BNP PARIBAS REAL ESTATE GUIDE TO

INVESTING IN GERMANY 2019

IN COLLABORATION WITH C/M/S/ Law.Tax

BNP PARIBAS REAL ESTATE

Real Estate for a changing world

BNP PARIBAS REAL ESTATE
INVESTMENT IN GERMANY

We offer investors a comprehensive range of services: Whether it concerns fund strategies, expert opinions on prospects and goals, optimisation or asset management, with our six business areas we can support and advise you in all phases of the investment cycle.

Our clients include institutional investors, insurances, real estate firms, investment companies, private investors, family businesses and open-ended and closed-end funds. We cover all types of property and are active in the segments offices, industrial, logistics, retail, hotels, development sites and residential properties. In 2018, we further strengthened our leading position and maintained our market share with 927 transactions and an investment volume of 11.6 bn €.

Our international network, with 5,400 employees in 32 countries around the world, can help you to take advantage of market opportunities anywhere.

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GERMANY BY NUMBERS 2018

Gross domestic product (GDP)
3,388 bn €
Share of EU's GDP around 30 %

Harmonised index of consumer prices
1.9 %
Eurozone average: 1.7 %

Population
83.0 m
Again an increase

Unemployment rate
5.2 %
Only 2.34 million unemployed

GPD-growth
1.5 %
EU average: 1.8 %

People in employment
44.83 m
Highest figure since reunification

Investment turnover
61.5 bn €
New record

Sources: Eurostat, Destatis, BNPPRE

GERMANY – THRESHOLD EXCEEDED: NEW RECORD INVESTMENT VOLUME

After three very good years, each with a transaction volume of well over 50 bn €, the 60 bn € threshold was broken for the first time in 2018, as expected, and a new all-time high was set with just over 61.5 bn €. Despite lowered GDP forecasts for the next two years and deteriorating sentiment indicators, investor interest in German real estate remains high. Although the growth rates are slightly declining, the economy also has good medium-term prospects and solid growth potential. In addition, unemployment will continue to fall according to current forecasts. The occupier markets are also benefiting from this, which is impressively underlined by the current take-up in office space, which at around 4 million m² represents the second-best result of all time. The scenario of high and stable demand coupled with noticeably rising rents remains intact and offers potential for increases in value in the coming years.

The market was clearly dominated by office investments, which contributed almost 29.7 bn € or 48 % to the overall result. Only in 2007 was the volume slightly higher, but this was mainly driven by large portfolios. Following in second place are retail properties, which contribute 11.2 bn € (18 %) to the turnover. This is slightly above the ten-year average, but at the same time 19 % below the previous year's result. Logistics investments, on the other hand, are still on the road to success, reaching 7.2 bn € (12 %) and thus achieving the second-best result of all time. Hotels have also continued the high records begun about four years ago, although at some 4 bn € (6.5 %) they are around 4 % below the previous year's figure. The A-cities (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, Stuttgart), which account for a little over 38.65 bn €, or around 63 % of the overall result, were particularly the focus of attention. These cities not only feature different levels of returns but also diverse economic structures with specific regional highlights. From the risk-spreading angle, this is a situation unique anywhere in Europe.

The great interest demonstrated by investors has, though, led to a reduction in the scale of supply, and has triggered increasing competition for attractive assets. Only with detailed market information, proven relationships with the vendors and comprehensive understanding of the market mechanisms is it possible to establish the right pricing and bring deals to a successful conclusion. As one of Germany's leading property consultants, with the highest brokerage volume in any long-term comparison, BNP Paribas Real Estate has the expertise needed to provide investors with full and complete assistance throughout the purchasing process. We would be delighted to talk to you about the opportunities offered for investing in this safe haven and to support you in taking advantage of these opportunities.

This guide takes a closer look at the various asset classes and the international law firm CMS outlines key legal and technical facts investors need to know about German property, including tax aspects. We hope this brochure offers you some initial guidance in your endeavours to manoeuvre in the German real estate market and we would be pleased to welcome you in Germany in the near future.

Piotr Bienkowski
Chief Executive Officer
BNP Paribas Real Estate Germany

INVESTMENT ASSET CLASSES

Find out more about the current situation and future trends for the five asset classes office, retail, logistics, hotel and residential of the German real estate investment market

OFFICE
AGAIN INVESTOR'S DARLING

The general conditions for office investments remain very good. Unemployment will continue to fall and the number of people in employment will rise further. Occupier markets are benefiting from this and the scenario of a strong and stable demand remains intact with significant rent increases at the same time.

Single deals with new all-time high

In 2018, again there was no way around office buildings. With 29.68 bn €, they again reached the top position and contribute 48 % to commercial investment turnover. A little more was invested in offices only in 2007, due to the many portfolio deals. This outstanding result is mainly attributable to individual deals which, at 27.14 bn €, set a new record of 34 % above the previous year's figure and doubled the ten-year average. They are thus responsible for 91 % of total turnover. Demand was primarily for large-scale office buildings, which is reflected in 66 sales in the three-digit million range. Among the most important were Gallileo and Omniturm in Frankfurt, Oskar in Munich, Springer Quartier in Hamburg, Zalando Campus in Berlin, RWI4 in Düsseldorf and Quartier Karlshöhe in Stuttgart. By contrast, with 2.55 bn € around a third less than in 2017 was invested in portfolio deals. The reason for this is too little supply, whereas investor interest, especially in core portfolios, remains very high.

New sales record in the A-cities

The A-cities (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, Stuttgart), which increased turnover by almost a third to 24.93 bn € and thus set a new record, were at the centre of the action. Frankfurt is the sovereign leader with 8.42 bn € (+50 %); the sale of a number of office towers contributed to the new all-time high above all. Düsseldorf with 2.54 bn € (+13 %) and Stuttgart with 1.51 bn € (+75 %) also set new records. The neck-and-neck race for second place was narrowly won by Munich with 4.25 bn € (+63 %) and Berlin with 4.22 bn € (-17 %) was therefore awarded bronze. At 3.06 bn € (+88 %), Hamburg achieved an excellent result and occupied its usual fourth place, and Cologne, at 918 m € (+15 %), also barely missed the billion mark. With a transaction volume of 4.15 bn €, cities outside the A-cities contributed around 15 % to the result only in terms of single investments. At 14 %, however, the increase here is noticeably lower than in the top locations. From an investor's point of view, A-cities remain the measure of all things. A shift in buyer interest towards B- or C-cities is not detectable.

Outlook

Although economic forecasts have become somewhat gloomy, very solid growth can be expected in 2019, so that unemployment will continue to fall and employment will rise. The office markets will also benefit from this. Against this background, the course has been set for rent increases and development potential for value appreciation. As a result, an above-average investment volume beyond the 20 bn € threshold is also expected in 2019. This is all the more true as other asset classes do not offer investors real alternatives to higher and above all safer returns. In the event of increasing global uncertainty, competition for premium properties may even intensify further, thus maintaining the pressure on yields.

Second best result ever
29.7 bn €
turnover

Still Investor's Darling
48 %
of commercial investment volume

New all-time high
27.1 bn €
single deals

Impressive new record
24.9 bn €
in A-cities

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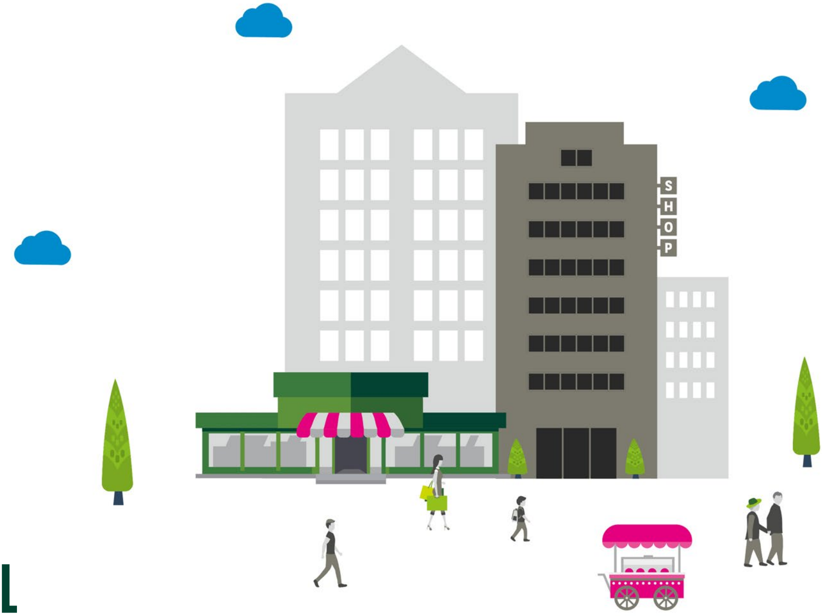

RETAIL
ABOVE THE LONG-TERM AVERAGE

In view of the fact that the 10 bn € mark was broken for the fourth time in a row, while the results between 2012 and 2014 fell short of this hurdle, it can be said that the overall balance is moderate in times of fundamental transformation processes in the retail landscape. The retail market still offers very attractive investment opportunities in several market segments.

Solid investment volume in long-term comparison

Although the retail investment market, with a transaction volume of 11.2 bn €, is lagging just under 19 % behind the previous year's result, it can top the ten-year average by a good 7 %. A look at the size categories shows that the decline can be localised particularly in the segment with at least 50 m €, where the volume was 26 % lower than in 2017. Among the most noteworthy transactions are the ensemble Leipziger Platz 14-16 and the shopping centre Das Schloss in Berlin as well as the Hanseviertel and Karstadt Sports in Hamburg, primarily large-volume highstreet properties in A-cities. In addition to these prominent deals, the merger of Karstadt and Kaufhof also had a significant impact on the result. In summary, single deals accounted for 6.28 bn € (56 % share), while 4.92 bn € (44 % share) were invested in portfolios.

Discount stores and supermarkets most popular

Compared to the previous year, only the department stores emerged as winners in the distribution of turnover among the different types of properties: pushed by the merger of Karstadt and Kaufhof, they increased by 151 % to 2.64 bn € and thus account for almost 24 %. All other types of properties cannot build on their results from 2017 and have to accept losses of 30 to 40 %. Nevertheless, supermarkets (a good 39 %) and highstreet properties (a good 24 %) maintained their positions within the ranking ahead of department stores. Shopping centres (just under 13 %) will have to settle for fourth place due to the increasing uncertainty in this segment.

Lively market activity also in small cities

In terms of single deals, smaller cities with up to 100,000 inhabitants are and remain the second-strongest category after A-cities with a share of almost 29 %, which is a clear indication that not only highstreet properties but also conveniently located retail parks as well as supermarkets and discounters with tenants of high credit rating offer attractive investment opportunities outside the metropolises. One of the most significant transactions of a retail park is the purchase of Kauf Park Göttingen, which in this asset class represents one of the largest deals of recent years.

Outlook

Even if the result of the retail investment market in 2018 does not come close to the results of previous years, there are no signs of real erosion processes. Both highstreet properties and retail parks continue to be very attractive to a wide range of investors – provided that criteria such as location, letting situation and alternate usability are right to meet future requirements. There are also other factors in favour of retail investments, in particular the continued very positive level of private consumption. Whether a good result can then be reported by the end of 2019 depends in particular on larger portfolio sales, which are essential for a positive result.

Significantly above ten-year average

11.2 bn €

turnover

Retail parks and supermarkets with highest share

39 %

of retail investment

Highstreet investments on second place

24 %

of turnover

Smaller cities with up to 100,000 inhabitants also very popular

Share of

29 %

of single deals

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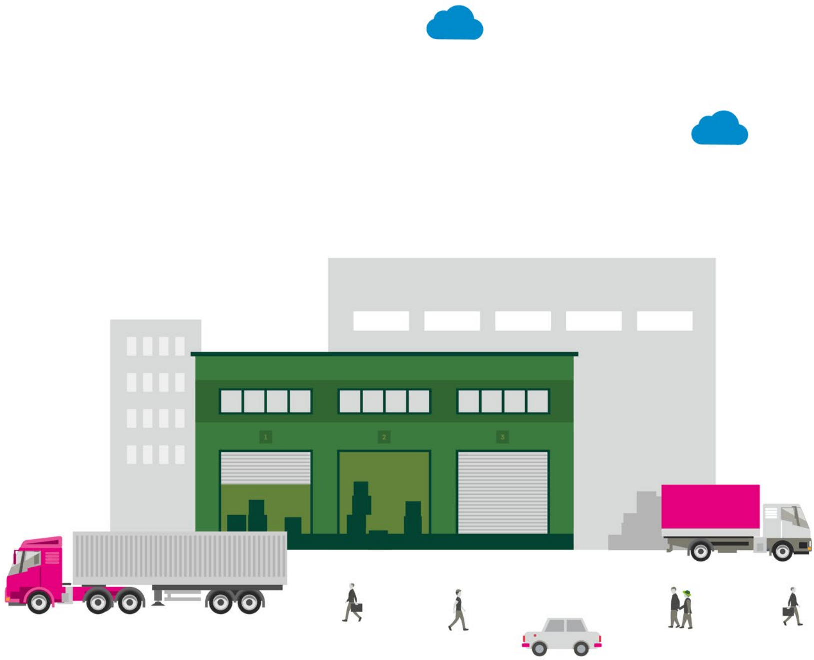

LOGISTICS
WELL ESTABLISHED AS ATTRACTIVE ASSET CLASS

The rally with logistics investments has continued. Based on their experience in other international markets, foreign investors in particular have shown disproportionate interest in the logistics asset class and accounted for over 50 % of total investment volume.

Second best transaction volume ever

Logistics investments have continued their success story. With a transaction volume of 7.2 bn € the previous year's record was missed as expected (-21.5 %), but nevertheless the second-best result ever was achieved. The decline is due to lower portfolio turnover, as several large pan-European logistics platforms were sold in 2017. In contrast, a new record of 3.19 bn € was set for individual sales. In addition to classic logistics properties and portfolios, light-industrial sales were increasingly registered, which are gaining more and more attention among investors. The decisive factors here are, on the one hand, comparatively attractive returns and a broader and thus less sensitive mix of uses. The most striking examples are the Laetitia and Optimus Prime portfolios. At just under 52 %, foreign investors contributed more to the result than German investors, even though their share declined due to the lower portfolio volume. Based on their experience in other international markets, foreign investors are showing disproportionate interest in the logistics asset class. As in 2017, Asian buyers were the most active and accounted for more than 20 % of the volume. North American (15 %) and European (just under 13 %) investors rank second and third respectively.

Metropolitan areas almost at previous year's level

The major metropolises have also benefited from the strong demand and, at just under 1.95 bn €, fell only marginally short of their previous year's result (-5 %). Some locations, such as Berlin, Düsseldorf, Hamburg and Stuttgart, were even able to increase turnover once again. By far the most was invested in Berlin (444 m €). However, Munich (342 m €), Hamburg (296 m €), Düsseldorf (290 m €), Stuttgart (238 m €) and Frankfurt (216 m €) also show very good results, especially in a long-term comparison. By contrast, investments in Cologne (97 m €) and Leipzig (26 m €) were noticeably weaker. However, this was primarily due to an insufficient supply.

Outlook

Logistics investments have once again confirmed the significantly higher level at which they have been operating for several years. This is unlikely to change in the medium term. Major trends that contribute to a high demand and thus form the basis for successful and sustainable investments are continuing. This includes above all the continuously increasing importance of e-commerce, which triggers additional demand. But ongoing rationalisation and outsourcing processes in industry also benefit the logistics markets. As the German economy will grow solidly in 2019, despite slightly lower GDP forecasts and declining sentiment indicators, investor interest will remain unchanged. Against this background, an above-average investment volume is also expected in 2019. Which level it will finally achieve depends primarily on the amount of larger portfolio transactions.

Second best result ever

7.2 bn €

turnover

Important asset class

12 %

of commercial investment volume

New all-time high

3.2 bn €

single deals

Asset class with increasing importance

2.5 bn €

light industrial

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HOTELS
SUCCESS STORY CONTINUES

The highly dynamic development of the German investment markets has very definitely extended to hotels. For several years now, they have been registering strong increases in transaction volumes.

Hotel investment turnover clears the 4 bn € hurdle

With an investment volume of more than 4 bn €, hotel investments exceed the 4 bn € hurdle for the fourth time in succession. Compared with the previous year, the volume was down just under 4 %, although this was not due to any decline in demand, but rather to limited supply, especially in the core and core-plus segment. A total of around 130 transactions were recorded, slightly more than in the previous year. Accordingly, the average volume per sale was around 31 m €, a good 8 % below the previous year's level. However, a somewhat different picture emerges for individual hotel sales: A new record of around 3.2 bn € was even set here. Since 2010, this segment has recorded continuous growth rates, to which a whole series of larger hotel deals with more than 100 m € contributed in 2018. These include the Hotel Bristol in Berlin, the Maritim Hotel am Heumarkt in Cologne and the Leonardo Royal Hotel Munich. In the case of the portfolios, on the other hand, turnover remained almost a quarter below the previous year's figure at around 820 m €. Especially here there was a lack of larger portfolios.

Different development in the cities

Hotel investment turnover in the eight major locations (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Leipzig, Munich and Stuttgart) developed quite differently year-on-year. In total, hotels with a volume of around 2.8 bn € were sold, with the major markets accounting for more than two thirds of the nationwide result. Although the outstanding result of the previous year was missed by around 11 %, the decline is not surprising given the record sales in Munich and Berlin in 2017. In 2018, the hotel investment volumes in Frankfurt (572 m €), Munich (541 m €) and Berlin (521 m €) are very close together. In fact, by far the most hotels changed hands in Frankfurt, while the capital's result is also based on larger transactions such as the sale of Hilton Berlin, which alone contributed almost 300 m €. Hamburg achieved a clearly above-average result of 369 m €, albeit down on the previous year. Cologne (324 m €), Stuttgart (213 m €) and Düsseldorf (193 m €), all of which were able to increase their previous year's figures, ranked second. At 74 m €, Leipzig achieved a result slightly above the long-term average.

Outlook

Hotel investments are in demand on a broad front, be it new buildings, existing properties or hotels in need of optimisation. No pronounced preference can be observed for the choice of location, at least in the large markets when attractive properties come onto the market, they usually also find their buyers. In the portfolio segment in particular, however, supply has been declining recently, which has prevented even higher results. Due to the harmonious market conditions, lively market activity can therefore also be expected for 2019. To which extent the investment volume will approach the 4 bn € mark again, will however highly depend on larger deals, especially in the portfolio segment.

Slightly above
4 bn €
investment volume
4 bn € threshold exceeded for the fourth time in a row

New record volume
3.2 bn €
single deals

Share of nearly
50 %
Foreign investors very active

2.8 bn €
More than two thirds of turnover in A-locations

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RESIDENTIAL
SECOND BEST RESULT EVER

The German residential property market remains highly popular with investors. A further growing population in the metropolises and rising rental and purchase prices form the framework for sustainably successful investments and open up future potential for value growth.

Renewed increase in residential investment volume

The transaction volume with residential portfolios (30 residential units or more) has increased again year-on-year. In total, residential portfolios changed ownership accounting for around 16.3 bn €, an increase of 16 % compared with 2017. Only in 2015 was the volume even higher thanks to the purchases of several large residential platforms which alone generated sales of almost 10 bn €. However, the takeover of the Austrian housing group Buwog by Vonovia in 2018, whose German holdings were included at over 2.7 bn €, also marked a significant deal. One of the largest portfolios of the year is also the Century portfolio, which the Danish pension fund PFA acquired from Industria Wohnen. Like all the others, however, it remained below the 1 bn € mark. A total of well over 300 transactions involving around 133,000 residential units were included in the result. On average, both the number of units per transaction and the average portfolio volume were above the previous year's figure.

Existing portfolios dominate

As in previous years, existing portfolios in particular accounted for just below 55 % of volume. However, two asset classes have been on the rise for several years: on the one hand, project developments are in high demand both in the particularly tense housing markets of the A-cities and in many smaller locations. They contribute around 24 % to the result. On the other hand, special forms such as student apartments and micro-apartments have increasingly established themselves as asset classes. In 2018, more than 1.7 bn € went into these forms of housing – more than ever before, so that they were even able to just exceed the older existing properties (10 %).

Growth especially outside the A-cities

Even though the A-cities (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, Stuttgart) still account for a considerable share of the residential investments (6.7 bn €), the increase in turnover is due in particular to the locations outside these big cities. The growth in the rest of Germany is 27 % compared with just 4 % in the top cities, which can be seen as a clear indication of the broad-based demand. Most of the investments were made again in the capital: More than 3.3 bn € was registered here, accounting for around half of the volume of the A-cities.

Outlook

With its extensive product range in both the existing and the new construction segments, the residential investment market offers interesting investment opportunities for a large number of investor types that rely on stable long-term cash flows. In addition, it continues to differentiate itself and increasingly offers opportunities in new segments, such as student housing, micro-apartments or assisted living. Therefore, residential investments should also be among the most popular real estate investments in 2019. However, the supply side remains the bottleneck, making reliable turnover forecasts difficult. However, a clearly above-average result should be possible.

Best result after 2015

16.3 bn €

investment volume

Significant increase compared to 2017

+16 %

Residential developments account for a quarter of turnover

3.8 bn €

New record for student-, micro-apartments, etc.

1.7 bn €

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KEY LEGAL AND TAX TERMS

Determining the correct path to take in the highly regulated German real estate market is sometimes regarded as challenging – and justly so. In the following, CMS lawyers Heinz Joachim Kummer and Thomas Link outline some key information about the German legal system and the operating environment here. With regard to the acquisition, financing and structuring of real estate ownership, the German legal system provides a large measure of accessibility, security, and certainty. In contrast, however, the statutory lease regime is rather complex and subject to looming one would not expect.

A WORD OR TWO ABOUT REAL ESTATE LAW IN GERMANY

On occasion, it is said that we Germans are painstaking, humourless, stiff, and (overly) meticulous. Well, these characteristics may be mere clichés, but admit it: right at this moment, you are smiling and silently nodding to yourself in confirmation. Certainly, not all of the mentioned characteristics invariably work to our benefit. On the other hand, however, some of them may even provide you with some clear advantages:

Germany has a sound, secure legal system. The courts work reliably. The legal situation is clear and unambiguous, creating – for domestic and foreign investors alike – a transparent, binding framework for investments, imbued with trust throughout. Nobody needs to fear being at the mercy of judicial or administrative arbitrariness or – and this is especially vital for foreign investors to know – of any unpleasant, surprising pitfalls that could jeopardise investments. Germany is a safe haven.

This principle is particularly true for real estate investments: For example, Germany has an elaborated land registration system. Each parcel of real property is documented in land registers, together with detailed information as to the current title holders and any and all encumbrances *in rem*, be they in the nature of easements, servitudes, or ground charges running with the land. In comparison to other jurisdictions, however, the primary achievement of the German system is that our land registers enjoy the status of irrefutable presumption. In other words, the entries in the land registers are generally constitutive and hence deemed correct, creating a legal environment for your investments that is not only utmost transparent, but also legally certain. Moreover, in contrast to jurisdictions under the Anglo-Saxon legal system, Germany provides codified law. In most countries around the world, legal systems generally fall into one of two primary categories: common law systems and civil law systems. The essential difference between the

two systems is that in common law countries, case law – in the form of published judicial opinions – assumes primary importance, whereas in civil law systems, codified statutes predominate. Germany is a civil law jurisdiction. Thus, agreements can be drafted in a much shorter form, concentrating mainly on regulating the parties' material economic interests.
However, still, agreements are not free of pitfalls: for example, the underlying codified law is sometimes mandatory. Contractual provisions deviating from mandatory law are undeniably invalid. Provisions deviating from mandatory law can even jeopardise the validity of other provisions – ones which would per se actually be permissible – and in the worst-case scenario, could even render the entire agreement invalid.
Like in other jurisdictions, consumer protection regulations are in place, particularly in order to afford protection against general terms and conditions *(Allgemeine Geschäftsbedingungen)*. Provisions in standard contracts, or even those which are supposed to be used several times, can thus be invalid, should they deviate too significantly from the statutory model. As a consequence, instead of the invalid provision in an agreement, the default statute will apply, potentially causing additional detrimental ramifications for the user than would have been the case had a permissible, individually drafted provision been included in the contract. Classic examples of this include provisions in lease agreements concerning maintenance duties and the allocation of operating and other ancillary costs. The same principles also apply, however, to sale and purchase agreements (frequently affected are provisions concerning representations and warranties and limitations of liability), as well as to turnkey and other construction contracts (frequently in connection with provisions concerning security deposits, contractual penalties or liquidated damages).

Yet if everything were so simple, then you would not need any qualified legal advice for your investments in Germany ...

1. Types of real estate

In Germany, real estate can be owned in the following ways:

- Freehold: title to the land and the buildings and / or structures on the land;
- Condominium ownership *(Teil- or Wohnungseigentum)*: title to separate units of a building combined with joint ownership of common areas in community with other co-owners;
- Ground lease *(Erbbaurecht)*: a right to construct and to own buildings on the premises during a long-term leasehold (often with a term of 99 years).

Title to property can be encumbered, both under the *law of obligations* alone, for example, by concluding lease agreements, as well as in rem, for example, by means of

- easements *(Grunddienstbarkeiten or beschränkte persönliche Dienstbarkeiten)*, and
- land charges or mortgages *(Grundpfandrechte or Hypotheken)*.

The difference is that in rem rights (that are also entered in the land register as such) apply not only with respect to the current owner of the property, but also with respect to each subsequent new owner of the premises.

2. Acquisition of real estate

Generally speaking, real estate is acquired by entering into and executing a sale and purchase agreement and subsequently registering the new owner in the land register. For the execution, usually, a number of closing conditions have to be satisfied. One particularly key condition includes clearance of any statutory or contractual rights of first refusal belonging to third parties. As a rule, not only the relevant municipalities, but also sometimes other public-law entities and institutions, enjoy statutory rights of first refusal which can be exercised under certain circumstances. In larger transactions, a merger control clearance by the German antitrust authority *(Kartellamt)* might also be necessary.
As a rule, however, the closing conditions can be easily and reliably satisfied. In general, two to three months will elapse between the signing of the sale and purchase agreement and the transfer of ownership in the land register. To protect the purchaser at the earlier stage and to place him in a position equivalent to ownership, a priority notice of conveyance *(Auflassungsvormerkung)* in favour of the purchaser is usually registered in the land register in advance. This step protects the buyer, who can thus – having this in rem securitisation in hand – pay the purchase price to the seller even prior to being registered in the land register as the new owner.
Please note that under German law, sale and purchase agreements must generally be certified by a civil-law notary *(Notar)* in order to be valid and thus also legally enforceable. The same applies to ground charges, covenants running with the land, easements, and servitudes. Please note that a German notary *(Notar)* should not be confused with a notary public in some common law jurisdictions. A German *Notar* holds a government appointment and bears extensive responsibilities, far beyond signature authentication. However, a German *Notar* is obligated to remain neutral, and therefore may not advise the transacting parties with respect to their interests. The latter function belongs to lawyers, who in turn must ensure that any agreement secures and contains provisions safeguarding their clients' objectives and requirements.
In the acquisition of real estate, notary fees and court costs (for the land register) are incurred; typically, these are assumed by the buyer. Both the notaries and the courts (land registers) are subject to uniform and transparent fee schedules; you should be certain to have your lawyers calculate in advance the costs you will have to expect.

Tax-optimised acquisition models

Real estate transfer tax *(Grunderwerbsteuer)* is usually incurred upon the acquisition of real property. The rate of taxation varies among the various German *Länder* (federal states), e.g., Berlin, North Rhine-Westphalia, Bavaria, Hamburg, Hesse, and so forth. Currently, this rate ranges between 3.5 % and 6.5 % of the relevant purchase price.
In recent years, a number of share deal models for avoiding real estate transfer tax have taken hold in Germany. Real estate investments are thus frequently structured in such a way so that real estate is acquired not through a holding company structure, but instead from a special purpose vehicle (SPV) – usually newly founded for this express purpose. This arrangement facilitates – in the event of an exit – the ability to sell the SPV units (without triggering real estate transfer tax) rather than the real property as such. However, since the German federal government newly formed in 2018 intends to render the established tax shelters more difficult, or at least less attractive, for this reason it is advisable to keep an eye on new developments. And when purchasing real property, please ensure that you make your investment on the basis of an acquisition structure that is optimal for your interests. Subsequent restructuring can trigger substantial costs and taxes, an occurrence which, naturally, should be avoided.

3. Financing of real estate

In order to be able to finance the purchase price even before the title has been transferred to the buyer in the land register, specific powers of attorney are usually provided for in sale and purchase agreements; on this basis, it is possible for the real property being to be encumbered by ground charges in favour of the financing banks even at this early stage, in order to enable the buyer to finance the purchase price to be paid (prior to transfer of the title). Reaching agreement on provisions for purposes of securitisation ensures that the lender banks cannot foreclose on their ground charges pertaining to the property until the seller has received the full purchase price; hence, the seller of the property is thus protected against any detrimental dispositions.

4. Leases

Both, legislation and the courts in Germany, are generally lessee-friendly. This is true not only of residential leases, but also – to a somewhat lesser extent – of commercial leases. The following is to provide you with a brief summary of the most relevant issues:

The written-form requirement

One peculiarity of German law that frequently leads to inconvenience is the so-called written-form *(Schriftform)* requirement. In principle, lease agreements do not require any specific form and can even be entered into verbally. This changes, however, if the lease is entered into for a fixed term exceeding one year. In this event, the entire agreement, including any exhibits, appendices, riders, or subsequent addenda, *must* be entered into in writing; moreover, a number of special requirements and specific standards must be satisfied. Otherwise, both parties have the right to terminate the lease agreement at any time, even prior to the end of the fixed term, with a short notice period *(Kündigungsfrist)* of generally only three or six months. Although the written-form requirement, as such, is well known, in this area parties often make mistakes, meaning that the risk of early termination is frequently incurred. This sounds dreadful, but even here, there are ways and means to effectively address these issues in practice.

Rent and indexation

With few exceptions, the amount of rent charged can be freely negotiated by the parties. However, there are also some exceptions to the rule: In some cities and regions, for example, rent controls *(Mietpreisbremsen)* must be complied with. If public funds are used for the premises, certain commitments and other restrictions might apply – in some instances, even for long periods of time after the funds have been repaid. These can encompass the establishment of maximum rents or occupancy rights, according to which the owner of the real property will be obligated to lease the premises only to financially disadvantaged persons, etc. However, both of these restrictions generally apply only to residential leases. Obviously, unexpected rental restrictions will have an adverse effect on your cash-flow calculations. Hence, please be very mindful of this consideration when investing in German real estate.

Most commercial leases provide for rent indexing; in general, the rent adjustment is often tied to inflation, using the Consumer Price Index as a benchmark. Please note, however, that such an indexation is generally permissible only for leases having a term of at least 10 years. Unlike other jurisdictions, Germany does not provide for any "rent review"; instead, each rent adjustment must be agreed upon in the lease agreement, in advance.

Service costs

General expenses for utilities and waste management (electricity, water, sewage, heating, refuse collection/recycling, etc.) and other overhead costs (real property tax, insurance premiums, etc.) can be allocated proportionately to the lessees, at least within certain limits. Here, too, the specific provisions contained in the lease agreement are dispositive. In addition to the generally applicable Heating Costs Allocation Regulation *(Heizkostenverordnung)*, leases generally refer to the Operating Costs Regulation *(Betriebskostenverordnung)*, in which an exhaustive catalogue meticulously regulates which costs may be allocated to the lessees. Commercial leases, in particular, usually provide that lessees can also be charged with other costs. All the same, please be careful: in this area as well, standard forms, etc., can turn out to be invalid.

Maintenance and repair

The law generally holds the lessor responsible for maintenance and repair at its own expense. It is common, however, for lease agreements to contain provisions concerning maintenance and repairs that deviate from this rule. Double net and even triple net agreements are also known in Germany, but usually only in commercial leases. Please note, however, that here too, certain requirements and restrictions must be taken into account. Should the provisions violate these principles, the provisions in question will be rendered invalid, with the consequence that the lessee-friendly statute will instead apply.

Term

Generally speaking, the term of leases can also be freely negotiated by the contracting parties, but may not exceed a 30-year period. If a longer term is nevertheless stipulated, then both parties will have the right to prematurely terminate the lease after 30 years have elapsed.
Regardless of this rule, both lessor and lessee have the right to terminate the lease for cause at any time; this particular right cannot be waived. However, this right of termination applies only if truly compelling reasons exist; in the event of doubt, grave breaches of contract must have been committed.
Commercial leases usually provide fixed terms with options for the lessee and specific termination options for both parties. Residential leases, on the other hand, are usually entered into for an indefinite duration; whether and when they can be terminated thus depends on the statutory provisions. Due to the lessee-friendly leanings found in the statutes, such leases can be terminated by the lessor only if certain very strict prerequisites are fulfilled.

Subletting and transfer of leases

The transfer of a lease agreement to a third party is permissible under German law only if all of the parties agree or such was agreed upon in the lease agreement in question beforehand. Even a simple subletting will generally require the consent of the lessor, but the lessor may refuse to consent only for compelling reasons.

Rental security deposits

Lessees are usually obligated to provide a rental security deposit, frequently in an amount equalling three months' rent (in the form of surety bonds or cash deposits etc.). In order to protect lessees, once the lease agreement comes to an end the lessee has the right to demand repayment of the rental security deposit not only from the current owner of the property (i.e., the lessee's current lessor), but also from all predecessors, stretching all the way back to the original property owner with whom the lessee had first entered into the relevant lease. As a consequence, even years after the sale of investors' property, claims can still be asserted against them based upon old rental security deposits. The only way to avert such consequences is to ensure that the parties agree upon the requisite provisions with the purchaser of the premises.

5. Building permits and green buildings

It does indeed, somehow, embody the "German approach" to be meticulous and perhaps, at times, even to overregulate: in principle, a building permit is required not only for the construction of a new building, but also for each substantial modification, and even for each major change of use. In some cases, even additional permits are required, such as those for operating restaurants, nursing homes and other special real estate assets. On the other hand, however, the prerequisites for the necessary permits are clearly regulated: For example, any party has the right to obtain a building permit as long as (i) no prevailing public interests conflict with the intended project and (ii) the local public infrastructure is suitably ensured. The circumstances in which such is the case are regulated in minute detail; it is particularly decisive whether the project matches the specifications of the underlying zoning plan and meets its resulting requirements.

As in other countries around the world, environmental protection is becoming increasingly important in Germany as well. Among other things, both new buildings and existing structures must meet specific standards for energy efficiency and energy savings. The precise specifications that particular types of buildings must satisfy, and the relevant time frames, can be derived from the provisions of statute. In some instances, far-reaching actions and expensive measures for clean-up or abatement of legacy waste are required for this purpose (insulation for façades and ceilings, replacement of technical equipment and facilities, etc.) that may have a substantial and/or material impact on the amount of the capital expenditure. Hence, such factors must also be taken into account with regard to the overall calculation when purchasing real property.

In Germany, we are also familiar with building certifications based on LEED, BREEAM and DGNB *(Deutsche Gesellschaft für Nachhaltiges Bauen)* standards, etc. As a result of the generally high building standards, such certifications are achievable in Germany – generally, with relative ease and without significant additional expense. Green leases, on the other hand, have not become common in Germany.

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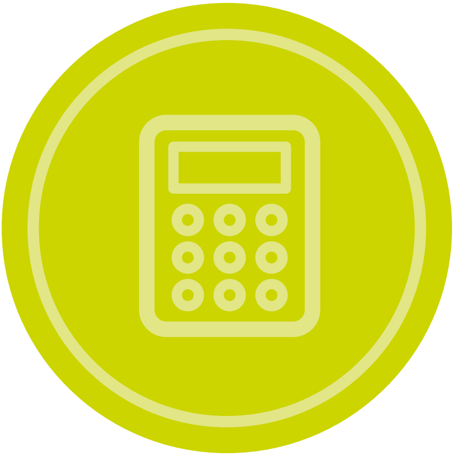
TAXATION OF REAL ESTATE INVESTMENTS IN GERMANY



1. Acquisition of Real Estate

The acquisition of German real estate and, under certain circumstances, the acquisition of corporations or partnerships owning German real estate will trigger real estate transfer tax (RETT). The rates for RETT can be set by the individual German states and range from 3.5 % to 6.5 %, depending on the location of the property. In case of an acquisition of a property the tax base for the calculation of RETT is the consideration paid by the purchaser. In case of a direct or indirect acquisition of a German or foreign corporate entity or partnership of 95 % or more of the shares or partnership interest by one purchaser or a group of companies qualifying as a so-called RETT-group owning German real estate RETT will be triggered. In addition to that, also the direct or indirect transfer of the interest in a German or foreign partnership of 95 % or more of the partnership interest within a period of five years will trigger RETT. In case RETT is triggered by the transfer of corporate shares or partnership interests RETT is not based on the full or partial consideration for the shares or the partnership interest, but is rather based on a special tax value of the entire real estate owned by the respective legal entity. A change of the RETT regime for share deals has been agreed amongst the German States pursuant to which the direct or indirect change of the participation in real estate owning corporations and partnerships of 90 % or more within 10 years will trigger RETT. The new law might come into force with retroactive effect as of 1 January 2019, however, certain grandfathering exemptions should be available.

2. Income Taxation

Rental income from German real estate and capital gains from the sale of German real estate are subject to German income taxation. The taxation rights remain with Germany also

in cases of non-resident taxpayers and is not excluded or limited by applicable tax treaties. The tax regime for resident and non-resident taxpayers is identical with the exception that non-resident individuals will not be granted the basic tax exemption which excludes taxable income up to an amount of 8,652 € from income taxation. The maximum tax rate for individuals can reach 47.475 % and the flat tax rate for corporations is set at 15.825 % (both rates combine individual income tax / corporate income tax and solidarity surcharge). Depending on whether the income from German real estate forms part of a commercial enterprise or forms part of a private investment taxable income is either calculated on an accruals basis or on a cash receipt basis. Expenses related to the generation of income from the property are fully deductible for tax purposes. This also applies to the deduction of financing cost if, however, the net annual interest expense per entity is below 3 m € or a specific equity ratio test is satisfied. If not, the deduction of financing cost is limited to 30 % of the EBITDA. Buildings can be amortised on a straight line basis with percentages ranging from 2 % over 2.5 % to 3 % depending on the age of the building, its characterisation as residential or non-residential building and the fact whether it forms part of a commercial enterprise.

3. Taxation of Capital Gains

A capital gain from the sale of German real estate is subject to individual income tax and corporate income tax. For individuals a capital gain from the sale of German real estate is tax-exempt if the property has been owned for more than 10 years. This also applies in case the individual owns the real estate via a non-commercial partnership or if a partnership interest is sold and the non-commercial partnership owns German real estate. There is no preferred tax rate for capital gains from the sale of real estate. However, for commercial real estate investors a tax-exempt reinvestment reserve can be created for the capital gain if specific requirements are met.
The sale of shares in a corporation owning German real estate may be 95 % tax-exempt for corporations if specific requirements are met. Due to a decision of the Federal Tax Court the sale of a real estate owning corporation by a foreign corporation can be tax exempt even if Germany has the taxation right under a tax treaty. In case the applicable tax treaty does not contain a specific provision for real estate companies the taxation right for capital gains from the sale of shares in a corporation by a foreign shareholder is typically assigned to the foreign country.

4. Trade Tax on Rental Income and Capital Gains

Rental income and capital gains from the sale of German real estate can be subject to trade tax. The tax rate is set by the municipality in which a fixed place of business is maintained. Rates range between 7 % and approx. 17 %. No trade tax is levied on individuals and non-commercial partnerships. No trade tax is levied on taxable commercial partnerships and corporations if the so-called extended trade tax relief can be applied. The application of the extended trade tax relief requires i.a. that the entity does not perform any commercial real estate trading activities, does not engage in the performance of detrimental ancillary services to its tenants, and does not rent out fixtures and fittings. Foreign commercial real estate investors can avoid German trade tax without having to fulfil the requirements of the extended trade tax relief if they do not maintain a fixed place of business in Germany. This requires i.a. that the day to day management of the foreign entity is conducted outside Germany.

5. Profit Repatriation

There is no withholding tax on the profit repatriation of rental income by individuals, partnerships or corporations. Further, profit distributions by partnerships are not subject to German withholding tax. The profit distribution by a German corporation to its foreign and domestic shareholders is in principle subject to German withholding tax on dividend distributions, but may be exempt in case the EU Parent-Subsidiary Directive or specific provisions of applicable tax treaties apply. Following the recent decision of the ECJ in the matter "GS" the specific German substance requirements for WHT-exemption for dividends will no longer apply.

6. Value Added Tax (VAT)

In connection with real estate only the standard tax rate of 19 % is relevant. The reduced VAT rate of 7 % is not applicable in this context. In general, the rental and sale of real estate is VAT-exempt. However, the landlord can opt for VAT if the property is rented out to an entrepreneur who uses the property for VATable output services. No VAT option is possible for the rental of residential properties. Input-VAT deduction is only possible to the extent the property is rented out with VAT. In case of a sale of the property such sale is either a non-VATable transaction if the seller is selling a fully rented property to an entrepreneur who continues such business or, if there is no transfer of a going concern, the seller can opt for VAT if the property is sold to an entrepreneur. Typically, the option will only be exercised if and to the extent the purchaser will use the property to provide VATable services.

7. Real Estate Tax

Real estate tax is levied by the individual municipalities on the owner of German real estate. The real estate tax is an annual tax and is typically far below 1 % of the fair market value of the property. In most cases the real estate tax can be charged by the landlord to the tenant. The present calculation method for real estate tax has been declared unconstitutional and the tax can only be levied after 2019 if a new law has been enacted before year end. The law is under discussion.

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