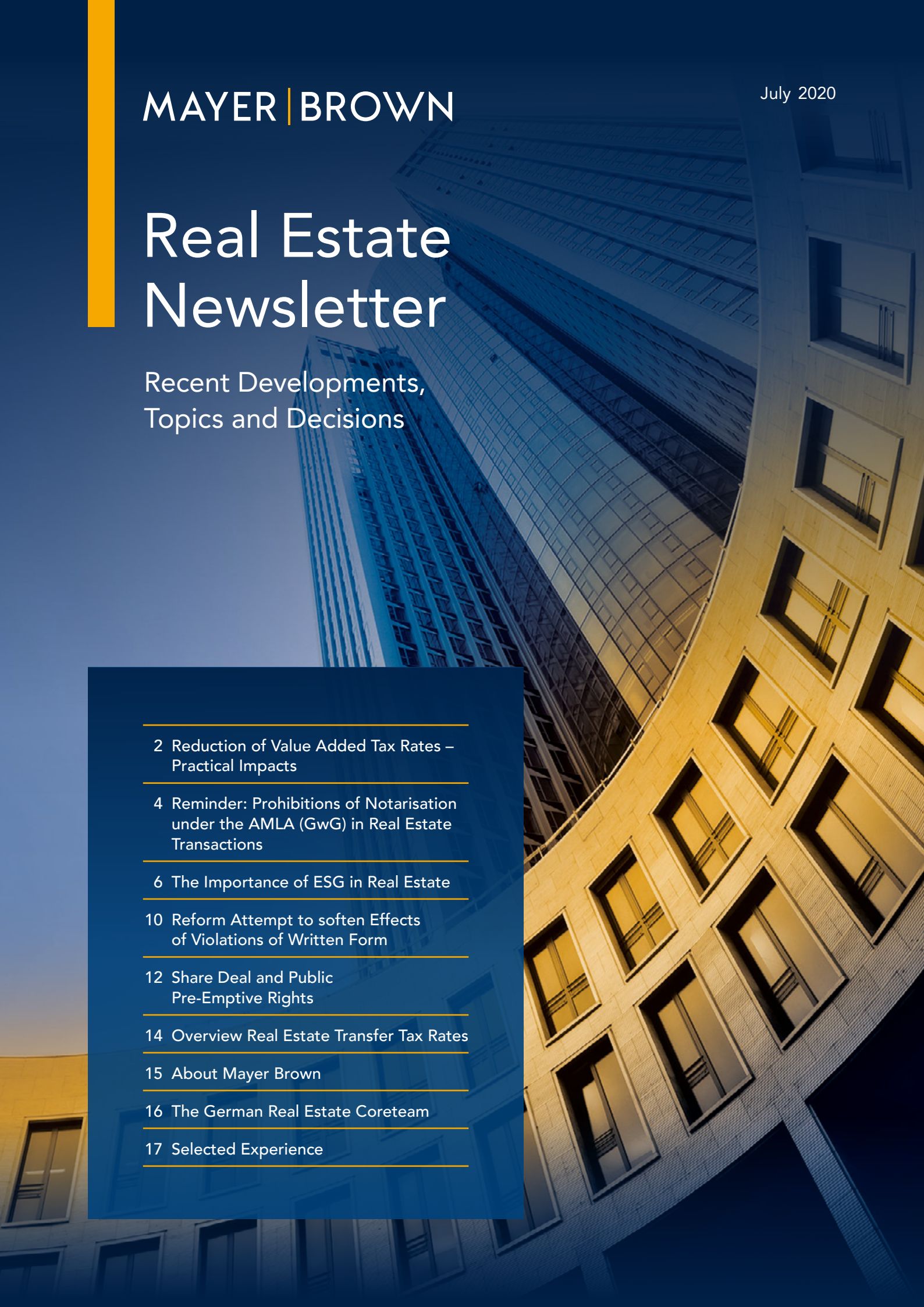
MAYER | BROWN

July 2020

Real Estate Newsletter

Recent Developments, Topics and Decisions



Reduction of Value Added Tax Rates – Practical Impacts

In effect from 1 July 2020 until the end of 2020, the German legislator has decided to reduce the value added tax ("VAT") rate from 19% to 16% and from 7% to 5%; respectively.

Tax

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Such reduction came at very short notice and is likely to cause some difficulties of implementation as well as raise questions of doubt. In a circular issued by the Federal Ministry of Finance, dated 30 June 2020 (GZ III C 2 - S 7030/20/10009), the fiscal authorities addressed various related topics. The following issues will be relevant for the real estate sector:

Long-term Services

In case of services that extend over a longer period of time (e.g., construction services or lease agreements), the service is generally deemed to have been rendered at the end of the performance period and the tax rate relevant at the end of this period shall be applied accordingly

Thus, if a construction work was started in April 2020 and completed in August 2020, the tax rate applicable will be that in force at the time the service is completed (i.e., 16%). Where appropriate, it may make sense (if and to the extent practicable) to agree on partial services whose completion falls within the period in which the lower tax rate applies.

Existing lease agreements, which are regarded as services which extend over a longer period of time in the aforementioned sense, are to be checked to see whether a net rent (should regularly be the case) or a gross rent (e.g., in the case of short-term residential lease agreements) has been agreed. If the lease agreement contains a gross rent provision, the reduction of the VAT rate leads to an increase in the net rent. In case of an agreed net rent plus VAT, only the amount to be paid by the tenant is adjusted. Permanent lease invoices have to be adjusted accordingly.

Down Payments, Partial Payments or Advance Payments

In the case of down payments, partial payments or advance payments, in the first instance, the tax rate is relevant which is valid at the time of the receipt of the respective invoice. The final invoice issued after the end of the performance period will then credit the amounts received in advance and the respective VAT will have to be corrected, if applicable. Thus, in total, the VAT rate applicable at the time of performance (end of the performance period) is applied.

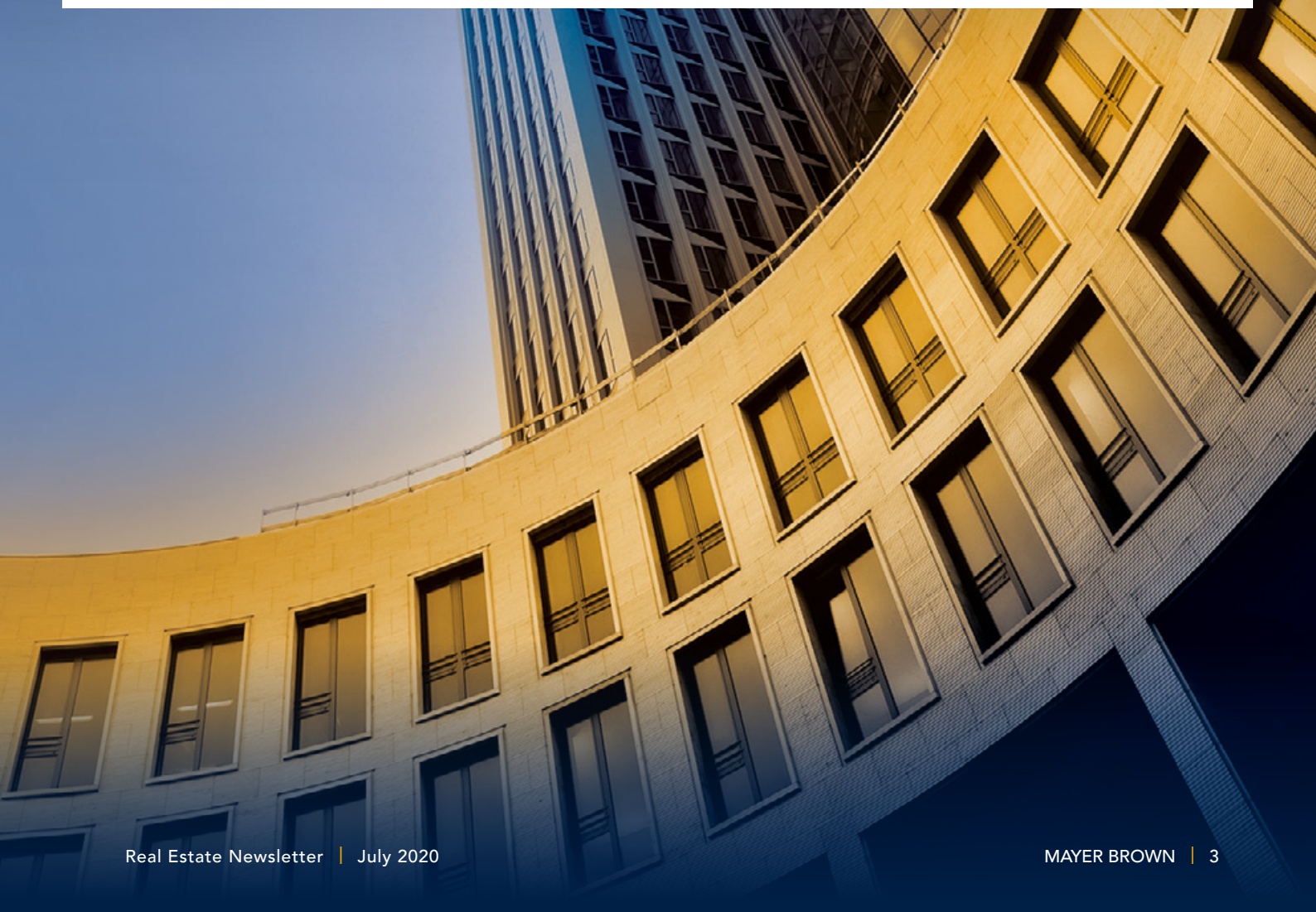
Reduction of Value Added Tax Rates – Practical Impacts

Incoming Invoices

With regard to incoming invoices for deliveries or services received, it must be checked whether the correct VAT amount was applied in accordance with the actual date of performance. If, for example, 19% VAT is charged in an invoice for services rendered in September 2020, the right to input VAT deduction is limited to 16%. However, the liable taxpayer resulting from the invoice is also liable for any VAT shown in excess until the invoice is corrected.

Effects on Service Contracts

If and to what extent the change in VAT rates also results in price changes in the various (service) contracts concluded by the companies depends on the individual contractual arrangements.



Reminder: Prohibitions of Notarisation under the AMLA (GwG) in Real Estate Transactions

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The last few months have been marked by the COVID-19 pandemic with its massive impact on business and the real estate industry. As a result of the general easing of restrictions, some organisational problems for the preparation and execution of real estate transactions have also disappeared.

This should be an occasion to recall the amendments to the Money Laundering Act (AMLA) that have come into force since the beginning of the year with regard to the preparation and execution of notarisation procedures.

For the first time, the amended AMLA imposes prohibitions of notarisation in connection with the real estate sector in two constellations. This is due to the fact that the legislator considers the real estate sector to be highly susceptible to money laundering.

In general, there is a first prohibition of notarisation for real estate transactions within the meaning of § 1 of the German Real Estate Transfer Tax Act (GrEStG), which covers both asset deals and share deals, unless conclusive documentation of the ownership and control structure of the companies involved is provided. This is related to the obligation to identify the beneficial owner. It is important to bear in mind here that the structure up to the level of the beneficial owner must be explained to the notary for this purpose and that control can be exercised not only over the shareholding relationships, but also over other constellations, such as trust or control agreements, and also through special voting rights. In most cases, a structure chart containing this information will be helpful. This is all the more true for cross-border investment structures. As a rule, these documents should be available, at least if the transaction is planned to be financed (also) with debt capital, since banks also have extensive documentation requirements for reasons of money laundering (AML) and of customer identification (KYC). Against this background as a result, there should be no great delay in the transaction.

More critical is the second, albeit narrower, case of the acquisition of a domestic real property by a foreign company as the buyer. In this constellation, there is an additional prohibition of notarisation if the foreign company is not registered in the transparency register of Germany or an EU member state. In this case, there is an early need for action, particularly if new special purpose vehicles are established for the transaction only upon a satisfactory due diligence. Without a registration in the transparency register, the notarisation must not take place. The acquisition

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- with companies that have been founded but not yet registered in all registers is therefore no longer possible. The picture of how quickly an entry in the transparency register can be made in various jurisdictions and an extract from the transparency register can also be obtained is still forming. It is important to note that although a simplified access for the public to the information is enabled in some places, the information provided usually does not contain all the necessary data to be collected. In Germany, extracts from the transparency register are not yet available electronically as easily as in the commercial register and the electronic land register. Although applications are made purely via an Internet site, the procedure is not particularly user-friendly and, above all, the applications are processed "manually" by employees. On average, this takes several days, sometimes even weeks. In cases where no transparency register has yet been set up abroad, as, for example, in the Netherlands, the work-around would have to be to have an entry made in the German transparency register. The same applies to companies from non-EU countries. Here, considerable time delays for the transaction may occur.

It is worthwhile to prepare and compile the documentation of the ownership and control structure at an early stage and, in addition, in the case of an acquisition by a foreign company, to arrange for the entry in the transparency register or the issue of an extract from the transparency register in good time. If the excerpt is not available in English in other EU countries and is only written in a less common language, a precautionary translation into German may be advisable. In this case, it is advisable to contact the notary public to be entrusted with the notarisation at an early stage in order to clarify language skills and details.

The Importance of ESG in Real Estate

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On 30 January 2020, we organized the 11th US Real Estate Forum in Frankfurt, together with ULI Germany. One topic was "ESG Integration within commercial real estate", which Jan von Mallinckrodt from Union Investment dealt with in his presentation.

The subsequent lively discussion among the participants confirmed the great interest of the real estate industry in this complex. A survey of institutional real estate investors conducted by Fonds Forum showed similar results. According to this survey, 52% are already considering the topic comprehensively in corporate and product development. Seventy-eight percent of those surveyed are convinced that there is no way around ESG. That proves it: Economic, ecological and social sustainability are becoming core issues in the real estate industry.

What does "ESG" mean?

The abbreviation "ESG" has become established as a term for sustainable investments. It stands for three sustainability-related areas of responsibility of companies: environmental, social and governance, i.e., environmental, social and corporate governance. The "environmental" factor includes, for example, environmental pollution or hazards, while the "social" factor includes working conditions, health, safety and human rights. "Governance" includes the independence of management and supervisory bodies, shareholder rights, etc.

The legal framework

National regulations

ESG-relevant regulations have existed in German law for a long time, such as those for the protection of the environment (e.g., Federal Immission Control Act) (environmental), for the protection of employees (e.g., Occupational Safety Act) (social) and for proper corporate governance (e.g., Stock Corporation Act, German Commercial Code, administrative instructions of the Federal Financial Supervisory Authority such as the minimum requirements for risk management, minimum requirements for the compliance function) (governance). However, these standards do not focus on the sustainability of corporate activity as a whole, nor do they allow companies to be assessed and compared on the basis of ESG factors. However, they do contain rules which basically provide for concrete duties of conduct and significant consequences for violations. Anyone who, for example, as the operator of a corresponding plant, causes unauthorised air pollution, must expect the plant to be shut down in accordance with § 20 BImschG. An employer who permanently and illegally orders overtime

The Importance of ESG in Real Estate

can, in the worst case, be punished with imprisonment of up to one year, according to § 26 ArbSchG.

EU Regulation

In March 2018, in response to the political and economic challenges posed by climate change, the EU adopted a Sustainable Finance Action Plan ("Action Plan"), which aims to contribute to sustainable finance by channelling capital flows towards environmental and social investments. The plan follows the Paris Climate Change Convention 2016 and the United Nations' Agenda 2030 for Sustainable Development. The Commission published the first comprehensive legislative proposals to implement the Action Plan in May 2018.

The Action Plan consists of a set of regulatory measures that impose obligations on financial market actors, such as capital management companies, insurance companies, pension funds or banks. These include managers of alternative investment funds under the AIFM Directive, i.e., all investment funds other than securities funds, including open-ended or closed-ended investment funds investing in tangible assets such as real estate, infrastructure or companies. The most important measures are the creation of uniform market standards and disclosure and reporting obligations.

TAXONOMY ORDINANCE: The classification of activities and assets as sustainable is currently characterised by a high degree of fragmentation. The so-called Taxonomy Regulation aims to eliminate this situation by creating an EU-wide uniform classification system ("taxonomy") for sustainable economic activities. The increased transparency should make it easier for investors to select environmentally friendly investments. The regulation defines criteria for determining when an economic activity is ecologically sustainable. An investment is considered essentially sustainable (so-called sustainable investment) if it promotes one or more of seven environmental objectives and does not significantly contradict any of the seven objectives:

- Climate protection,
- Adaptation to climate change,
- Sustainable use and protection of water and marine resources,
- Transition to a circular economy,
- Waste prevention and recycling,
- Prevention and reduction of pollution, and
- Protection of healthy ecosystems.

Technical evaluation criteria for determining what constitutes a significant contribution to an environmental objective and what constitutes a significant impairment of other objectives should be defined by the Commission in delegated acts. The scheme is technology neutral, only solid fossil fuels, such as coal, cannot be declared sustainable. However, gas and nuclear energy are not explicitly excluded from the regulation. In addition, minimum social conditions must be observed.

All financial market participants who do not describe their financial products as sustainable or "green" investments are in principle subject to the obligations of the Taxonomy Ordinance. They must inform their customers in advance whether and to what extent they include sustainability

The Importance of ESG in Real Estate

- risks in investment decisions and, if applicable, regularly inform them about the sustainability impact of the product even after the contract has been concluded.

From 2022, the transparency obligations for financial market participants are to apply.

DISCLOSURE REGULATION: The Taxonomy Regulation is supplemented by the Disclosure Regulation (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosure requirements for the financial services sector), which entered into force on 29 December 2019. The regulation regulates how financial market participants must inform about sustainable investments and sustainability risks in the future and which information they must make available to the public. It includes publication obligations on the website of financial market participants and rules on what must be included in pre-contractual information. Furthermore, information is to be provided on the compatibility of their remuneration policy with the inclusion of sustainability risks.

BENCHMARK REGULATION: This is supplemented by the so-called Benchmark Regulation (Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 20176/1011 as regards EU reference values for climate-related change, EU reference values in line with the Paris Convention and sustainable disclosure of reference values), which entered into force on 10 December 2019. The new reference value category includes a low carbon investment benchmark based on a standard reference value for decarbonisation and a carbon-favourable reference value that makes it possible and transparent to align an investment portfolio with climate change objectives. One intention is to prevent "greenwashing", i.e., deceiving investors by making misleading or unfounded statements about the environmental impact of the benchmark.

The Regulation establishes uniform rules on how financial market participants must inform investors about the consideration of ESG risks and opportunities. The Regulation also requires that negative ESG impacts of investments that lead, for example, to the destruction of biodiversity, must be disclosed.

EU ECOLABEL: Finally, the package of measures will include the introduction of an EU ecolabel for financial products. This certification approach, which has long been in place for everyday consumer goods, is to be applied to certain investment and insurance products in future. This refers to certificates, unit-linked insurance and real estate AIF sold to private customers. In this context, numerous questions still need to be clarified.

The Practice

The issue of ESG has long since reached the real estate industry, as the real estate sector is considered one of the key factors in climate protection. Together with the construction industry, real estate accounts for around 40% of carbon dioxide emissions worldwide. In Germany, buildings are responsible for around one-third of CO_2 emissions. ESG criteria have an impact, above all, in the following areas:

The Importance of ESG in Real Estate

Investment decisions and ongoing asset management

ESG aspects are taken into the account over the entire investment life cycle. To this end, due diligence checks are carried out at the time of acquisition with a special focus on sustainability. The certification of the sustainability of buildings is of particular importance. If a property meets international standards, it is much more likely that it will not lose value – which pays off when it is sold. During the holding period, properties are regularly evaluated and optimised according to ESG criteria, with the focus on increasing energy efficiency through energy controlling and operational optimisation. Investments in energy-efficient building refurbishment are regarded as among the most effective means of increasing energy efficiency and thus reducing CO_2 consumption. In this way, building owners can reduce maintenance costs and offer their tenants more efficient space.

Renting

Tenants are an important driver of green buildings as more and more organisations have a corporate policy that influences their choice of premises. Modern and efficient buildings attract the best tenants, who in turn provide more secure rental income. Important plus points are the health and well-being of the employees, which are achieved through technical building equipment, public transport connections, and amenities, such as charging stations for electric cars and parking facilities for employees' bicycles, fitness rooms, etc.

In addition, landlords have begun to offer tenants "green", also sustainability-oriented, rental contracts. Although there is no uniform standard for such rental contracts, "green" rental contract clauses can be divided into two categories. On the one hand, I am talking about regulations that are linked to the substance and equipment of the property. On the other hand, they are regulations that focus on the sustainable, resource-saving and ecological use and management of the property. The ZIA Zentraler Immobilien Ausschuss e.V. has written a publication with recommendations for regulations.

The consideration of ESG may also have an impact on the selection of tenants, e.g., where investors do not wish to be associated with certain activities or sectors for environmental or social reasons.

Summary

ESG will play an even greater role in the real estate industry in the future in view of the comprehensive set of EU regulations described above. The decisive factor will be whether social and environmental benefits can be reconciled with the return expectations of investors. It is increasingly assumed that this can even lead to higher investment performance, because future challenges are already being taken into account. In any case, it is time for all market participants in the real estate industry to take a closer look at the issue of ESG and take it into account in their strategy, organisation and decisions.

Reform Attempt to soften Effects of Violations of Written Form

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The legislative initiative of the State of NRW of September 2019 would lead to a significant defusing of the current situation.

Up to now, a violation of the written form requirement of Section 550 BGB (German Civil Code) has meant that a commercial lease agreement concluded for a longer period of time can be terminated prematurely, Section 550, 578 (2) p.1.

Up to now, a commercial lease agreement is deemed by law to have been concluded for an indefinite period of time in the event of a breach of the written form requirement, Section 550 BGB. Any contractual agreements made regarding the term of the contract no longer stand in the way of ordinary termination. The period of notice for commercial leases is, due to the quarterly calculation, between six and nine months, depending on the date of termination, see Section 580a, para. 2 BGB.

According to the explanatory memorandum to the law (*Gesetzesbegründung*), the provision of Section 550 BGB was originally intended to protect only the purchaser (landlord) of a real estate property as defined by the legislator. The purchaser should have the possibility to withdraw from a rental agreement that has been transferred to him, if it does not comply with the written form requirements. The landlord should thus be protected from being bound by regulations that are disadvantageous to him and of which he could not originally have been aware due to the lack of the written form.

However, after the regulation was also retained with the reform of the law of obligations (*Schuldrechtsreform*), the case law against this background is moving further and further away from the original justification for the law and granting extensive termination options for a large number of possible violations of the written form. For a long time in practice, this was justified by written form healing clauses to create legal certainty. The clauses for the healing of the written form always took effect when there was a violation of the written form. The parties thus committed themselves to remedy regularly existing defects of the written form by mutual consent and not to terminate the contract for this reason until the defects have been remedied. Such clauses were, however, extensively rejected by the jurisdiction of the Federal Court of Justice (BGH, XII ZR 114/16).

Currently, the possibility of termination due to a lack of the written form is therefore only limited by the violation of good faith. For this reason, the purpose of the legislative initiative is that, even in the event of non-compliance with the written form, termination is only possible to the extent historically provided for in the above-mentioned law.

Reform Attempt to soften Effects of Violations of Written Form

- The legislative initiative therefore essentially provides for the following new regulations:

  - In accordance with the provisions of the legislative initiative, the possibility of termination will henceforth only exist for the purchaser of a property in the event of a breach of the written form requirement.

  - The purchaser of the property can make use of the possibility of termination three months after becoming aware of the lack of the written form.

  - The tenant is granted a right of objection. The tenant is entitled to this right of objection insofar as he/she agrees to the agreements made in conformity with the written form by continuing the rental relationship. All other agreements made in addition to this shall cease to apply for the period of continuation of the rental relationship.

The project is particularly welcome, since a large number of terminations are actually made in order to withdraw from contracts which have become uneconomical for the terminating party due to the existing market situation. Legal certainty has been impaired by this for a long time, which has a negative impact on both landlords and tenants.

However, the legislative initiative does not answer some questions. For example, it remains open what happens in the event of an objection to the termination of the lease, which is justified by the lack of the written form, if the lease contains a defect in the designation of the rental space or another similarly significant statement. It is also possible that the contract will remain in force to the detriment of both contracting parties if the provisions which were not made in writing are no longer applicable. In this context, it would be desirable if the legislative initiative, which in principle is to be evaluated positively, were to be extended in these points by a possible right of election and/or supplementary right of the parties.

According to the latest information, the federal council (*Bundesrat*) has already decided in its session on December 20, 2019, at the request of the state of North Rhine-Westphalia, to introduce the legislative proposal into the federal parliament (*Bundestag*) (BR-Drs. 469/199). In the meantime, the federal government submitted the legislative proposal to the federal parliament on 5 February 2020. However, the submission was also accompanied by a negative statement of the federal government.

The federal government argued that the legislative proposal would, among other things, apply to residential tenancy law as it stands and that, in the absence of practical problems in this area, no new regulation was necessary. Furthermore, the federal government also has doubts about the actual improvements in practice. These and other points will be part of the legislative process, so that it is to be hoped that the termination due to a violation of the written form will be defused, at least also taking into account the criticism by the federal government.

Share Deal and Public Pre-Emptive Rights

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Introduction

Potential public pre-emptive rights in connection with the acquisition of real estate are regulated by a variety of German Laws. The so-called municipal pre-emptive right (*Gemeindliches Vorkaufsrecht*) in accordance with Sec. 24 of the German Building Code (*Baugesetzbuch*) seems to be the most frequent one. A municipal pre-emptive right is generally linked to the acquisition of real estate by way of Asset Deal. Consequently, the municipality is to be notified of and provided with all asset purchase agreements. Deviating from this, the acquisition of real estate by way of Share Deal in general does not trigger the municipal pre-emptive rights and there is currently no general obligation to notify the competent municipality. However, in individual and rather rare cases, the Federal Court of Justice (*Bundesgerichtshof*) has previously ruled that an acquisition of real estate by way of Share Deal may trigger a municipal pre-emptive right. The Administrative Court (*Verwaltungsgericht*) of Berlin has now followed up on these previous rulings in its accelerated decision (*Eilentscheidung*) dated 13 December 2019.

The Decision

The applicant acquired the majority of shares in two companies in April 2019. The relevant companies, among others, are legal title holders of real estate located in Berlin and subject to an environmental protection area (*Milieuschutzgebiet*). After the District Office (*Bezirksamt*) became aware of the transaction, it ordered the applicant to submit the relevant documentation, in particular the sale and purchase agreement. According to the District Office, the acquisition of the companies may trigger the municipal pre-emptive right. By way of accelerated proceedings (*Eilrechtsschutzverfahren*), the applicant defended itself against such order to submit the relevant documentation arguing that a Share Deal in general does not trigger a municipal pre-emptive right. However, the Administrative Court of Berlin ruled that the requirements to order submission of the relevant documentation were indeed fulfilled. According to the Administrative Court, the order by the District Office was based on the public interest to determine the potential basis for the existence of a municipal pre-emptive right. Furthermore, the Administrative Court ruled, that it was conceivable that, under certain circumstances, a Share Deal may provide for a so-called circumvention transaction (*Umgehungsgeschäft*) and that it was in the public interest to clarify whether a Share Deal may provide for such contractual arrangements.

Effects on Practice

It should be noted that, for the time being, the Administrative Court of Berlin did not deal with

Share Deal and Public Pre-Emptive Rights

- the question whether the requirements for the existence of a municipal pre-emptive right were fulfilled. It "only" dealt with the preliminary question whether submission of the documentation in connection with a Share Deal may be ordered by the municipality. The Higher Administrative Court (*Oberverwaltungsgericht*) of Berlin-Brandenburg, as the relevant court of appeal (*Beschwerdegericht*), may (if at all responsible) deal with the question whether the requirements of a municipal pre-emptive right are fulfilled.

  However, the accelerated decision of the Administrative Court of Berlin is in line with the overall tight housing market in Germany. In the light of the political objective to secure housing spaces in Germany, the municipal pre-emptive right has increasingly come into focus. This has already been demonstrated (among others) by recent proposals to change the relevant public laws regarding pre-emptive rights. Against this background, further developments in case law and practice remain to be seen. If, in fact, a public law tendency was to be developed according to which Share and Asset Deal were to be treated equally, further changes regarding civil pre-emptive rights (e.g., regarding heritable building rights) may follow.

Overview Real Estate Transfer Tax Rates

The following table provides an overview of the current status of the real estate transfer tax rates in the individual federal states (30 June 2020). There have been no changes since the last issue in October 2019.

Baden-Württemberg	5,0 %
Bayern	3,5 %
Berlin	6,0 %
Brandenburg	6,5 %
Bremen	5,0 %
Hamburg	4,5 %
Hessen	6,0 %
Mecklenburg-Vorpommern	6,0 %
Niedersachsen	5,0 %
Nordrhein-Westfalen	6,5 %
Rheinland-Pfalz	5,0 %
Saarland	6,5 %
Sachsen	3,5 %
Sachsen-Anhalt	5,0 %
Schleswig-Holstein	6,5 %
Thüringen	6,5 %

Tax

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- REIT structuring and compliance
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- Distressed real estate
- Transfer tax, property tax and assessment challenges
- Real estate litigation

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Selected Experience

Advised **DIC Asset AG** on the acquisition of the "SAP Tower", Eschborn. The as-new and fully let "SAP Tower" property in the Eschborn-Süd industrial park (near Frankfurt am Main), built in 2018, comprises around 8,950 sqm and has landmark character. The building is characterized by a modern architectural concept, high construction quality and state-of-the-art technical equipment. The sole first tenant is the software company SAP. SAP uses the property as a sales and demonstration center in connection with "SAP Digital Studio", among other things. The average lease term is around 8.0 years. The total investment costs for the property amounted to approximately EUR 69 million.

Advised **Principal Real Estate GmbH** on the sale of the business park "Air Cargo Center" in Langenhagen (near Hannover). The industrial park, which was built in 1997 and extended in 2000, has around 22,400 sqm of rental space and is almost fully let. The main tenants are the aircraft maintenance company MTU Maintenance Hannover GmbH and Connox GmbH. The purchaser is Swiss Life Kapitalverwaltungsgesellschaft mbH.

Advised **LaSalle Investment Management KVG mbH** on the acquisition of the office building "Economic Quarter" in Hamburg's City Süd for its pan-European fund Encore+. The Economic Quarter has 28,000 sqm of rental space on ten floors. The total property currently has a WALT of 8 years with an annual rent of EUR 5 million. Seller is the asset manager Blackrock.

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