2018 – XII ZR 129/16)

INTRODUCTION: The German Civil Code (*Bürgerliches Gesetzbuch – BGB*) prescribes the written form for the effective agreement on a term over one year in lease agreements. In the past, Section 126 BGB was referred to for the criteria necessary for this. This section prescribes that either the document is signed by both parties on the same copy or two identical copies determined each for the other party, each signed by one party only. It was concluded from this that the written form is only complied with in case of separate signing if the copies were also received by the respective other party, that is, if the signed copies were exchanged between the parties. In earlier decisions, the German Federal Court of Justice (*Bundesgerichtshof – BGH*) had merely judged that it is insignificant where the signed documents are subsequently located or whether they later still exist at all. Now, the BGH rejects the requirement to exchange the copies and differentiates between questions on the compliance with the written form and on the valid conclusion of a contract – in line with earlier decisions, for instance on delayed acceptance due to great time differences between the signing of the contract documents by both parties.

THE DECISION: The decision was based on an agreement about a long-term use of the roof and open spaces of a property in order to construct and operate a photovoltaic system. This was signed in each case by one party on separate copies, and only sent to the other as a copy by fax. The owner subsequently terminated the contract. The legal dispute concerned the issue of the continuation of the contract. The BGH also did not consider Section 126 BGB to have been comprehensively satisfied because it is not in any case proper form to conclude a contract via fax. It stressed, however, that in order to meet the written form required for lease agreements it is only a matter of compliance with the "pure written form of the declarations" as the outer form, irrespective of how such a contract would be subsequently concluded. The written form is also complied with if the lease agreement, "with terms identical to the contract terms set out in writing", were only concluded verbally or by implication. This would satisfy the protective purpose of the written form both in regard to providing information to a buyer as well as for the provability of long-term agreements and as a warning against thoughtlessly entering into long-term commitments.

IMPACT ON DAY-TO-DAY BUSINESS: The BGH's judgement is only ostensibly a relief for practice. Legally, the distinctions between the features of Section 126 BGB appear to be amply constructed. Above all, however, the case law still entails risks for the practice in the form of possible massive evidence problems, both regarding the effective conclusion as well as whether the contract effectively concluded actually has the same content as the written version(s). Thus, it is recommended to continue to adhere to documented written contractual conclusion of lease agreements through the exchange of separately signed copies or joint signing on one contract document.

Insolvency Avoidance of the Transfer of a Lease Agreement

(BGH, judgement of 1 March 2018 – IX ZR 207/15)

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INTRODUCTION: The Federal Court of Justice had to decide on the insolvency avoidance of the transfer of a lease agreement to an affiliated company of the debtor. A particularity of the case was that the group company and prior to the transfer the debtor in insolvency were tenants of a warehouse renting it to a sub-tenant under identical conditions as the conditions of the main lease, except for the amount of the rent.

THE DECISION: Scarcely seven months before the debtor in insolvency filed an application to open insolvency proceedings over its assets, it leased a warehouse for the purpose of sub-letting for storage of de-icing salt. The monthly net rent in the sub-lease agreement with the federal state of North Rhine Westphalia for the storage of salt was higher than the rent agreed according to the main lease agreement, so that the debtor was left with a surplus of EUR 3,749.00 per month. Both leases were transferred to the defendant, an affiliated company of the debtor in insolvency, with the consent of the owner of the warehouse on the one hand and the sub-tenant on the other. The insolvency administrator contested this process and demanded compensation for the value. The Federal Court of Justice decided in favour of a challenge of a gratuitous transaction pursuant to Section 134 (1) InsO [German Insolvency Code] and ordered the defendant to pay the EUR 100,000.00 claimed with interest.

The Düsseldorf Higher Regional Court (court of appeal) focused on the fact that the defendant had assumed both rights and duties from the lease agreement. In contrary to this opinion, the Federal Court of Justice decided that, in this particular constellation, the transfer of the lease agreement was a gratuitous benefit. Because the duties undertaken had to be assessed as being significantly less than the rights obtained, meaning that no adequate counter-performance was provided by the defendant to the debtor in insolvency.

Shortly after the transfer of both leases, the managing director of the defendant, who is also the sole shareholder, transferred his company shares in the debtor to the managing director of the debtor. The transfer of company shares in the debtor so close to one another in terms of time was not made a further subject of discussion in the judgement because this was not relevant to the assessment of the gratuitous nature in the relationship between the debtor and the defendant.

IMPACT ON DAY-TO-DAY BUSINESS: Caution should be exercised in restructuring and transfer of contracts within a group. It is not only recommended to observe the "*arm's length principle*" with regard to tax issues, but also to possible later insolvency of a group company. This does not only apply for lease agreements, but the assessment could also turn out to be comparable as regards the transfer of other contractual relations. In the case of insolvency avoidance, it simply depends on the relationship between the debtor in insolvency and the addressee of an avoidance. A possible benefit for other parties involved in the group or other actions, which, where applicable, are economically closely connected with the contested legal action, remain unconsidered.

Analogous Application of Section 179a German Companies Act (AktG) to Partnerships

(OLG Düsseldorf, judgement of 23 November 2017 – I-6 U 225/16)

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INTRODUCTION: The Düsseldorf Higher Regional Court had to decide on an action by a partner in a KG [German form of the limited partnership] which was directed against a resolution of the partners' meeting, in which it was resolved to sell a property which was the only investment property in the limited partnership's assets. In the view of the limited partnership, the sale was necessary to avoid insolvency. The resolution was passed with a relative majority, which, according to the requirements of the articles of association, was in principle sufficient for the partners' meeting resolution to be valid. Greater majorities are required for particular resolutions, but the case of the sale of the entire asset is not covered in the articles of association. In the plaintiff's view, the resolution would have required a 75% majority on the basis of Section 179a AktG.

The Higher Regional Court in principle accepted the analogous application of Section 179a AktG to limited partnerships. Due to the particularities of the individual case, however, the plaintiff was not able to successfully assert the invalidity of the resolution.

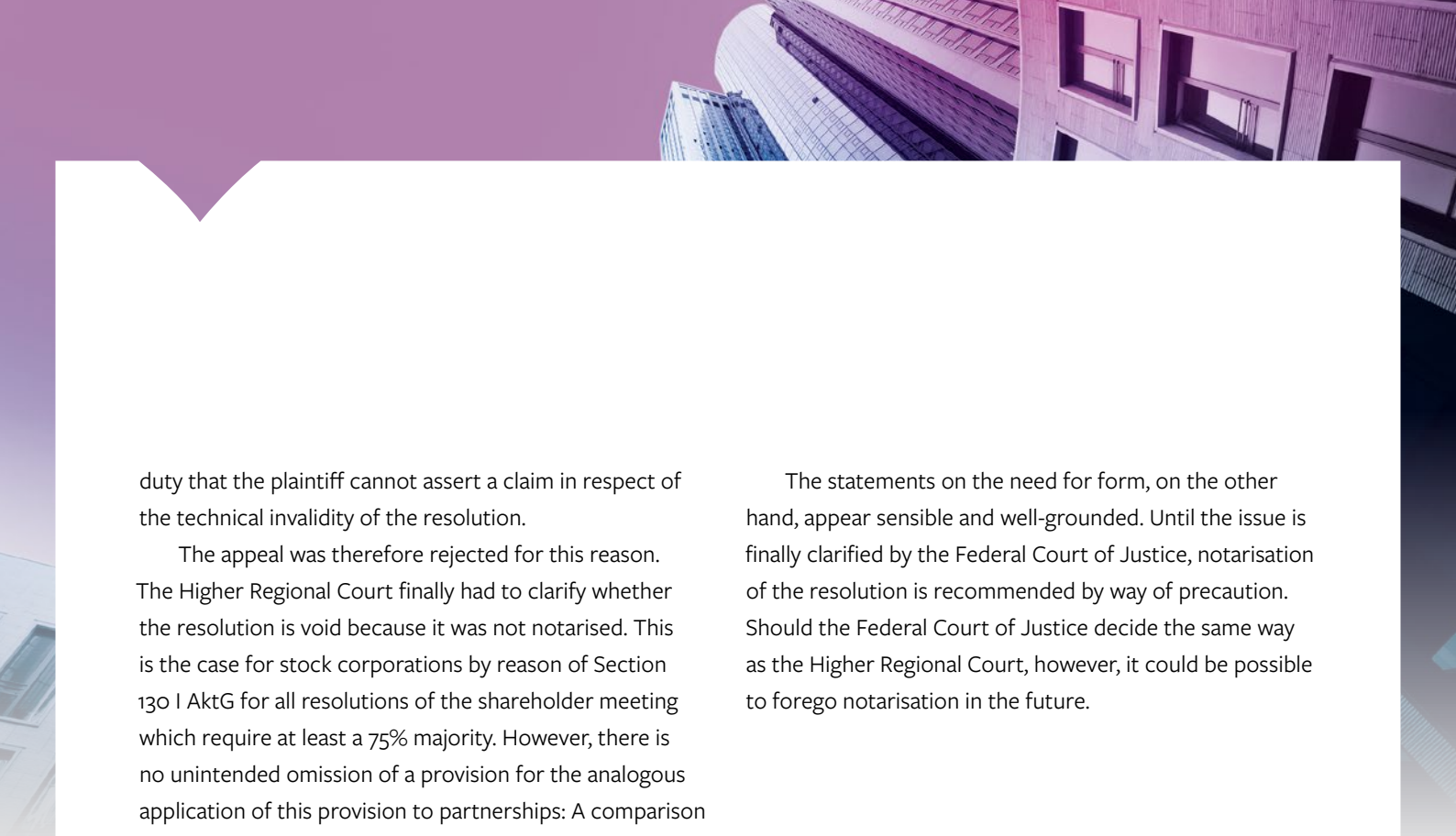
THE DECISION: In the case of stock corporations, Section 179a I 1 AktG requires a resolution of the general meeting for contracts in which they undertake to transfer the entire assets of the company; pursuant to Section 179 II 1 AktG the resolution must be passed by a 75% majority of the equity capital . Should this provision be analogously applicable to the limited partnership, the contract described above would require a 75% majority of the company shares because it involves the transfer of the entire assets. Since this is not the case, however, the resolution would be invalid.

The Federal Court of Justice (*Bundesgerichtshof*) ruled in 1995 (judgement of 9 January 1995 – II ZR 24/94) that Section 179a AktG expresses a principle based on the law as it applies to associations and is therefore also applicable in principle to partnerships like the limited partnership. It is however unclear whether it simply follows from the analogy that the partners' meeting must pass the resolution or whether the resolution must also be passed with a 75% majority.

The Düsseldorf Higher Regional Court follows the opinion of the Federal Court of Justice at least for cases in which the articles of association contain no explicit statements about the majority requirements for the transactions mentioned. The articles of association provide that the partners' meeting decides on all cases stipulated in statute and in the articles of association. However the articles do not explicitly provide how resolutions are to be adopted in the case of a transfer of the entire assets of the company.

The Higher Regional Court ruled here inter alia that it is the spirit and purpose of the law to protect the pecuniary interests of the partners. Since the partners of partnerships are just as worthy of protection, the general character of the law must also be reflected in the approval requirement with the appropriate quorum, which may not be reduced by the articles of association according to Section 197a I 2 German Civil Code (*Bürgerliches Gestzbuch – BGB*). Therefore, Section 179a AktG is analogously applicable to the limited partnership, at least in the present case.

However, in the present case the Higher Regional Court declared the resolution was not invalid. This is because the limited partnership was in a serious crisis at the time of the resolution and the sale of the property was the only possibility to avert insolvency. In this particular situation, the plaintiff had the duty to agree to the sale on the basis of the fiduciary duties as partner. It follows from this



duty that the plaintiff cannot assert a claim in respect of the technical invalidity of the resolution.

The appeal was therefore rejected for this reason. The Higher Regional Court finally had to clarify whether the resolution is void because it was not notarised. This is the case for stock corporations by reason of Section 130 I AktG for all resolutions of the shareholder meeting which require at least a 75% majority. However, there is no unintended omission of a provision for the analogous application of this provision to partnerships: A comparison with the GmbH (German form of small limited company), for which the analogous application of Section 179a AktG is also recognised, shows that there are, in principle, rules for other forms of company on this issue. Sections 161, 119 German Commercial Code (Handelsgesetzbuch – HGB) also contain no form requirements for resolutions by the partners' meeting.

An analogy with the provision in Section 130 I AktG as well as the notarisation requirement is therefore to be rejected.

IMPACT ON DAY-TO-DAY BUSINESS: Even through the Federal Court of Justice decided in 1995 that Section 179a AktG is a general principle which is also transferable to partnerships, the scope of this analogy is still unclear today. The Higher Regional Court's judgement makes it clear that the analogy not only extends to the resolution by the partners' meeting, but also to the majority requirements in the decision. This opinion is not widely shared in the literature, however, and it appears possible that the Federal Court of Justice will decide differently if it comes to deal with the subject.

The court's argumentation also raises questions about the fiduciary duty of the partners. Admittedly, a fiduciary duty of the partners is indeed to be welcomed, in particular in times of crisis, but it is questionable whether this can extend so far that the private autonomy of the partner is excluded in resolutions of the partners' meeting.

The statements on the need for form, on the other hand, appear sensible and well-grounded. Until the issue is finally clarified by the Federal Court of Justice, notarisation of the resolution is recommended by way of precaution. Should the Federal Court of Justice decide the same way as the Higher Regional Court, however, it could be possible to forego notarisation in the future.

Overview Real Estate Transfer Tax Rates

Tax

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The following table provides an overview of the current status of the real estate transfer tax rates in the individual federal states (26 June 2018). Changes since the last issue in spring 2018 are marked in bold.

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 %

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Selected Experience 2017/2018

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 com-pany 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.

Advised **Natixis Pfandbriefbank** as mandated lead arranger on the EUR 157 million acquisition financing for Eschborn Plaza. Office Aurec acquired the Eschborn Plaza property in Frankfurt for a consortium of Israeli Investors from Commerz Real.

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.

Advised **Art-Invest Real Estate Funds** on sale of the office building "Am Mozartplatz" in Frankfurt to Park Lane Investors Group for further project development.

Advised **Concarus** on the acquisition of the "Circoleum" office ensemble from the Munich Real I. S. Group. The Circoleum, which has about 21,100 sqm of usable space and 449 parking spaces, is mainly leased by the Fresenius Group.

About Mayer Brown

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