Real Estate Tax Services News

Keeping you informed

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German Ministry of Finance proposes legal changes to increase the appeal of Germany as a fund holding jurisdiction

In brief

The German legislator joins other ongoing initiatives considering changes to the regulation of alternative investment funds at European level. Following the recent issue of draft legislation proposing simplifications to the German fund regime, the German Ministry of Finance is consulting with industry associations on possible improvements targeted at making Germany more attractive as a fund location. This coincides with the review of the AIFMD currently being undertaken by the European Commission preceded by input from the ESMA and Commission over the past year.

The improvement of the existing German fund regime is intended to result in overarching economic benefits for the German fund industry.

The draft bill comes with a number of points of interest for the real estate sector.

In detail

Alongside implementing amendments to the Directives 2009/65/EC and 2011/61/EU, including dedicated pre-marketing rules, and to the EU transparency and taxonomy regulations (EU) 2019/2088 and 2020/852, the draft bill introduces simplifications to the German Investment Act (*Kapitalanlagegesetzbuch*, or KAGB). These changes seek to reduce bureaucracy and facilitate digitalised supervision, abolishing numerous written form requirements and therefore reducing costs to investors.

Perhaps most significantly, the proposed changes will also enable fund providers to widen their fund product offerings with the proposed legislation seeking to introduce:

- open-ended infrastructure investment funds;
- closed-ended master-feeder funds; and
- the possibility for closed-ended funds to use the legal form of a *Sondervermögen* (contractual fund) special fund for professional and semi-professional investors.

The VAT exemption for the management services of investment funds will also be extended to the management of venture capital funds.

A brief overview on fund structuring and vehicle choice

Increase of permissible leverage

The amendments would increase the permissible leverage limit applicable to special property funds from 50% to 60%. This is to allow fund managers more flexibility, especially in times of crisis and aligns with thresholds used in other similar regulatory contexts.

Enhancing master-feeder structures

For the first time, the new sections 272a to 272h introduce master-feeder structures for closed-end funds, which were previously not permitted. This change is targeted at making Germany more flexible as a fund location, offering fund managers more options and investors a wider choice of possible products.
The content of the regulations is largely based on the existing regulations for open master-feeder structures in sections 171 to 180.

Relaxation of internal financing structures in real estate funds

The new sentences 2 and 3 of section 240 are intended to facilitate the capitalisation of real estate companies with shareholder loans, where the companies are wholly owned by real estate investment funds. The existing restrictions for shareholder loan financing, which had attracted criticism in the past by market participants, should no longer apply in these cases offering greater flexibility.

The financing restriction would however remain in place for non-wholly owned participations.

Infrastructure funds under new sections 260a to 260d

The introduction of the open infrastructure fund option serves to create a suitable fund vehicle for small (retail) investors to invest in infrastructure project companies and relevant real estate. Due to their structure as open public investment funds, which invest primarily in highly illiquid assets, being infrastructure project companies and real estate, infrastructure funds have a particularly similar structure to real estate funds. Section 260 therefore refers comprehensively to sections 230 to 260, which apply equally to infrastructure funds other than where the new sections 260b to 260d provide for the contrary.

In order to be considered an infrastructure investment fund, the new section 260b(4) states that at least 60% of the value of the fund is invested in infrastructure project companies. Additional diversification and risk concentration limits apply.

Closed-ended *Sondervermögen* for special investment funds (*Spezial-AIF*)

A special investment fund for professional and semi-professional investors (*Spezial-AIF*) could previously only use the contractual form of a *Sondervermögen* as an open-ended fund. The new section 139 sentence 2 would also permit a closed-ended use of the *Sondervermögen* funds. This mirrors similar options widely in use in other territories, for example as is the case with Luxembourg FCPs.

Open real estate special funds as Investment-KG

As another addition to the fund vehicle selection, a *Spezial-AIF* for real estate should also be available as an open limited liability partnership structure, or so-called “open Investment KG” (*offene Investmentkommanditgesellschaft*).

Our view

The draft as presented will be welcomed in many of its aspects. However, further improvements in relation to other formal arrangements may also result from the consultation process, which will run until 16 December 2020. These may seek to mirror existing regulatory frameworks in territories such as Luxembourg, which is widely considered as a benchmark for the real estate sector.

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