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Investing in German Real Estate

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Preface

The German real estate markets have established themselves as one of the most attractive destinations for international capital flows both in terms of use types and locations. Although Germany is a popular investment destination among investors for being stable, it is far from being static. Due to Germany's federal structure, there is not one predominant major city, as seen, for example, in France with Paris or in the UK with London. What makes the German market interesting is that Berlin, Hamburg, Munich, Frankfurt am Main, Dusseldorf and Cologne – the so-called Big Six – are all compelling investment destinations.

Interest rates have remained low and cities such as Munich, Hamburg and Frankfurt have strong local micro-economic climates that have helped ensure stable and attractive yields for investors looking for safe-haven investments. Both direct and indirect real estate investments in Germany are more popular than ever before. German as well as foreign companies pursue cross-border consolidation efforts to leverage synergies. Although the investment markets have been in global competition for several years, local market and industry expertise is essential in order to be able to make optimal investment decisions in the race for targets. To this end, the following study includes an introduction to Germany's tax conditions and regulatory and legal frameworks in addition to providing an overview of market sectors and their respective developments. In our daily dialogue with our customers, we constantly keep our fingers on the pulse of the markets, continuously redefine our comprehensive consulting approach and expand our product portfolio by applying innovative tools.

This study aims to contribute to a better understanding of the German real estate markets, their drivers and the regulatory framework. Please do not hesitate to contact us to talk about your experiences.

We look forward to constructive discussions and wish you an inspiring read.

Berlin, November 2019

Susanne Eickermann-Riepe
PwC German Real Estate Leader PwC

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German Real Estate Valuation Leader

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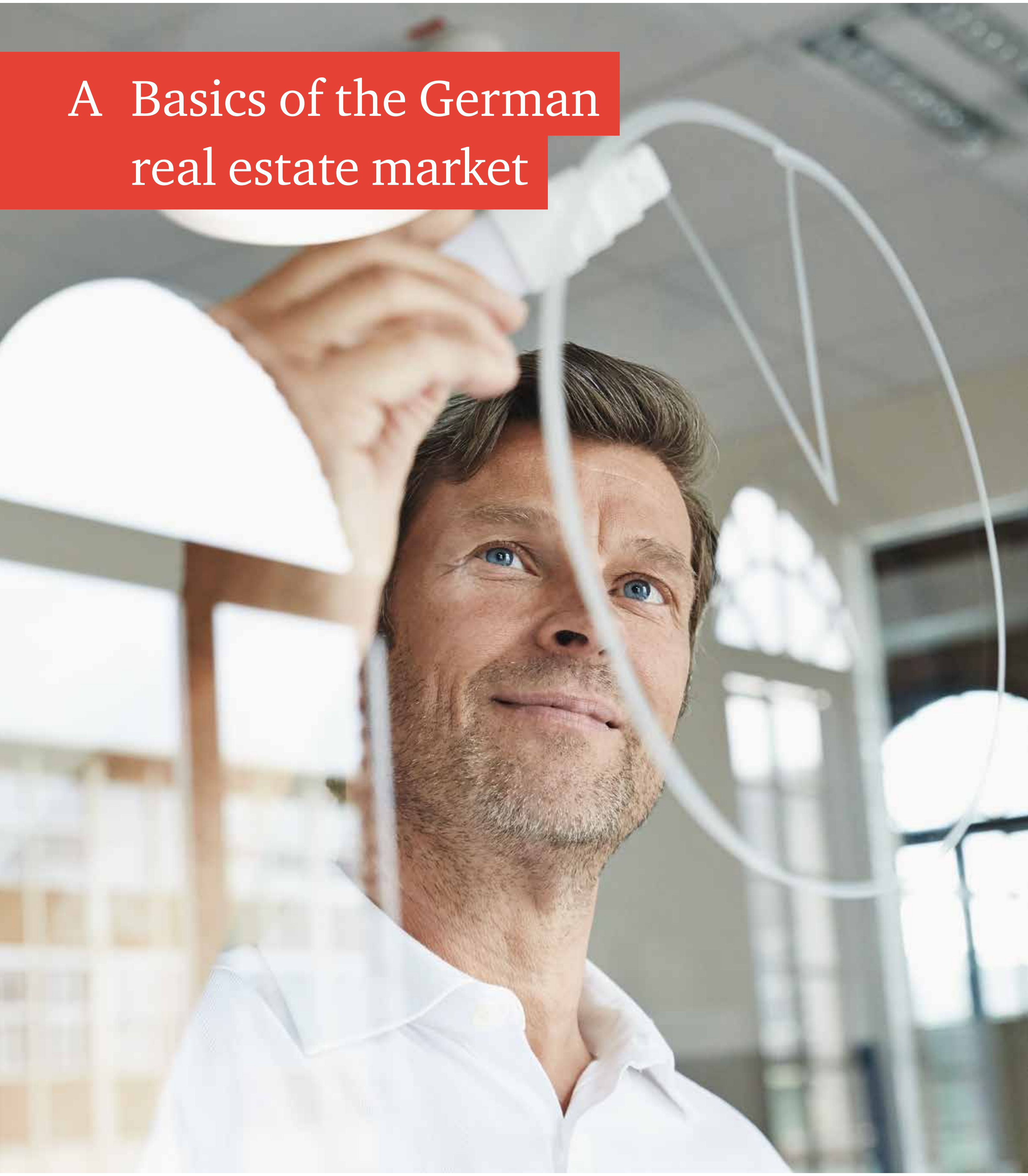
A Basics of the German real estate market



1 Structures of the real estate market

1.1 Location structure

More than one metropolis

In Germany, the country's federal structure means that there is no one dominant metropolis like London in the UK or Paris in France. Rather, the important real estate markets are spread over several metropolitan regions. The most important ones are Berlin, Hamburg, Munich, Frankfurt am Main, Cologne and Düsseldorf. Together they are referred to as the "Big Six", or, with the addition of Stuttgart, the "Big Seven".

In addition, cities like Hanover, Dresden, Leipzig, Nuremberg, Essen and Dortmund represent promising second-tier real estate markets.

Fig. 1 Major real estate locations in Germany

Reurbanisation leads to shrinking villages and booming cities

The economic situations of the individual regions in Germany differ somewhat, and the gap between growing and shrinking areas is increasing. In economically weak areas with decreasing populations, the real estate sector is confronted with vacancies as well as price and rent declines. At the same time, there are growth regions in which rents and property prices are rising. Here significant new construction investments will be necessary as a result of economic prosperity and population growth.

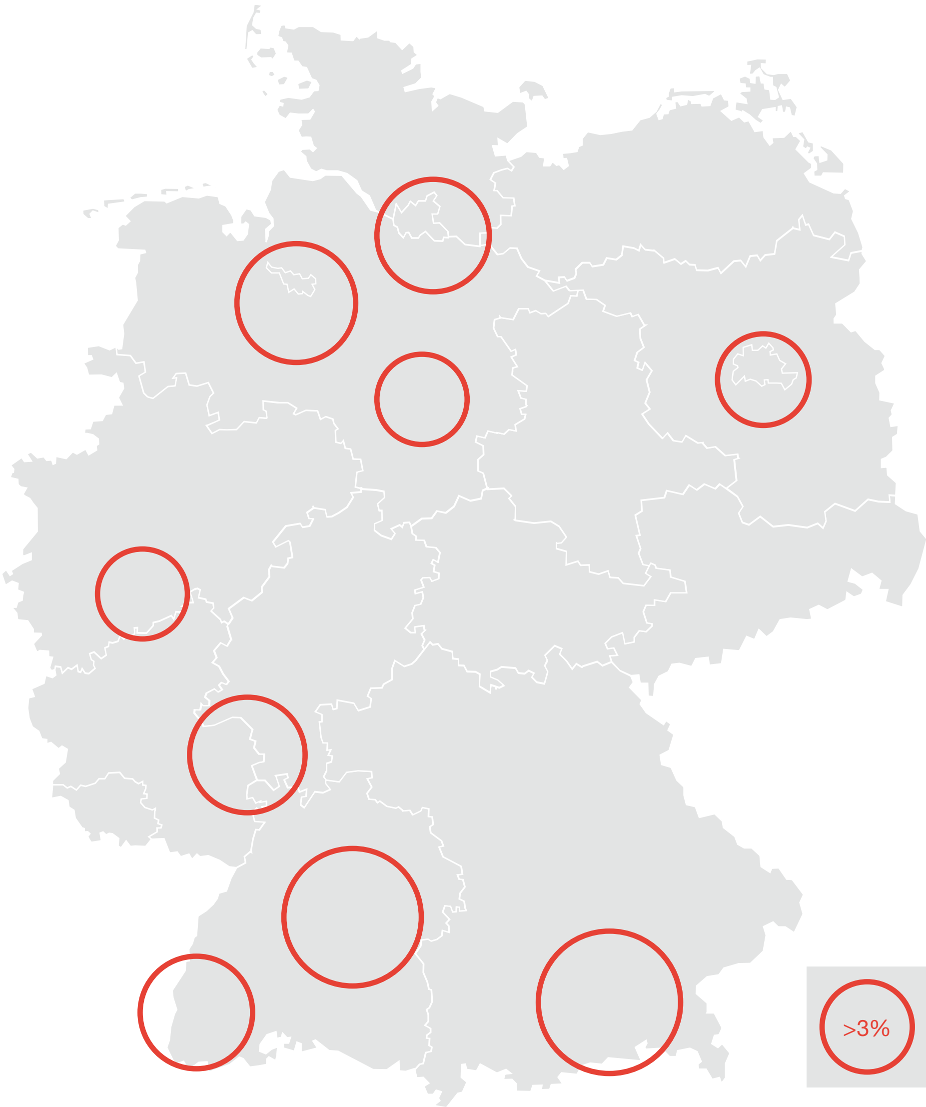
Generally, the trend towards reurbanisation continues. While cities experienced growth stagnation in the 1980s and 1990s, as people moved to suburbs and smaller towns, this situation has changed fundamentally over the last decade. A large proportion of jobs in Germany are now concentrated in cities, and the number of residents in large and medium-sized cities has steadily increased.

This was predicted by the results of a representative study conducted across Germany by Immowelt AG in 2012, which reported that 67% of residents of small towns and villages wished to move to larger cities. Reasons cited were greater cultural offerings, better shopping options and attractive job prospects, as well as the desire for a more modern life and a shorter commute. As a result, small towns and villages in rural areas such as Brandenburg or Thuringia in eastern Germany and certain areas in North Rhine Westphalia in the west are shrinking. In contrast, 84% of the urban population were generally satisfied with their choice of place of residence and only 8% were considering moving to a small town or village. As a result, major cities like Munich or Frankfurt am Main have already experienced a population increase of up to 20% in the first 15 years since the millennium, reports the *Handelsblatt*.[1]

[1] Cf. Handelsblatt, January 13th 2017.

Fig. 2 Regional shift and population concentration in metropolitan regions

Forecasted change in population from 2005 to 2025.



Germany's diversified market structure and the current reurbanisation – and ensuing rapid development – of large German cities offer tremendous opportunities for institutional real estate investors.

1.2 Institutional real estate investment structure

Stable development of institutional real estate developers

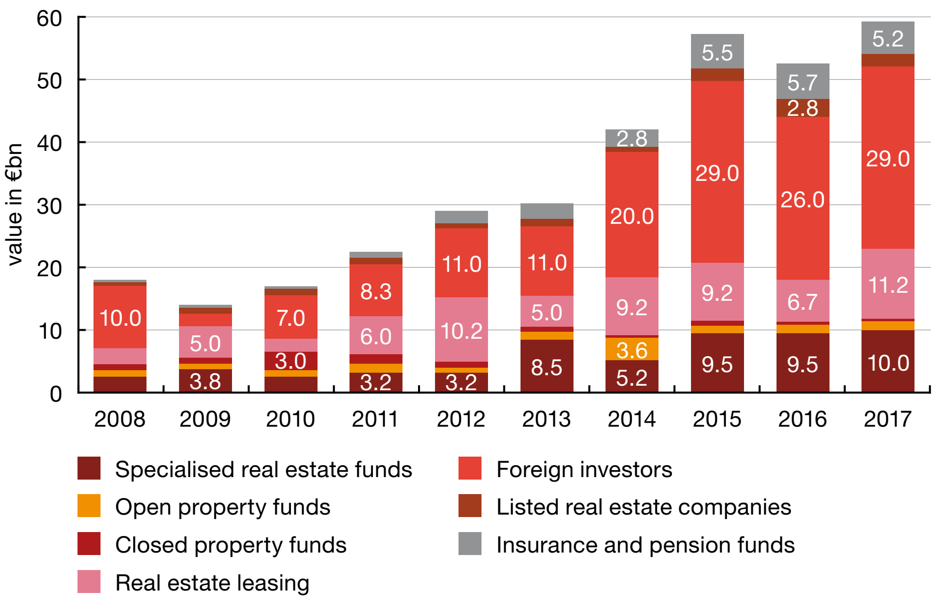
The German investment real estate market has witnessed extraordinary growth rates over the last decade and remained a hotspot in the international real estate transaction market in 2018 and 2019.

At the end of 2018, investment volume reached a new high of €61.5 billion. This represents an increase of about 6% compared with the same period in 2017, which saw a total turnover of almost €57.8 billion – the second-best result to date.[2]

As outlined in Figure 3, this development attracted foreign investors in particular. Apart from in 2016, their share in the overall commercial real estate investment market has constantly risen since the financial crisis in 2009. Despite high international demand, domestic players still dominate the market with around 50% of the transaction volume.

Specialised funds, in particular, as well as insurance companies and pension funds, have increasingly manifested themselves as buyers in the past few years.[3]

Fig. 3 Individual and portfolio investments in commercial real estate by institutional investors

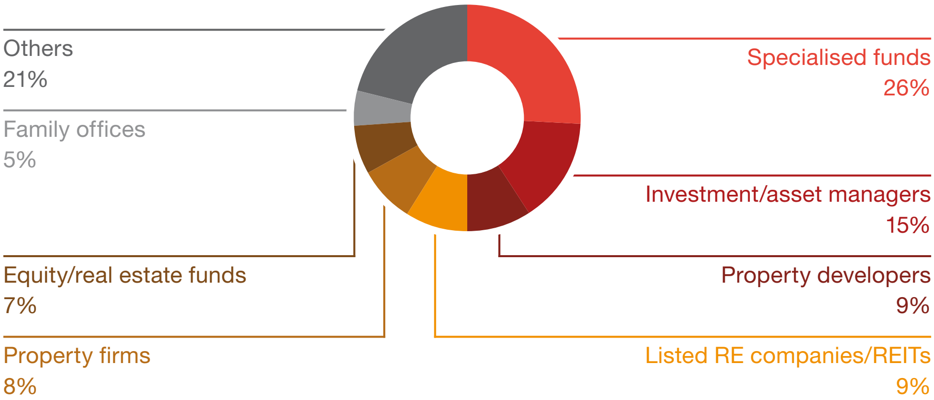


Source: BulwienGesa AG/Drees&Sommer, Die 5%-Studie – wo Investieren sich noch lohnt, 2018.

Another notable development is the resulting structure of institutional real estate investments. As outlined in the pie chart below, specialised funds are still the largest group of investors, contributing 26%, followed by listed real estate companies (15%), investment and asset managers (9%), and equity/real estate funds (8%).

[2] Cf. BNP Paribas, Investmentmarkt Deutschland, Real Estate Report H1 2019, 2019.
[3] Cf. BulwienGesa AG/Drees & Sommer, Die 5%-Studie – wo investieren sich noch lohnt, 2018.

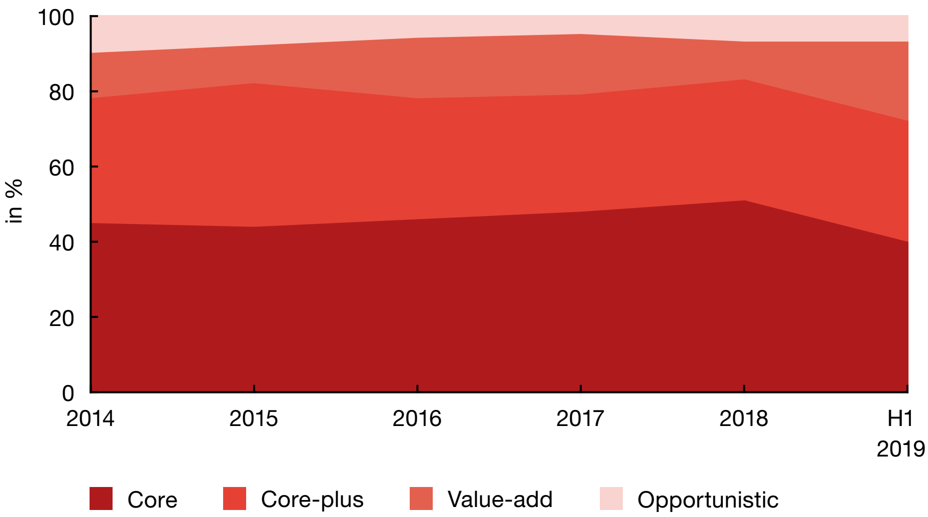
Fig. 4 Institutional real estate investment structure



Source: BNP Paribas, Investmentmarkt Deutschland, Real Estate Property Report H1 2019, 2019.

When assessing the commercial investments in terms of risk profile, there is a clear recent trend away from core investments and towards more risky ones. Investors are willing to take higher risks despite a lack of sufficient core assets or because the prices of core assets are too high to meet internal hurdle rates. When bringing this into perspective with the development of commercial real estate investment volume outlined in Figure 3 on the previous page, it can be reasonably concluded that investment value in both 2018 and 2019 would have been even higher if if a larger number of suitable core investments had been available, especially for institutional investors.

Fig. 5 Transaction volume according to the risk profile of the investment



Source: Jones Lang LaSalle, Investmentmarktüberblick Deutschland, 2. Quartal 2019.

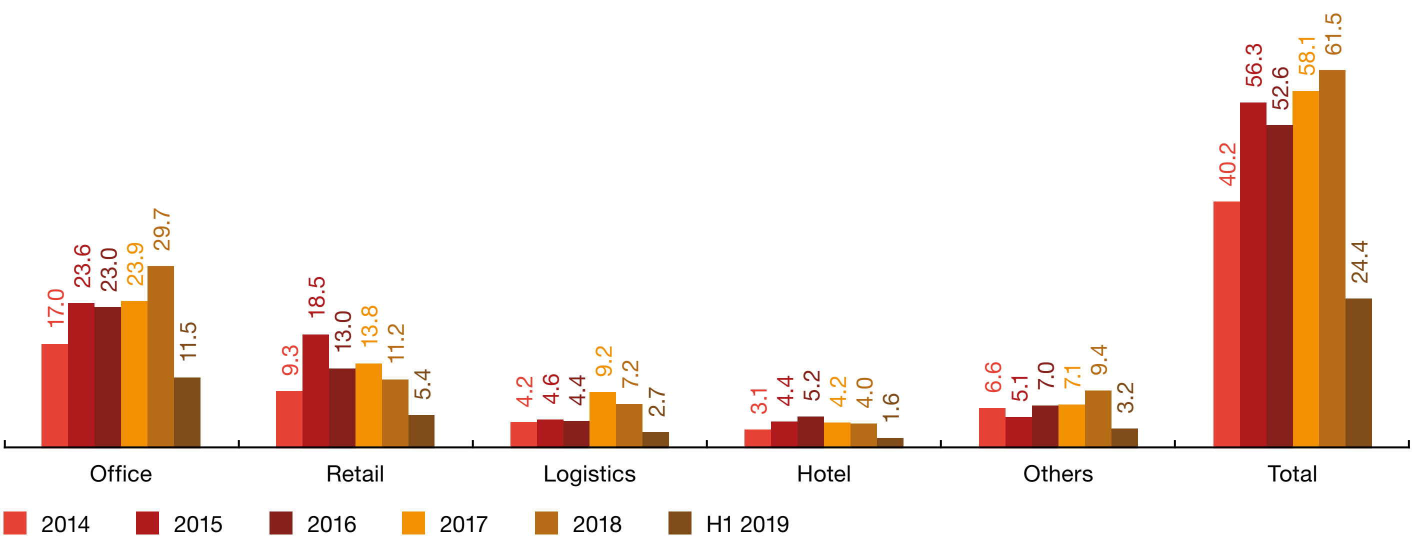
1.3 Investment turnover

The German investment markets have developed positively overall in 2018. The investment turnover of €61.2 billion in 2018 exceeded the previous year's figure by 23%.

Investment turnover had already reached €24.4 billion in the first half of 2019. Overall, the sales volume is at a very high level. As a result, the German investment market is also highly attractive on an international level. The transaction volume generated at the country's six most important locations – Berlin, Düsseldorf, Frankfurt am Main, Hamburg, Cologne and Munich – totalled some €11.7 billion, or almost 50% of the total investment volume in Germany in the first half of 2019.[4] With regard to commercial use, office real estate made up the most significant part of turnover at €11.5 billion, accounting for 47% of total turnover. This was followed by investments in retail real estate valued at €5.4 billion, comprising 22% of total turnover. In these times of e-commerce, people are able to purchase goods and services easily from home, and the demand for faster delivery in big cities has led to an increasing demand for logistics real estate over the last five years. At around €1.63 billion, logistics real estate was responsible for some 6.7% of the transaction volume. The smallest part of the transaction volume came from hotel real estate, with a turnover of €3.92 billion or 16.1%. Experts predict a further positive trend and expect a total investment volume of between €55 billion and €60 billion by the end of 2019.[5]

Fig. 6 Investment in commercial real estate by type of use

in €bn

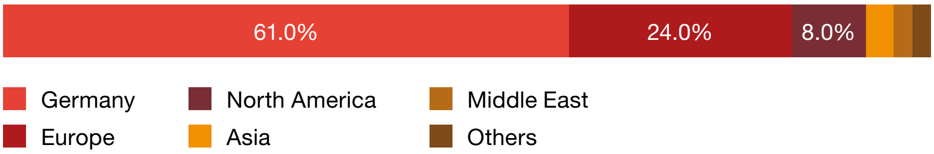


Source: Based on BNP Paribas, Investmentmarkt Deutschland, Real Estate Property Report 2014–Q2 2019, 2019.

[4] Cf. BNP Paribas Real Estate, Investmentmarkt Deutschland, Property Report Q2 2019, 2019.
[5] Cf. BNP Paribas Real Estate, Investmentmarkt Deutschland, Property Report Q2 2019, 2019.

In the first half of 2019 more than half of investors in commercial real estate were German. A further 24.5% of capital invested is from other parts of Europe. North Americans invested 8.5% of total capital. Germany has also become a very popular and attractive investment country for Asian investors, who contributed 3.1% of investments. Minor contributions were made by investors in the Middle East and other parts of the world.

Fig. 7 Origins of capital by region in H1 2019



Source: Based on BNP Paribas, Investmentmarkt Deutschland, Real Estate Property Report Q2 2019, 2019.

B Market conditions

1 The residential property market

The German residential property market is not an "owner market"

The residential property market in Germany was comparatively stable for several decades and experienced only moderate growth rates in both sale prices and rents. This has changed dramatically in recent years. With the low interest rates maintained by the European Central Bank and thus massive amount of liquidity available in the market, as well as international investors acknowledging Germany as a safe investment haven, the Big Six real estate hotspots in particular experienced increasing demand for residential properties. This has led to significant increases in prices and rents.

From an international point of view, Germany is still not a homeowner market but rather a long-term rental market. Young people prefer to rent a flat instead of purchasing their own home at an early stage. On the one hand, this is due to the increasing flexibility of the labour market and changing family structures; on the other hand, there are also historical reasons for this choice. The German market for residential properties is characterised by state housing associations, which, in the second half of the last century, ensured that the population had a supply of affordable housing. However, state influence on the housing market has been pushed back over the last two decades as a result of the privatisation of state housing associations. The buyers were predominantly financial investors operating on the global level.

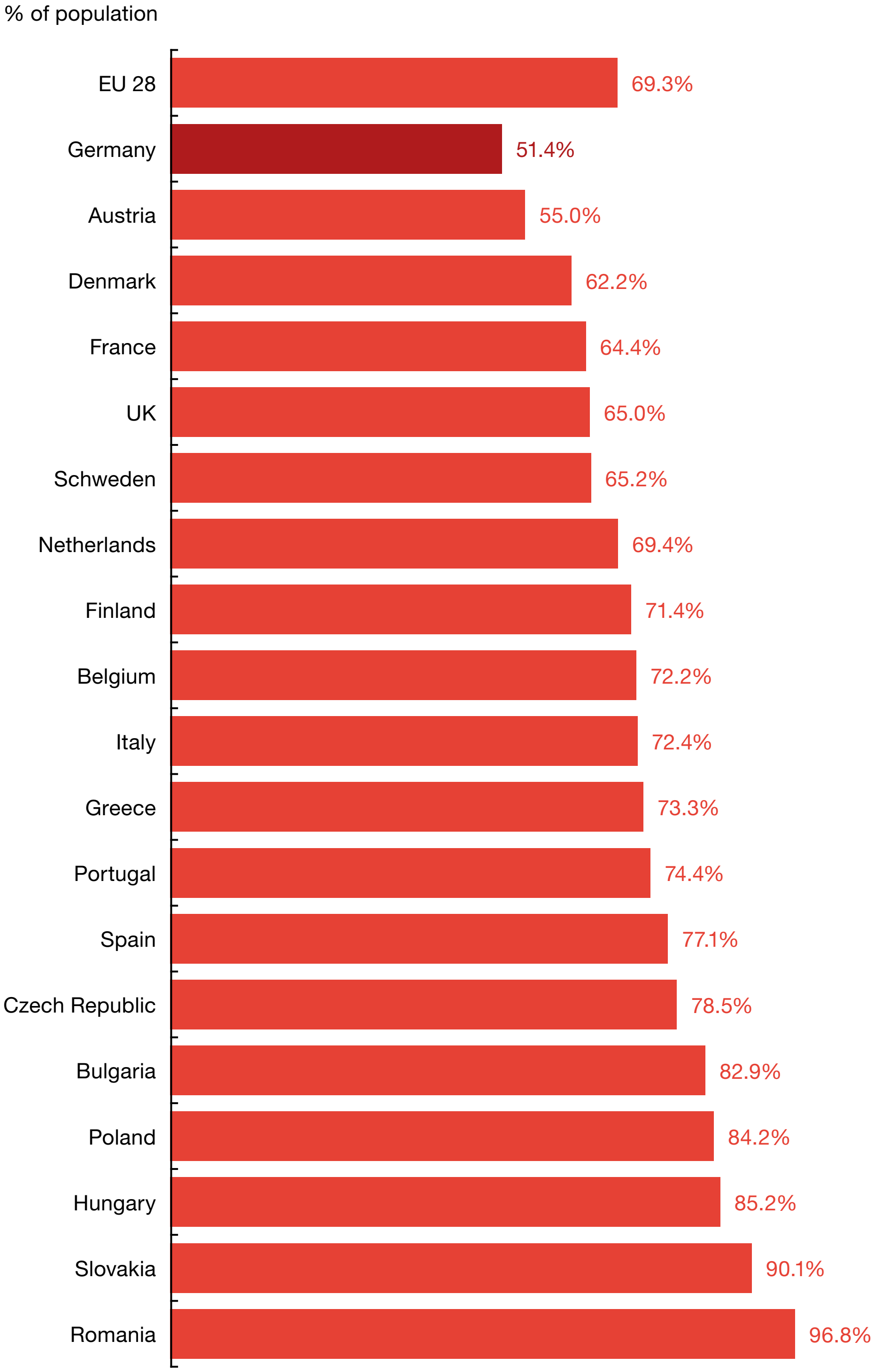
Another major factor is German tenancy law, which in international comparison is quite tenant-friendly. Moreover, apart from certain booming metropolitan areas, the general rent level is comparatively low, which further strengthens the case for renting.

On the basis of the latest figures published by Eurostat in 2019, an EU-wide comparison shows that the housing ownership ratio is highest in Eastern European countries. The high share of residential property in Central and Eastern European countries is mainly due to the wave of privatisation following the fall of the Iron Curtain. Germany occupies second-to-last place with a home ownership ratio of about 51% and thus well below the EU average of 69%.[6]

With the current low interest rates, many tenants find that it would be equally affordable to pay off a loan and decide to buy their own home. This puts further pressure on the market, considering its larger effect given the low ownership ratio in Germany.

[6] Cf. Eurostat, Distribution of population by tenure status, 2016; LBS Research, 2019.

Fig. 8 Distribution of population by tenure status, 2019



Sources: Eurostat, Distribution of population by tenure status 2018, 2019; LBS Research.

1.1 Supply

The number of building permits issued and flats completed in Germany has slightly decreased since 2015, reversing the strong upward trend seen in the first half of the decade since 2010. According to the Federal Statistical Office (Destatis), construction of a total of 196,400 homes was approved in Germany between January and July 2019. This was 3.4% fewer building permits than in the same period of the previous year. These permits applied to new buildings as well as to construction works on existing buildings.[7]

Differentiated offers for residential properties

Overall, expansion of supply in the medium term may have a damping effect on further rent rises and price growth rates, especially in rural areas where too many new single-family houses were built.[8] However, despite a general increase in construction activities, there is a marked undersupply – with increasing demand in urban areas.[9] Hence, both prices and rents are likely to rise even further in the coming years, especially in large cities.

1.2 Demand

The two main factors that influence demand for housing are population development and the number of households in existence.

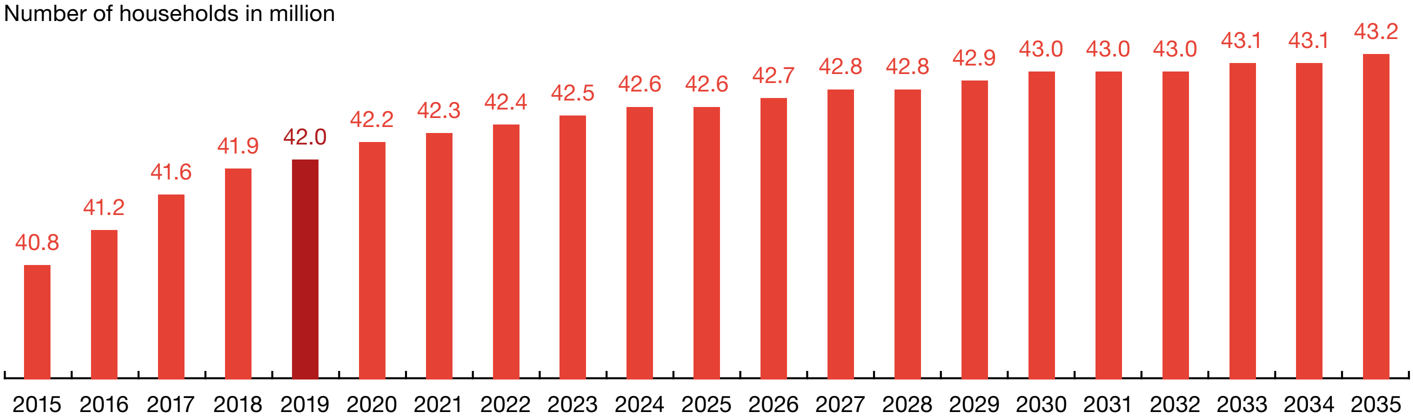
While the number of households is predicted to increase, especially to 2035, the population is expected to decline from today's 83 million to about 68 million in 2060. The latest migration development will lead to a net plus of about one million people in Germany. Overall, the population of Germany is shrinking and growing older.[10] Nevertheless, large regional differences in development are expected.

For the time being there is a rising number of households and thus stable demand

In contrast to the shrinking population, the number of households is increasing.

Fig. 9 Expected future development of household numbers to 2035

Number of households in million

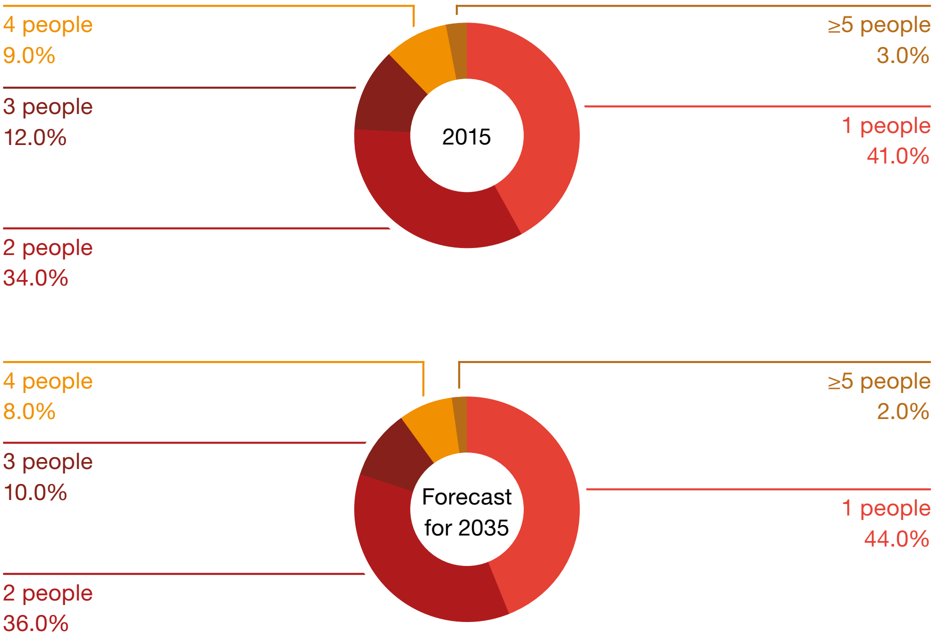


Source: Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017.

7 Cf. Statistisches Bundesamt, Bauen und Wohnen, Baugenehmigungen und Baufertigstellungen im Hochbau, September 2019, www.destatis.de.
8 Cf. Institut der deutschen Wirtschaft Köln, Wohnungsmangel in den Städten, Leerstand auf dem Land, June 19th 2017.
9 Cf. IVD, Wohn-Preisspiegel 2018.
10 Cf. Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausrechnung, 2017.

The trend towards a reduction in the number of people per household will continue. By 2035, for example, the share of single-person households is expected to further rise to 44% from 42% in 2015.[11]

Fig. 10 Development of size of households



Source: Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017.

This development will further drive positive developments in the housing market in economically attractive growth regions. At the same time, increased vacancy will be evident, especially in the regions of the former East and structurally weak western regions such as the Ruhr area.

1.3 Rental price development

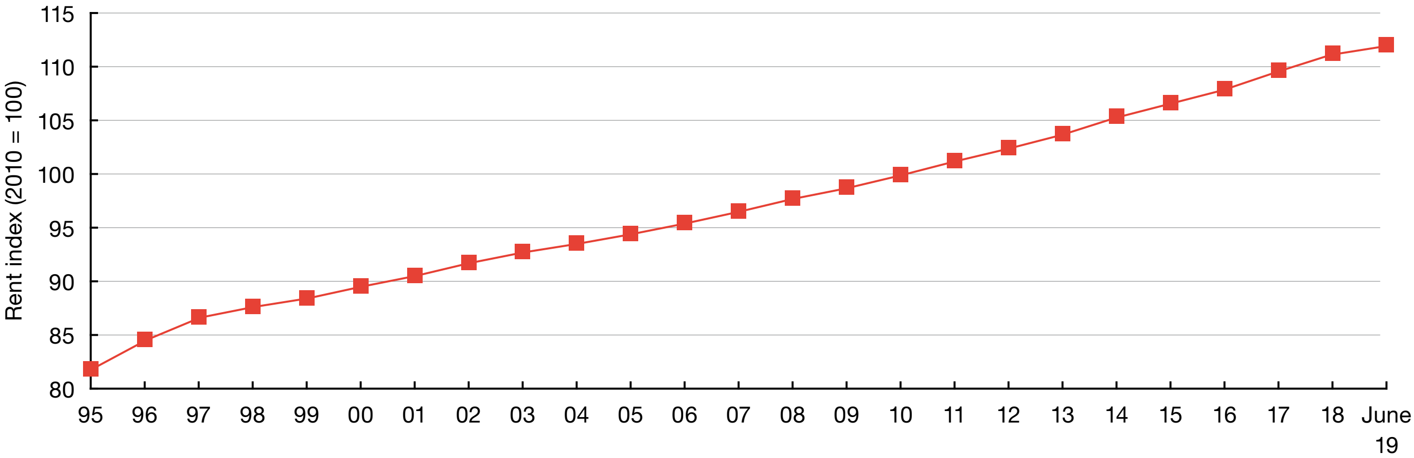
Residential rents in Munich are the highest

Rents have been rising in Germany since the mid-1990s, with statistics on residential rents showing an overall steady increase in rental prices.

The analysis of rental price development is based on the *Wohn-Preisspiegel* (Residential Rent Index) published by the German Real Estate Association (Immobilienverband Deutschland, or IVD), which records the development of the housing market in some 390 cities in Germany. In 2018, rents in Germany rose by an average of 1.6%. Taking into account the inflation rate of 0.5% for the comparative period, this shows a moderate price increase.

[11] Cf. Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017, www.destatis.de.

Fig. 11 Residential rent index, 1995–June 2019



Source: Statista, Mietindex 1995–2019, 2019.

While this increase as seen in Figure 11 seems quite moderate, there are also differences in rental prices in the individual segments and cities.

Tab. 1 Residential rents for selected German cities in 2018

Location	Good (in €/m²)	Average (in €/m²)
Berlin	14.0	10.4
Düsseldorf	12.5	11.3
Frankfurt am Main	13.0	12.5
Hamburg	15.1	13.0
Cologne	15.0	12.8
Munich	18.7	16.9
Stuttgart	15.0	13.7

Source: IVD, Wohn-Preisspiegel 2018/2019 2019.

There is obviously a huge difference between rents in rural and urban areas, and rental prices also vary greatly among metropolitan areas in Germany. While cities in northern and eastern Germany have below-average rental prices, the southern and western regions have rents that are above average. Residential rents are historically highest in Munich, with ongoing strong demand due to its strong economic and industrial background and high employment rates.

In Berlin, where rents have always been comparatively low due to its status as a (once) divided city with limited economic capabilities, the situation has also substantially changed in recent years. Since Berlin began developing into one of Europe's most sought-after hotspots for young international creatives, demand for housing has increased sharply. According to a study conducted by PwC and the Urban Land Institute, Berlin has become the most popular destination for people under the age of 40 in Europe. This has led to an average annual population increase of about 50,000 people in recent years,[12,13] a change which is reflected in residential rents.

[12] Cf. PwC, Emerging Trends in Real Estate – Reshaping the future® – Europe 2016, 2016.
[13] Cf. Senatsverwaltung für Stadtentwicklung und Wohnen Berlin, Evaluation der Bevölkerungsprognose Berlin 2015–2030, 2017, www.stadtentwicklung.berlin.de/planen/bevoelkerungsprognose.

1.4 Purchase price development

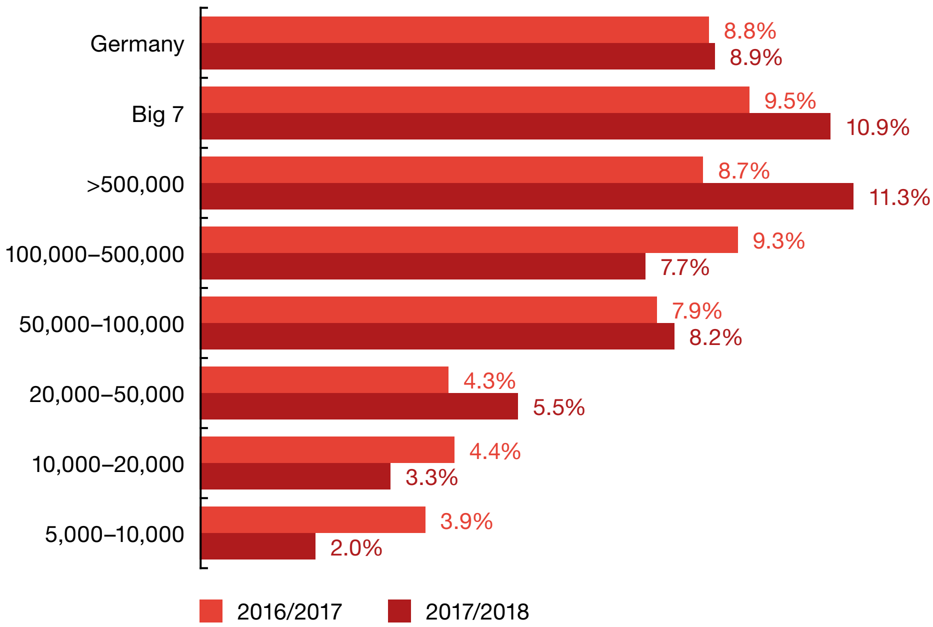
Moderate increases in value of residential properties

Since the mid-1990s, the price increase in German real estate has been relatively moderate until recent years. Compared with rental prices in other European countries, which, by 2010, had seen increases of 16% (Netherlands), 65% (France) and 96% (Luxembourg), prices in Germany have largely remained stable.

This sideways trend for German housing prices has changed dramatically in recent years, however. While in rural areas and cities with fewer than 30,000 inhabitants prices have remained stable, cities with more than 100,000 inhabitants and metropolitan regions have experienced tremendous development. This trend was even more pronounced in 2018. Prices for residential property increased more sharply than in previous years in all segments in 2018. In German cities in particular, significantly higher price increases for condominiums and single-family houses than in previous years can be observed.

There are significant differences in the price levels depending on the size of the city, as outlined in Figure 12.

Fig. 12 Residential price increase by city size

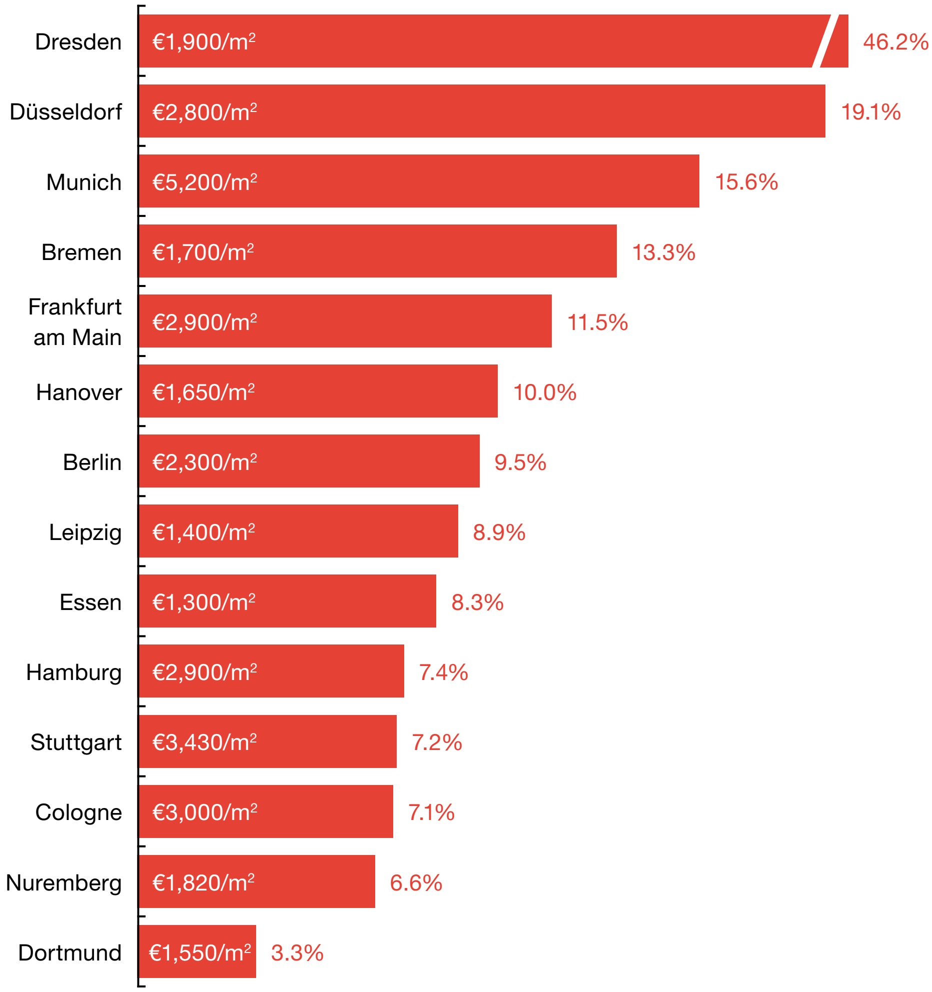


Sources: IVD, Wohn-Preisspiegel 2017/2018, 2018, and 2018/2019, 2019.

In the case of residential housing prices, there are also strong regional differences within Germany. In the cities of Munich, Heidelberg, Ingolstadt, Freiburg, Stuttgart and Frankfurt am Main, as well as in their surrounding regions, house prices are ten times higher than in the cheapest municipalities. While average prices for flats increased by more than 11% to about €2,100 per square metre in cities with over 500,000 people, flats in small cities of between 5,000 and 10,000 cost just one-fifth of this, with a price increase of only about 2%.[14]

[14] Cf. IVD, Wohn-Preisspiegel 2016/2017, 2017, and 2017/2018, 2018.

Fig. 13 Flat prices per square metre in large German cities with price increase in 2018



Source: IVD, Wohn-Preisspiegel 2018/2019, 2019.

The price increase in 2018 was highest in Dresden at 46.2%, reaching an average price of €1,900 per square metre. However, when looking at the price per square metre outlined in the above chart for each city it should be noted that these represent the average price ranges for the entire metropolitan area. Hence, prices may vary significantly within these cities. For example, while the average price in Berlin is given as just €2,300 per square metre, prices in central parts of Berlin may be far above this average.

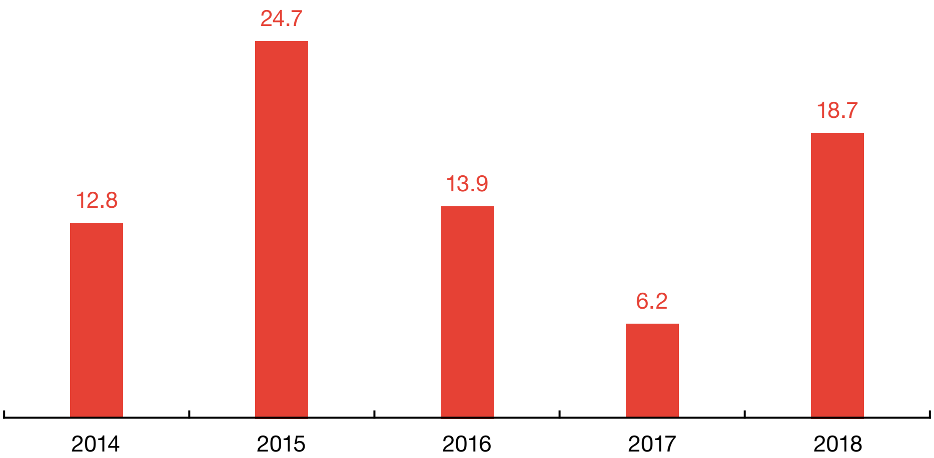
1.5 Investment turnover

The German market for residential property has been characterised by volatile development in recent years. In 2015, the investment market for residential property portfolios in Germany experienced its highest turnover since 2002 at €24.7 billion. In the following year turnover decreased by nearly 44%. The transaction volume of residential portfolios in the end of 2018 totalled around €18.7 billion.[15]

[15] Source: Based on Jones Lang LaSalle, Investmentmarktüberblick Deutschland 2. Halbjahr 2018. 2019.

Fig. 14 Development of transaction volume for residential portfolios in Germany

in €bn



Source: Based on Jones Lang LaSalle, Investmentmarktüberblick Deutschland 2. Halbjahr 2018. 2019.

2 Market for office properties

Munich has the largest number of office properties, while the highest rents are paid in Frankfurt am Main

The market for office properties developed favourably in 2016. Turnover for office space in most German locations clearly exceeded the previous year's level. Vacancy rates were also further reduced due to the high level of demand. This trend continued in 2017. In 2016, the prospects for German office markets were influenced by various trends. First, overall economic growth since the global financial crises, and especially over the last five years since 2012, has led to in an increasing demand for office space. Moreover, an optimistic outlook and healthy sales among companies have led to positive developments in the office property market. The decline in unemployment and the expected increase in disposable income also made domestic demand more important for the German economy.

Tab. 2 Market for office properties 2019

Location	Take-up (m^2)	Prime rents (€/m^2)	Prime yield (%)	Vacancy rate (%)
Berlin	841,700	35.50	2.7	1.8
Düsseldorf	415,000	28.00	3.1	6.3
Frankfurt am Main	633,300	40.50	2.9	6.1
Hamburg	580,000	29.00	2.9	3.4
Cologne	305,200	25.00	3.1	2.6
Munich	975,000	40.00	2.8	2.4
Stuttgart	215,300	24.00	3.1	2.1

Source: Based on Jones Lang LaSalle, Office Market Overview Big 7 | 2nd quarter 2019, 2019.

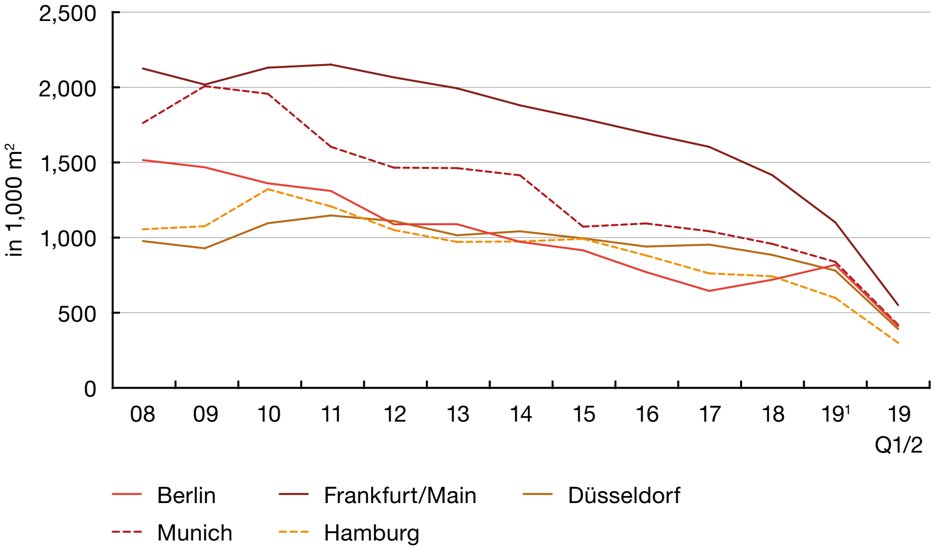
With more than 975,000 square metres of newly occupied office space, Munich is the fastest-developing office location in Germany. The highest rental level for prime locations was €40.50 per square metre in Frankfurt am Main.

2.1 Available office space

In terms of the amount of office space available, calculated as the sum of vacancy and available space under construction, all major German cities show a uniform trend. Since 2010, strong demand and limited new supply has led to a decrease in available office space. Munich has experienced the sharpest decrease in available office space compared to other German cities over the last seven years.

However, in Berlin the amount of available space is also at a record low, with less than 418,000 square metres of office space available in the first half of 2019. In Düsseldorf, the amount of available office space has stagnated and the vacancy rate has decreased. In the middle of 2019, the amount of available office space in the remaining three cities fell by 6.5% compared to 2018 as a result of the reduced vacancy rate. Frankfurt am Main had the largest amount of office space available at 1.12 million square metres.[16]

Fig. 15 Available office space, 2008–2019



¹ prediction (nach 2019Q1Q2)

Source: Based on BNP Paribas, At a Glance – Main Office Markets in Europe – Q2 2019, 2019.

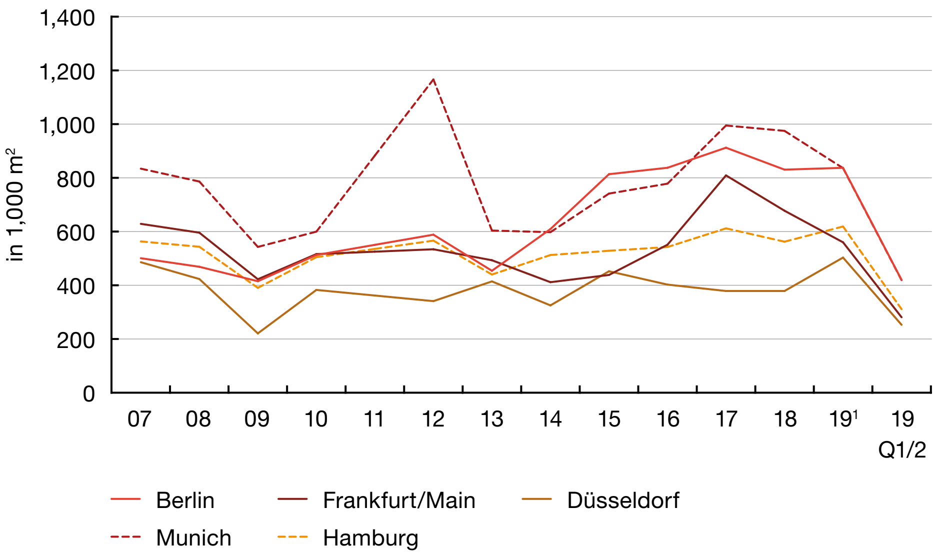
[16] Cf. BNP Paribas Real Estate, Büromarkt Deutschland Property Report 2019; Büromarkt Berlin, München, Frankfurt, Hamburg, Düsseldorf 2019, 2019.

2.2 Office space turnover

Growing demand for office space

A growing economy and low interest rates have led to a greater demand for office space. These factors have had a visible impact on office space turnover in recent years. Following the last peak in office space turnover in 2012, the numbers steadily increased at the five most important locations for office space until 2017 and slightly decreased between 2017 and H1 2019. In the middle of 2019, nearly 26 million square metres of office space were rented or leased. According to the situation in the first half of 2019, the turnover of office space in 2019 has increased compared with 2018, except for a small decline in Munich and Frankfurt. Berlin and Munich are predicted to have the largest sales volume, with a rental office area of about 835,000 square metres each in 2019. Compared with the first half of 2018, the figure for Berlin increased by 0.69%. The biggest increase was seen in Düsseldorf, which was 33.2%.

Fig. 16 Office space turnover, 2007–2019



[1] prediction (nach 2019Q1Q2)

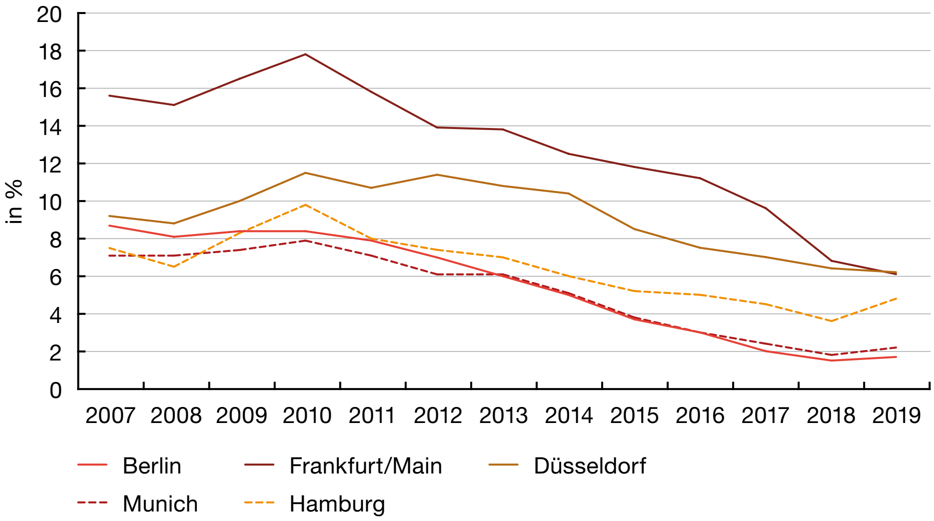
Source: Based on Jones Lang LaSalle, Office Market Overview Big 7 | 2nd quarter 2019, 2019.

2.3 Vacancy rate

Berlin recorded the lowest vacancy rate at 1.7%

As a result of the increasing demand for office space, especially in the large metropolitan areas, vacancy rates declined further by 2018 and are now at their lowest in more than a decade. At the five top locations shown in the figure below, the vacancy level has decreased significantly during the years since 2010. During this period, the highest average annual reduction in vacancy rate was recorded in Berlin, at 17%. In 2019 the highest vacancy rate, at 6.2%, was seen in Düsseldorf and the lowest, at 1.7%, in Berlin. However, with the ongoing Brexit developments, Frankfurt am Main, as one of the main financial hubs in Europe, is expected to receive further attention from financial institutions looking for an alternative to London. Hence, further declining vacancy rates may be foreseeable and will help Frankfurt am Main to compete with the other members of the Big Six.

Fig. 17 Office vacancy rates, 2007–2019



Source: Based on BNP Paribas, At a Glance – Main Office Markets in Europe – Q2 2019, 2019.

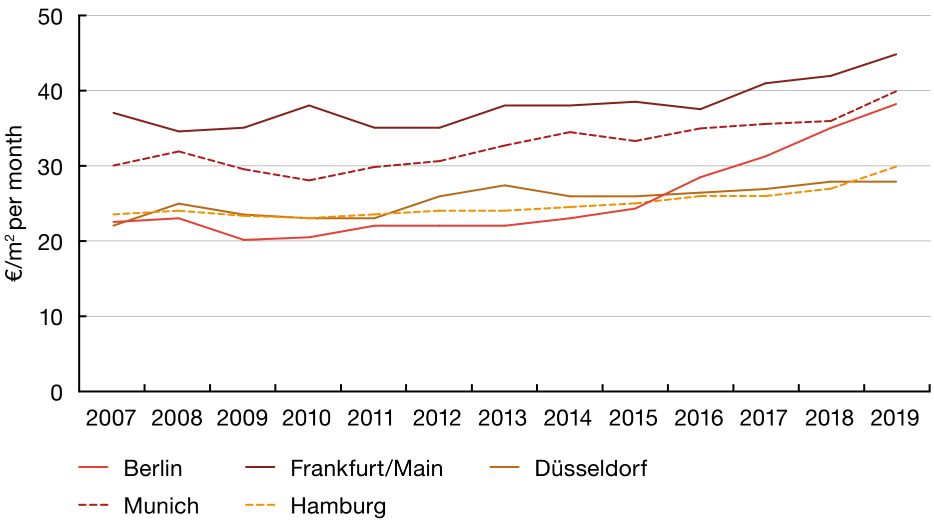
2.4 Top rents

Moderate rental development

The strong growth of rental prices, especially since 2015, is indicative of the shortage of office space supply, and the booming office rental market continued to thrive in 2019. Prime rents increased in Berlin, Munich and Frankfurt am Main while remaining stable in Düsseldorf and increasing slightly in Hamburg. Sales in prime office buildings in Berlin, Frankfurt and Munich increased significantly, with increases of 9.1%, 6.9% and 11%, respectively.

Among these five major cities, Frankfurt am Main leads the ranking again, with a price of €44.50 per square metre for high-quality office properties in a prime location, followed by Munich (€40.00 per square metre) and Berlin (€38.50 per square metre). At €28.00, the lowest square metre prices were recorded in Düsseldorf, respectively.

Fig. 18 Prime office rents, 2007–2019

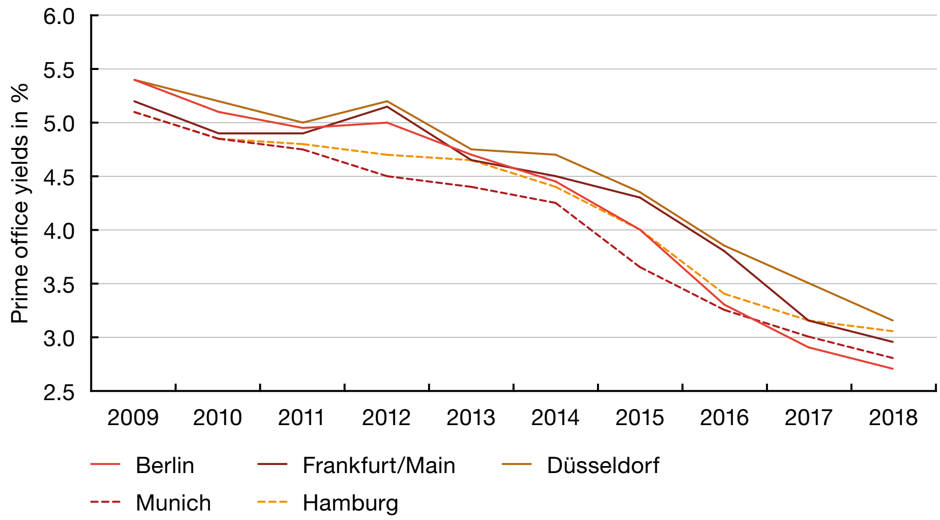


Source: Based on BNP Paribas, At a Glance – Main Office Markets in Europe – Q2 2019, 2019.

At 3.1%, Berlin currently has the lowest prime yield for office space

The resulting rising price level and comparably stable development in rents led to a further reduction in office space yields in 2018, a trend which has continued since 2009. After 2017, the prime yields in the office locations shown below fell further by 2018, due to sustained high demand from investors and the simultaneous lack of exclusive office properties. The highest prime yield of 3.15% was recorded in Düsseldorf and Cologne. Relatively speaking, Berlin is currently the most "expensive" location with a yield of 2.7%, closely followed by a yield of 2.8% in Munich. Frankfurt am Main and Hamburg also showed a decline in prime yields to 2.95% and 3.05%, respectively. Should the high level of competition in top office properties persist in individual cities, a further slight decline in the top rate is to be expected.

Fig. 19 Prime office yields, 2009–2018



Source: Based on BNP Paribas, Investmentmarkt Deutschland, Real Estate Property Report 2017–2018, 2018.

3 Market for retail properties

While the overall growing economy and decreasing unemployment have had a positive impact on consumption, the development was also attributed to a change in consumer behaviour. E-commerce has gained importance in the last seven years.[17] This general trend leads to pressure on the retail property sector especially in secondary locations.

[17] Cf. BNP Paribas, Investmentmarkt Deutschland, Retail Property Report 2018, 2018.

3.1 Available supply of retail space

Demand for top locations in the large German cities is still healthy. Nevertheless, different developments can be observed in individual submarkets. For smaller shops, there are still enough prospective investors who are usually willing to pay the high rents. However, longer marketing times may be recorded here, since the number of users and therefore competition among them is slightly lower than in previous years. In the case of medium-sized shops and larger units, where fashion concepts are often the focus of attention, the adaptation processes are more evident. Here, in principle, declining demand can be observed. Marketing processes in this segment are not only going to be longer than in previous years but are increasingly being concluded with concessions in terms of rental charges or performance-based contract arrangements. In addition, international brands are still among the most important buyers, but they need considerably longer to make decisions. Given these developments, future demand may shift more strongly to areas that are adjacent to the top locations in order to benefit from lower rents. In some cities, the first steps in this direction can already been seen.[18]

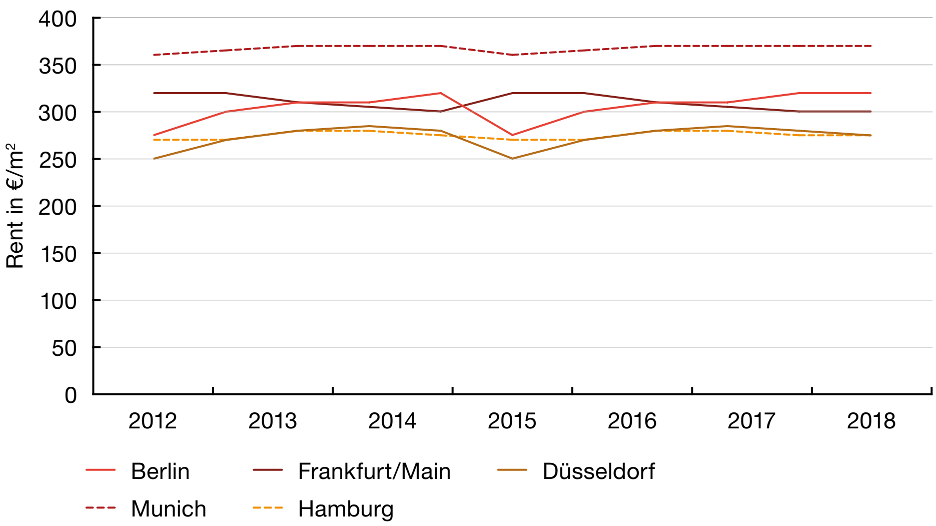
3.2 Rent development

The highest retail rents are paid in Munich

Top rents for prime retail spaces have been comparatively stable over the last year. In 2018 the highest prime rent was reported in Munich at €370 per square metre, having remained at the same level since 2014. Berlin came in second place with €320 per square metre (3.2% increase compared to 2017), which was €20 per square metre ahead of Frankfurt am Main. Besides Frankfurt am Main, other top locations like Hamburg (€275 per square metre) and Düsseldorf (€275 per square metre) showed slightly lower prime rents compared to 2016.[19]

In 2018, in about 8% of a 23-city sample, top rents fell compared to the previous year. In most cities observed, the maximum rents have remained constant.

Fig. 20 Development of prime retail rents at the top five locations



Source: Based on BNP Paribas, Retailmarkt Deutschland, Real Estate Property Report 2015–2019, 2019.

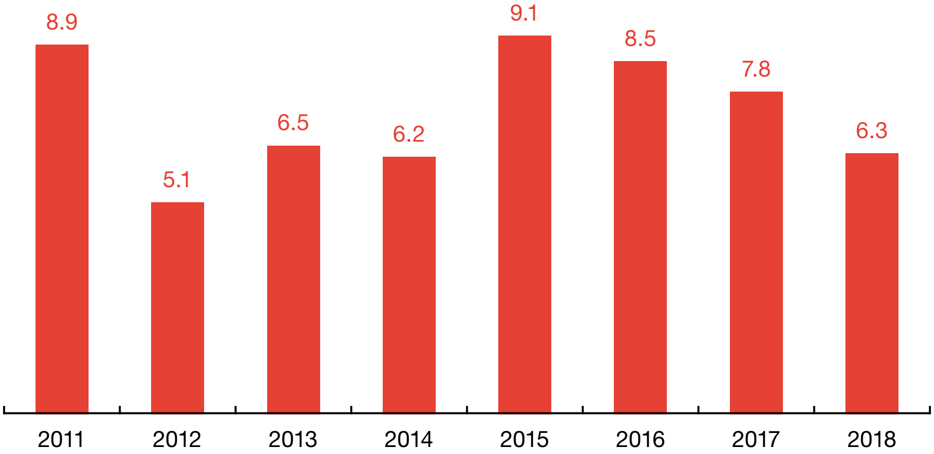
[18] Cf ibid.
[19] Cf. BNP Paribas, Retailmarkt Deutschland , Real Estate Property Report 2019, 2019.

3.3 Investment turnover

The success of 2011 was exceeded by retail investments in 2015, by which transaction volume for retail real estate had grown by more than 70% since 2012 to a total of €9.1 billion. Single-investment volume increased by about 40%. In 2018, total investment volume declined by 19% to €6.3 billion. Individual investments accounted for €6.3 billion of the total investment volume in retail real estate, 19.2% less than in 2017. The turnover of portfolio transactions dropped by more than 16.7% compared to the previous year to €4.9 billion.

Fig. 21 Retail investments in Germany 2011–2018

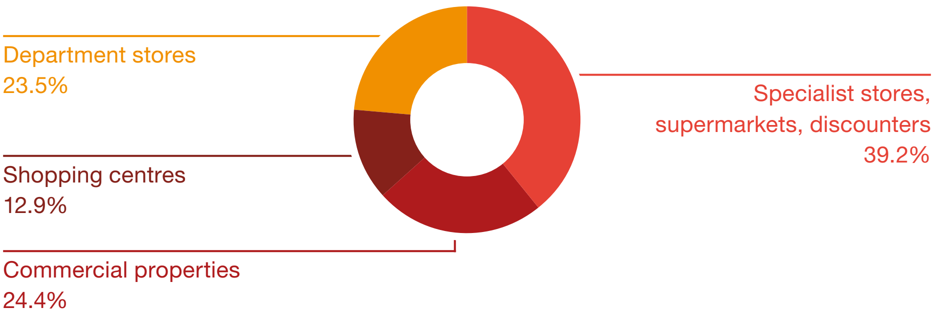
Single investments (€m)



Source: Based on BNP Paribas, Retailmarkt Deutschland, Real Estate Property Report 2011–2018, 2018.

The overall focus of investment segments has changed in recent years, with growth in the specialist store, supermarket and discounter segment in 2018.

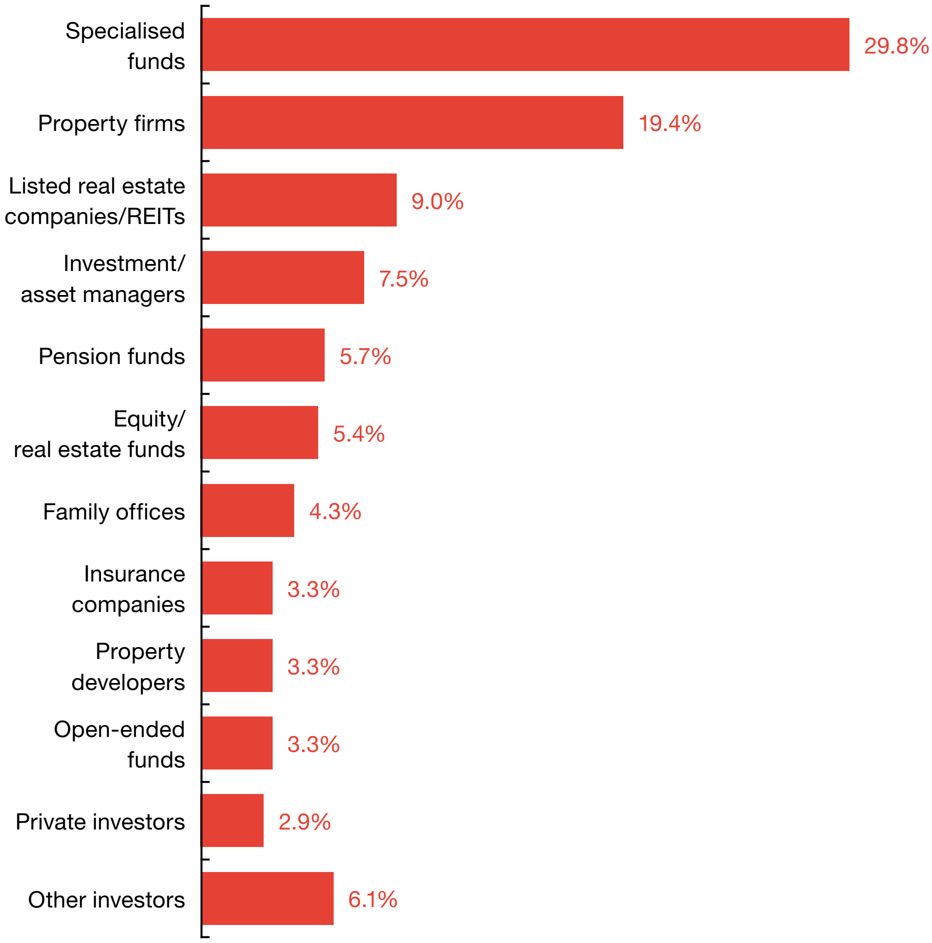
Fig. 22 Retail investments by property type in Germany in 2018



Source: Based on BNP Paribas, Retailmarkt Deutschland, Real Estate Property Report 2019, 2019.

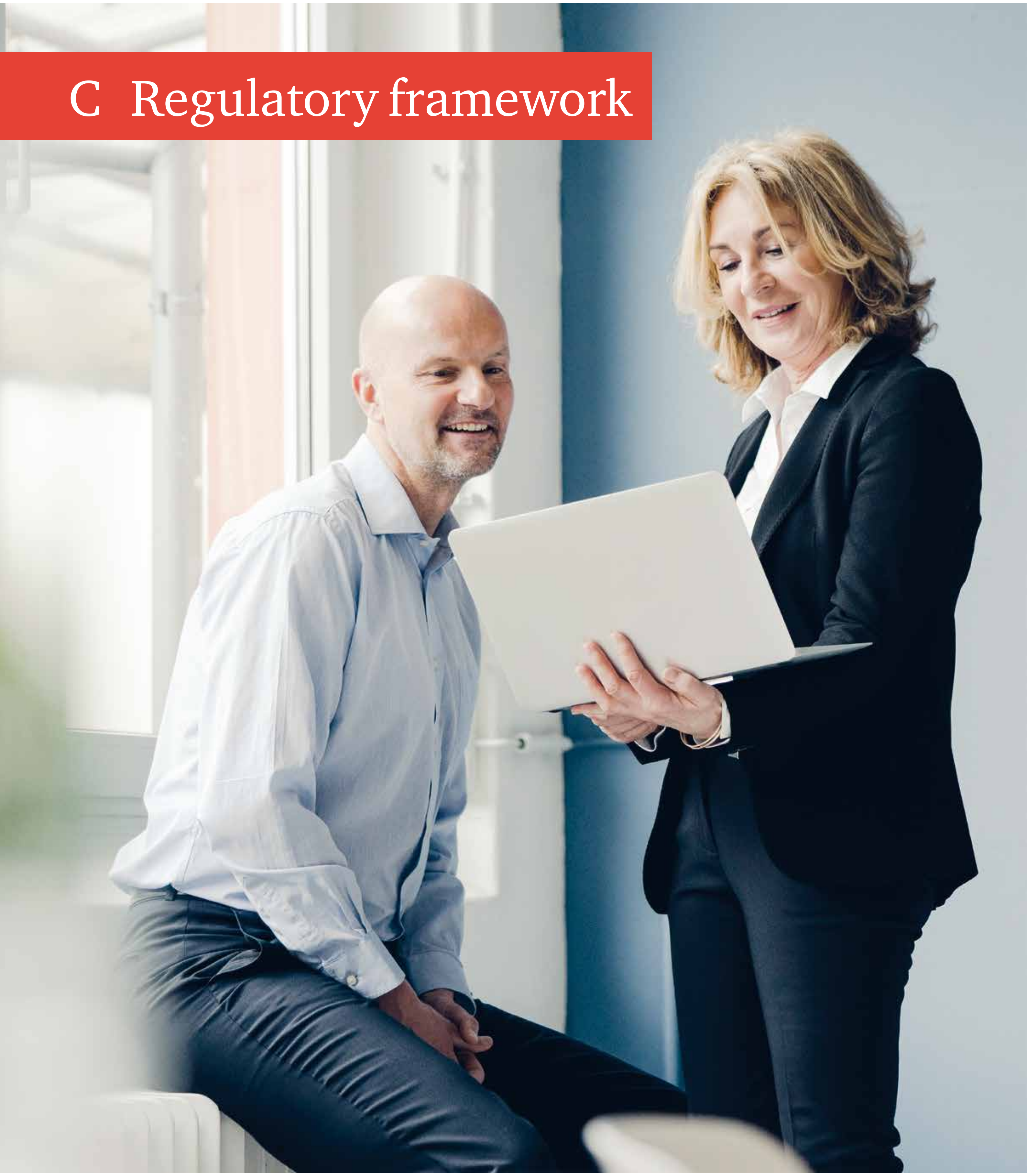
Almost half of the transaction volume was realised in the specialist store, supermarket and discounter segment. The volume of transactions in the commercial building segment was around €2.74 billion in 2018, whereas shopping centres generated around €1.45 billion. The department store segment made up 23.5% of the total retail investment volume, at €2.64 billion.

Fig. 23 Retail investment volume by investor groups in Germany in 2018



Source: Based on BNP Paribas, Retailmarkt Deutschland, Real Estate Property Report 2019, 2019.

C Regulatory framework



This chapter provides insights and outlooks of the most relevant legal aspects for those considering investing in German real estate without being exhaustive. After taking a brief look at the different types of interest in real estate under German law, this chapter focuses on the key aspects to be considered while drafting and negotiating acquisition agreements concerning German real estate.

1 Types of interest in real estate

In Germany, any legal or natural person with legal capacity may own real estate. In general, there are no restrictions on foreign individuals or entities owning or occupying German real estate.

Typically, real estate in Germany is held by rights in rem, in other words by way of a full ownership, heritable building rights or condominium rights. These rights, which may be transferred in a real estate transaction and which are described in more detail in this section, require registration with the relevant land register.

1.1 Ownership (Eigentum)

An ownership right grants an individual the right (i) to possess, use and dispose of land at the owner's discretion to the extent that a statute or third-party right does not conflict with this, and (ii) to exclude others from every influence.

German law distinguishes between the following types of ownership:

- Sole ownership (Alleineigentum): Only one legal or natural person owns the land and is authorized to control and dispose of it.
- Co-ownership (Miteigentum): Several legal or natural persons can be co-owners of a land. The co-owners hold notional – not factual – shares or fractions of the land. Each owner can dispose of his share without the consent of the other co-owners, but only the community of owners can dispose of the whole land.
- Joint ownership (Gesamthandseigentum): The land is held by two or more joint owners, who may only dispose of the land together, but not individually.

1.2 Heritable building rights (Erbbaurechte)

Under German law, buildings firmly attached to the ground are considered to be integral parts of the land on which they are located. Therefore, the ownership of a building belongs to the owner of the related land. A sale of the land consequently includes the buildings located on it.

One of the exceptions of this rule is a heritable building right. This transferable and heritable right to erect a building on or under the ground surface of a land is granted by the respective land owner to an individual. In order to become legally binding, the heritable building right has to be registered in the land register for heritable building rights. The general maturity for a heritable building right is usually up to 99 years, after which the right extinguishes and ownership of the buildings passes to the landowner against payment of a financial compensation, unless agreed otherwise.

1.3 Condominium (Wohneigentum)

Condominium created by contract or by declaration of the land owner to the land registry describes the ownership over individual units in a multi-unit residential property in accordance with the provisions of the German Condominium Property Act (Wohnungseigentumsgesetz, WEG). It is most common in larger cities and allows for the co-ownership of the common parts of a building (e.g. structure of the building and stairs) by all condominium owners, while each individual unit is separately owned. The management of the jointly owned property and the costs are agreed between the condominium owners in specific regulations. The existence of condominium property is registered in the condominium land register.

2 Acquisition agreements

Prior to the signing of the actual acquisition agreement, the parties of a real estate transaction often conclude memorandums of understanding, letters of intent, heads of terms or the like, which contain the key issues of the envisaged transaction. Unless such preliminary agreement is notarized in case of an asset deal, it will have no binding effect.

In comparison to common law agreements, acquisition agreements governed by German law are quite often shorter. The reason is that there is less need for specific contractual provisions describing and defining every detail or legal consequence in view of the widely codified German law. If a notarization is required, the notary public as a neutral party will attempt to balance the interests of the parties and may suggest changes to the acquisition agreement already negotiated by the parties and their advisors in order to ensure its legality and implementation.

In this section, a few material issues that prospective buyers of German real estate regularly encounter, are described in more detail.

2.1 Description of the targeted real estate

The German law requirement of specification (Bestimmtheitsgrundsatz) requires a precise definition and description of the subject matter of the purchase and sale in the acquisition agreement, be it in a share or an asset deal. In case of an asset deal, the acquisition agreement must contain a detailed list of the assets being sold and transferred to the buyer. General descriptions like “all assets and inventory of the seller” are not sufficient. For this reason, asset purchase agreements contain extensive lists of the assets to be sold as well as summaries of the entries in the land register in relation to the real estate.

2.2 Warranty and liability

In a share deal the buyer acquires the company with all its liabilities and obligations. Under current market conditions, real estate is sold in an asset deal in its current condition existing on the date of transfer of ownership. Against this background, it is crucial that buyers obtain all relevant information regarding the acquired company respectively the acquired real estate. The information evaluated does have a critical impact on the negotiation and drafting of the acquisition agreement as known risks can be reflected in the purchase price or covered by specific contractual arrangements (such as indemnification clauses).

The due diligence findings also influence the scope and limitations of the representations and warranties in the acquisition agreement. In case of their breach, the seller is primarily obliged under German statutory law to cure the defects. As a seller is often not able to cure a defect in relation to real estate or shares, the parties will in most cases agree on specific consequences of the breach of a warranty and remedies in the acquisition agreement (e.g. claim for damages). Representations and warranties are often knowledge-based and typically refer to subjects such as:
- Corporate status of the seller (and the target company);
- Assets and liabilities; and
- Public permits and environmental issues.

As to the latter, it should be noted that environmental protection has become increasingly more important in Germany in recent years. This development is reflected in statutory building and energy standards as well as in stringent soil protection laws. Under German public law, the owner/occupier (e.g. tenant) of a real estate as well as the party causing the contamination are responsible for soil and groundwater pollution. The relevant public authority can therefore ask a buyer, who acquired a contaminated real estate, to remove residual pollution, contamination, hazardous substances, etc. at his own expense. The economic risk can be mitigated by including a respective indemnification clause in the acquisition agreement in addition to the related representations and warranties.

2.3 Leased real estate

Whether a real estate is leased, is not only relevant for the financing of a real estate transaction with regard to the expected cash-flow, but also for liability reasons. Pursuant to sec. 566 of the German Civil Code, the buyer of leased real estate automatically enters into the rights and obligations contained in the lease agreement in lieu of the lessor. The change of ownership does not constitute a sufficient ground for an extraordinary termination of a lease agreement by the new owner.

Against this background, the terms and conditions of the lease or leasehold agreement should be thoroughly reviewed. Lease agreements are highly regulated, but parties may, in general, conclude agreements that deviate from statutory provisions. Broadly speaking, the German lease law tends to protect the tenant more than the landlord.

In order to safeguard the interests of the prospective buyer of a real estate, acquisition agreements typically contain extensive representations and warranties in connection with lease agreements, in particular, with regard to the completeness and correctness of the existing lease agreements as well as the payments thereunder.

Excursus on terms and conditions of lease agreements

a) Duration

Parties of a lease agreement may freely agree on a fixed or indefinite term of the lease agreement. It is quite common that lease agreements under German law contain contractual renewal options. In case of a fixed term, statutory provisions on extraordinary termination for cause cannot be excluded by the parties.

Relevant for investors is, in particular, that lease agreements with a term of more than one year need to be in writing. A breach of this written form obligation does not affect the validity of the lease agreement, but the lease agreement is deemed to have been concluded for an indefinite period with the consequence that both parties would be entitled to terminate the lease agreement subject to six months' notice (unless a shorter notice period was agreed).

b) Rent

In general, the rent is freely negotiable between the parties and is usually oriented towards the size of the rentable space. Commercial lease agreements often contain automatic rent adjustments in form of a stepped rent or an indexed rent based on the German consumer price index (Verbraucher-preisindex). However, an excessive rent above the usual level or non-transparent rent adjustment clauses might be regarded as invalid by German courts.

Commonly, tenants are obliged to provide a security deposit by way of a cash payment to the landlord or by way of a guarantee by a bank or a parent. On termination of the lease agreement, the deposit must be returned, provided that the lease premise is in the agreed state.

c) Ancillary costs; operating costs

According to German law, the landlord must bear all costs to which the rented object is subject. However, in many cases costs for water, sewage and refuse collection etc. as well as possible operating costs relating to the property (e.g. for insurance, maintenance of common parts of the building) are passed on to tenants as an ancillary charge subject to the stipulations in the lease agreement. It should be noted that not all operating costs are apportionable. Clauses on operating costs that are not sufficiently precise might be considered void by German courts.

d) Maintenance, repair and renovation at end of lease

The landlord is responsible by law for maintenance and repair, but it is often agreed by contract that the tenant must bear minor repairs and maintenance work to a certain extent and subject to statutory provisions on general terms and conditions. On termination of the lease agreement, tenants are obliged to return the leased premises in the state in which they were handed over at the beginning of the lease.

e) Subleases and assignment

According to German law, tenants cannot freely dispose of the lease and require the consent of the landlord for subletting or sharing the leased premises with further parties. Such consent is often given in the lease agreement. The same applies to any assignment of a lease agreement.

Please note, that the state of Berlin is currently considering to introduce rent regulation laws for residential lease agreements eg rent freeze for five years. This process should be further monitored.

2.4 Easements and other restrictions

If a buyer is interested in the acquisition of a real estate by way of an asset or share deal, particular attention should be paid to the question whether the property is encumbered with any rights or restrictions.

When negotiating and drafting an acquisition agreement, a particular attention should be paid not only to any land charges (for more details please see section 4.1) registered in the land register with regard to the real estate, but also to easements and contractual restrictions related to the real estate as these may significantly affect the value of the real estate.

Easements (Grunddienstbarkeiten) as well as limited personal servitudes (beschränkt persönlich Dienstbarkeit) have to be registered with the competent land register and constitute legal relationship between the beneficiary and the obligor. For example, a property can be burdened by an easement restricting the use of or construction on a property. As far as legally possible, investors may request that the encumbered real estate is released from such easements prior to the completion of the transfer of ownership.

In most German federal states, public easements (Baulasten) are recorded in a register for public easements (Baulastenverzeichnis). In contrast to easements, public easements constitute a formal obligation of a land owner vis-à-vis the building authorities. They are not at the disposal of the land owner and can only be released by the competent building authority. A public easement, which may, for instance, state that the land owner is not allowed to build on a specific area of the land, also applies to any future owner of the respective land.

Parties are also free under German law to agree on a variety of obligations and rights relating to real estate. These contractual restrictions (e.g. contractual building restrictions) only take effect inter partes. In a share deal, such contractual rights and obligations can have a material effect on a buyer, who intends to acquire the company which entered into the contract.

3 Financing considerations

Typically, real estate transactions are to a substantial amount financed by borrowed capital. The most important type of financing real estate is a bank loan. As a security for the repayment of the loan financing the purchase price the property is often encumbered.

3.1 Land charges

German law provides for two kinds of security granting realisation rights over properties: mortgages (Hypotheken) and land charges (Grundschulden; together with Hypotheken referred to as '**Land Charges**').

Mortgages depend on the existence of an underlying claim (accessoriness). A mortgage can therefore only be enforced, if the secured repayment claim exists and a mortgage can only be assigned together with the underlying claim. In contrast, land charges can legally exist independent of a claim.

A Land Charge becomes legally existing only upon registration with the land register. The registration will include details of the amount of debt, the creditor's name, interest, non-recurring additional payments. The ranking of a Land Charge is determined by the order of registration. If several Land Charges registered in a land register of a property have to be compared, the date of registration decides. For this reason, financing parties generally request first ranking security.

A Land Charge can be created over one single property, or be extended to cover several properties and grants the financing party the right to foreclosure into the encumbered property in the event that the debtor does not fulfil his/her obligations under the loan agreement. In accordance with the strictly regulated procedure set out in the German Code of Civil Procedure (Zivilprozessordnung) in connection with the German Act on Enforced Auction and Receivership (Gesetz über die Zwangsversteigerung und die Zwangsverwaltung), the financing party may either sell the encumbered property to satisfy its claim or have it placed under forced administration until the debt is satisfied from the profits from the property.

3.2 Other security rights

Besides Land Charges, share and interest pledges can also be used as a security for loan claims. In contract to a pledge over interests in a German limited partnership (Kommanditgesellschaft), the pledge of shares in a German limited liability company (Gesellschaft mit beschränkter Haftung) require notarization by notary public.

Another option of providing security for financing parties is through a global assignment agreement, by which several existing and future claims are assigned to the respective financing party. The individual claim must be precisely and clearly described in the agreement.

D Tax conditions

Optimisation of tax structures is indispensable

The issue of taxes must be taken into account as a key factor when drawing up an investment concept. A lower tax burden can lead to increases in yields. Although the tax level in Germany is comparatively high, it can be influenced by the design of the investment (e.g. legal form of the property holding company, financing structure, application of double tax treaty). Knowledge of the German tax system and the double tax treaty with the respective home country of the investor are indispensable for making optimal use of tax-structure options.

With respect to the German real estate transfer tax (RETT) it should be noted that it is intended to tighten the RETT rules applicable on the transfer of partnership interest and shares in corporate entities which hold directly or indirectly German real estate. According to a press release (dated 24 October 2019) the new rules might not be finalised this year and it is intended to implement new RETT rules in the first 6 months of 2020. However, the press release does not comment on whether the new RETT Act will apply retroactively (i.e. from 1 January 2020 onwards). Given the long legislative process and recurring delays, a retroactive effect cannot be excluded but should be unlikely as retroactive effect was also not envisaged as part of the law that was originally planned to enter into force on 1 January 2020.

1 Types of tax and real estate

The following table provides an overview of the main types of tax that are important for real estate deals:

Tab. 3 Types of real estate-related taxes

Tax type	Tax rate	Comments
Real estate transfer tax	No uniform tax rate	Varies between 3.5% and 6.5%, depending on federal state (RETT applies on asset deal transactions and share/ interest deals under certain conditions)
Land tax	No uniform tax rate	Fairly low tax burden/depending on the lease agreements Land tax can be re-charged to the tenant
Income/corporate tax/Solidarity surcharge	Corporate tax – 15% Income tax (ITA) – between 0% and 45% plus 5.5% solidarity surcharge on CIT and ITA	For Corporate Tax purposes dividend income and share deal capital gains can be subject to participation exemption (if certain conditions are met) With respect to deduction of financing expense the German interest capping rules need to be considered
Trade tax	No uniform tax rate	Between 7% and 17.5% (municipality-dependent); special relief is available for mere asset administering owners
Withholding tax on dividend distributions	25% plus 5.5% solidarity surcharge	Levied on corporations profit distributions; potential reduction under national rules, EU-Parent-Subsidiary-Directive or the double tax treatment

E Financial framework

Real estate finance involves financing or refinancing the acquisition and/or development of real property where the principal debt is generally secured by the capital value of the property and the debt is serviced from the income generated by the occupation of the property.

1 Real estate finance

The most widely used financing instrument in Germany is the bank loan. Depending on the scope of their offering, loan providers fall into two groups: universal banks and special banks.[20] Universal banks offer broad financing options and are not obliged to carefully examine the property to be financed. If the investor decides to work with a preferred partner bank with whom long-standing relations exist (their principal bank or, in German, Hausbank), it often takes less time to process the loan application because the investor's creditworthiness has already been established.

In addition, the investor may be able to get more favourable conditions based on many years of good relations. Compared to universal banks, mortgage banks give very limited loans. Mortgage banks have what is known as a mortgage bond privilege (Pfandbriefprivileg), which allows them to offer cheaper refinancing options.[21]

A credit check is carried out when applying for a loan. This is done primarily on the basis of the documents to be submitted together with the loan application. As a rule, the documents contain a description of the investment project, a financing plan, and corresponding creditworthiness and assets (targets) documents.[22] These differ according to the applicant and the object to be financed. In addition to the quality of the documents to be provided, it is also important to convey a positive impression on the loan application.

Fixed-interest agreements are common in Germany

On the basis of the creditworthiness check, the bank decides whether and under which conditions it will grant a loan to the applicant. Conditions include in particular the maturity, interest rate, repayment and collateralisation of the loan. The duration of a loan agreement is generally between 10 and 15 years, taking into account the possibility of repayment before expiry of the contract term. With respect to the reimbursement of capital use, a fixed-rate agreement is customary in Germany. The interest rate period for the loan term corresponds to this. If the borrower does not use the agreed due loan amount in due time, the bank calculates the unpaid amount of the loan. In practice, repayment usually takes place through an annuity loan.

[20] Cf. Brauer, K.-U., Immobilienfinanzierung, 1999, p. 354.
[21] Cf. ibid, p. 355.
[22] Cf. ibid, p. 368.

In order to avoid insolvency or the reluctance of the borrower to pay back the loan, collaterals must be ordered for each loan. This ensures that the loan granted can be repaid as completely as possible by utilising the credit guarantees. In the case of a real estate loan, the collateralisation of mortgage rights in the form of a land charge or mortgage entered in the Land Register is customary.

The amount of the loan provided by a bank differs according to the bank and the investor. However, it is always dependent on the refinancing option. Mortgage bonds, or Pfandbriefe, which are customary in Germany, offer the submitting Pfandbrief banks a low-cost refinancing option. Pfandbrief banks are subject to strict legal requirements, in particular with regard to the value of loans. Pfandbrief banks are required to determine the loan value for each loan they wish to refinance through a mortgage bond. Only the long-term, sustainable characteristics of the collateralised real estate may be taken into account. In addition, the value of the loan may not generally exceed the market value. A Pfandbrief bank can refinance only 60% of mortgage bonds via a conservatively determined mortgage value.[23] Any additional loan amounts must be refinanced elsewhere. As a general rule, the more the sum exceeds the 60% limit, the more expensive the loan becomes. This conservative financing is particularly suitable for private investment. It also meets the requirements of investors with a high equity base and is particularly widespread in times of crisis.[24]

[23] Cf. Section 14 of the Pfandbrief Act (Pfandbriefgesetz, or PfandBG), 2005.
[24] Cf. Hagen, Der Pfandbrief – sichere Refinanzierung (auch) in Zeiten der Krise, 2005.

F Guidelines for investment in Germany

The purchase of real estate and real estate portfolios offers a multitude of opportunities, but at the same time it brings exposure to risk. In addition to general investment risks, real estate transactions carry additional property-specific risks, such as market, location, development, asset and exploitation risks. For this reason, a detailed, systematic analysis of qualitative and quantitative information and data should be carried out before making an investment. This allows the potential risks of the planned transaction to be identified in advance and the opportunities to be exploited in a systematic and targeted manner.

The following section gives an example of the steps taken to carefully analyse, examine and evaluate a transaction opportunity in Germany. A distinction is made between an asset deal and a share deal. An asset deal is a direct transfer of ownership of individual properties or portfolios, whereas in a share deal the shares of a property-holding special purpose vehicle (SPV) are transferred or sold.[25]

1 Deal structures

1.1 Asset deals

An asset deal is often chosen, if the buyer is not interested in acquiring the whole business or if during the due diligence phase certain risks have been identified in relation to the target company which the buyer does not want to take.

German law distinguishes strictly between the primary obligation (legal transaction in personam) and the performance of such obligation (legal transaction in rem). With respect to an asset deal this means that the parties involved have to conclude (i) an asset purchase agreement (that is the legal transaction in personam) and a conveyance agreement (so-called Auflassung as the legal transaction in rem).

By the asset purchase agreement, the owner of the real estate sells the real estate to the buyer against payment of a purchase price agreed upon. The asset purchase agreement has to be notarized in order to be effective. A notarization in Germany is a quite formal, serious act, whereby the entire purchase agreement (including ancillary contracts and exhibits) is read aloud by the notary public in the presence of the interested parties before the deed is signed and sealed (literally) in the presence of the notary public. Notarization is also required for later modifications or amendments of the purchase agreement as well as to a binding offer concerning real estate. An infringement of this formal requirement leads to invalidity of the whole agreement.

Having signed and notarized such purchase agreement, the legal status in rem of the real estate has not changed. For the transfer of ownership (legal transaction in rem), the aforementioned conveyance agreement (Auflassung) must be executed by the parties in their simultaneous presence before a notary public. In practice, the purchase agreement and the conveyance agreement are often agreed in one notarial deed.

[25] Cf. Saemann, P.; Schlüter, C., Immobilientransaktionen, 2007, p. 73.

The notary's fees are calculated on the basis of a statutory schedule and depend on the transaction value, however, fees are capped at a transaction value of EUR 60 million. The notary public is often also authorized by the parties to supervise the satisfaction of closing conditions and to make all necessary applications and declarations (such as the clearance certificate by the tax authorities (Unbedenklichkeitsbescheinigung) in order to effect the transfer of the land. The notary public may also set up escrow arrangements and notify the buyer when the payment for the purchase price is due.

As a last step of the asset deal, the change of ownership of the German plot of land needs to be registered with the competent land register (Grundbuch) in order to become valid. Prior to the entry into the land register, the buyer has an expectant right (Anwartschaftsrecht) in obtaining the respective land. The land register is kept at the competent local court and displays property information in the land register directory (Bestandsverzeichnis) and additional information, such as legal owner of the property and property encumbrances. It enjoys public faith in Germany, i.e. the person registered in the land register is considered as the person who is entitled to dispose of this property. Therefore, as long as the buyer does not have positive knowledge to the contrary, ownership can be acquired in good faith from the person registered in the land register (bona fide; Gutglaubenserwerb).

Since a significant period of time can pass between the signing of the purchase agreement and the entry in the land register, there is a risk that the name of a second buyer is registered in the meantime. In order to protect the buyer's claim for the transfer of the property, a priority notice of conveyance (Auflassungsvormerkung) can be registered with the land register with the consequence that any registration violating the secured claim is invalid, but only in relation to the previous owner as the creditor of the secured claim.

Excursus on public auctions

Besides a private sale by way of an asset deal there is also the possibility to acquire a real estate by public auction under certain conditions. In financial agreements, a borrower who owns a real estate, often grants the lender a first-ranked land charge on a real estate as a security. If the borrower defaults on the loan, the respective lender may enforce the land charge, among other options, through a compulsory sale of the real estate by public auction. The proceedings of the public auction are used to offset the remaining loan amount.

In order to commence the strictly formalized procedure of a public auction, the lender requires an enforceable title. The owner of a real estate usually submits to immediate enforcement when establishing the land charge. If he has not declared such submission to enforcement, the creditor has to go to court in order to get an enforceable title.

The public auction is arranged and supervised by the competent local court in accordance with the German foreclosure law (Zwangsversteigerungsgesetz) upon application by the creditor. For instance, the competent legal court determines the value of the real estate based on an appraisal of a court appointed real estate appraiser. Due to the complexity of the auction proceedings, it is recommended that prospective buyers engage the services of legal advisors.

1.2 Share deals

In the course of a real estate share transaction, not the real estate itself is acquired, but the company owning the real estate. As a share deal does not affect the ownership of the target company's assets, the buyer acquires the company with all its assets (including real estate) and liabilities.

Share deals are often preferred to asset deals for tax reasons and, in contrast to an asset purchase agreement, a notarization of a share purchase agreement is, in general, not required under German law. As an exception thereof, the sale and purchase as well as the transfer and assignment of shares in a German limited liability company (GmbH) require notarization.

For purposes of taxation and of liabilities, it is common to make use of special purpose vehicles in case of a share deal. These legal entities, often organized as German limited partnerships (Kommanditgesellschaft – KG) with a limited company (e.g. a German limited liability company; Gesellschaft – mit beschränkter Haftung – GmbH or a foreign limited company) as sole general partner (so-called GmbH & Co. KG), are formed exclusively for the purpose of transferring and financing real estate. Since the interests in German partnerships are not freely transferable, the acquisition of partnership interests requires the approval of the other partners, unless otherwise agreed in the partnership agreement. In contrast, shares in GmbHs or German stock corporations are freely transferable, provided that the articles of association not provide for any restrictions on transfers of shares (e.g. approval by the shareholders' meeting).

It is common for only 94.9% of the shares to be transferred since a transfer of 95% or more would trigger the obligation to pay real estate transfer tax (RETT). The remaining shares may be acquired after five years. Please note that the German RETT regime for share deals might be tightened in the near future to expand the scope of the tax to include sales of less than 95% of a company's share capital and to lengthen the monitoring period to ten or even fifteen years. Investors should closely monitor the legislative process.

While negotiating a share deal, it must be taken into consideration that, in particular with regard to a GmbH, there is no reliable shareholder register or other formal record of share ownership. Although a list of shareholders of a GmbH has to be filed with the commercial register, such list only indicates the accuracy of the current shareholding structure and is not a condition precedent for the share transfer being valid.

Only under certain conditions, a shareholder list may prove a basis for a bona fide acquisition of the share, if the shareholders' list has already been incorrect in respect of the share for over three years or if the incorrectness of the list is attributable to the true owner of the share. However, good faith in the existence of a share in a GmbH and its freedom from encumbrances is not protected under German law.

For the reasons stated above, a thorough legal due diligence review of the target's corporate history, in particular in respect of the chain of title regarding the target's current shareholders is an essential element of the acquisition process in case of a share deal.

2 Relevant due diligence areas

Before a real estate investment in Germany is considered, due diligence should be performed in accordance with the above criteria. If the German real estate market, the German legal situation and the German tax regime are adequately known, this can be carried out by the investor. Otherwise it is strongly recommended to outsource such analysis to a third party with appropriate expert knowledge and market experience. It should be noted in particular that a due diligence analysis can only reduce the risk of an investment when it is carried out properly; that is, independently and robustly.

Depending on whether the planned transaction is to be implemented in the form of an asset or share deal, it is advisable to focus on different aspects of due diligence.

2.1 Asset deal – real estate due diligence and valuation

The following analyses are recommended for real estate due diligence and valuation in the course of an asset deal.

2.1.1 Due diligence

1. Analysis of net profit
The current income and expenditure situation of the property (or properties) should be analysed in detail and the actual net profit achieved should be reliably derived. In particular, a comprehensive examination of the following items is useful:
- Analysis of rental income, including revenue reductions due to vacancy and outstanding payments (rental analysis)
- Assessment of the cost of management based on the current contractual situation and examination of additional cost statements
- Maintenance and repair costs
- Key real estate figures (eg, vacancy rates, average rent, maintenance costs and operating costs per square metre)
- Re-letting (re-letting periods, rental incentives and rent-free periods and their effects on cash flow)
- Normalisation of one-time effects (exceptional or one-time income, special expenses and/or non-operating costs)
- Analysis of existing main contracts (eg, management agreements, maintenance contracts) with regard to their potential risks and their financial implications

2. Analysis of rental accounting
Spot checks of previous revenue and expenditure on the basis of the tenant's rent book and rent accounting, and confirmation of their correctness on the basis of sample checks from tenant and bank accounts

3. Inspection of the rent roll
Examination of the rent roll based on the rental contract regulations (including index clauses, leasing expired dates, etc)

4. Analysis of commercial anchor tenants
Eg, company profiles, creditworthiness, creditworthiness check

2.1.2 Valuation

1. Valuation of the property
Through nationally and internationally recognised and valid assessment methods such as the White Book (International Valuation Standards Council), the Red Book (Royal Institution of Chartered Surveyors), the Blue Book (The European Group of Valuers' Associations) or the generally accepted German valuation standards (Verordnung über die Grundsätze für die Ermittlung der Verkehrswerte von Grundstücken, or ImmoWertV)

Value driver and sensitivity analysis
Identification of value drivers, sensitivity analysis to assess critical value points

Portfolios
Valuation as sum of the parts or as total portfolio, assessment of special premium for the valuation

Hidden reserves/value potential
Identification of potential value uplift or hidden reserves, recommendation on actions to take to release reserves

2.2 Share deal – real estate due diligence

2.2.1 Due diligence

2. Analysis of the earnings situation
For example, historical analysis of business results, result normalisation

3. Analysis of the assets
For example, analysis of net financial liabilities, working capital, debt-like items, off-balance sheet items

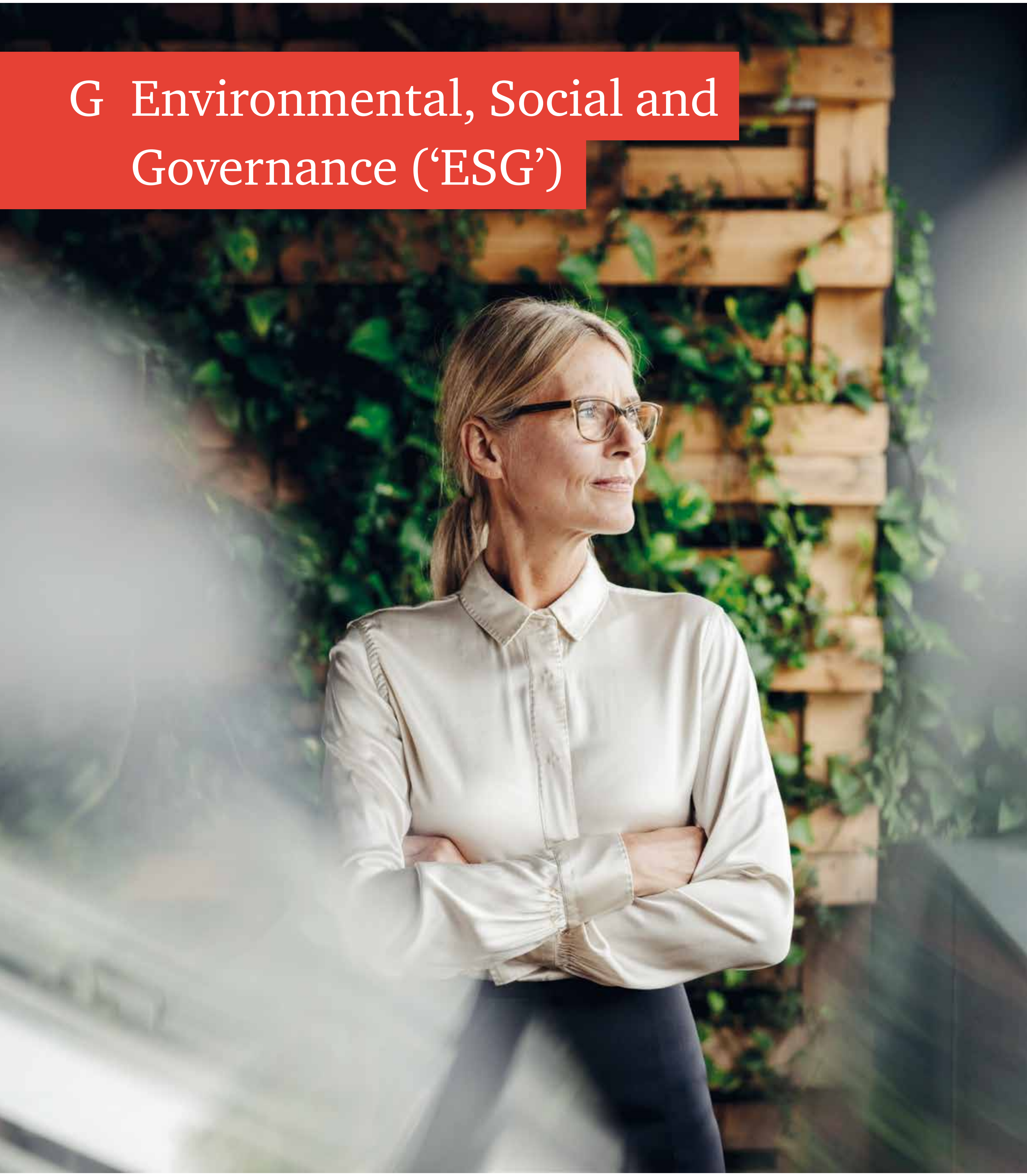
4. Analysis of cash flow statement

2.2.2 Valuation

1. Creation or review of an integrated business plan
(Cash flow statement/profit and loss balance sheet)

2. Definition of peer group and allocation of cost of capital
Consideration of special accounting or tax issues within the course of the valuation

3. Business enterprise valuation
Indicative or full scope



G Environmental, Social and Governance (‘ESG’)

Since the UN Conference on Environment and Development in 1992, it has been recognised that equal promotion of environmental, social and governance issues is a prerequisite for a stable society. This was accompanied by the establishment of the abbreviation ESG. ESG is used whenever ecological and social aspects as well as responsible corporate management are used as evaluation standards.

National and international climate targets, ever stricter statutory requirements and an increasing demand for high-quality, healthy and environmentally friendly working and living environments have led to a significant increase in the importance of ESG criteria. However, there are no statutory requirements as to when corporate action is considered sustainable. Within the framework of the *EU Sustainable Finance Action Plan*, a classification system (taxonomy) is currently being developed for this purpose. According to the current draft ordinance, this system is intended to define specific climate and environmental protection goals and minimum social requirements.

1 Market environment and trends

Even without a statutory regime the following developments can be noted:

1.1 Increase of transparency due to reporting and information obligations

Sustainability reporting has become an established component of corporate communications. It is not only the companies that are subject to reporting duties that publish supposed governance information in addition to economic, social and ecological figures. In addition, the increase in information duties, for e.g. in energy and data protection laws, has led to more transparency in the real estate sector.

1.2 Tightening of risk management processes

Many companies have adapted their due diligence and risk management processes to monitor ESG risks. Therefore, properties with a high location risk (e.g. due to political unrest or extreme weather conditions) are excluded from purchase and sustainability criteria (e.g. climate impact, conservation of resources, user comfort) are becoming a standardized evaluation program in technical due diligences. The identified issues are included in the calculation of purchase prices and asset management budgets. In addition, more and more companies are pursuing minimum standards for employment, environmental protection and anti-corruption.

1.3 Quality improvement through life cycle analysis

ESG criteria are relevant at each stage of the investment cycle. Therefore, during project development it is important that not only a sustainable building structure is built, but that the preconditions for a sustainable building operation with a high level of user comfort and resource-conserving conversion possibilities are created.

2 Contract design

Transaction contracts take ESG criteria into account, such as through representations and warranties. Loan, insurance, management and rental contracts increasingly provide for compliance with specific ESG standards. The provisions exceed mere declarations of intent and concern, for e.g. the exchange of information, the implementation of an energy monitoring and management system and compliance with certification requirements. In light of this, all contracts should be coordinated. Only when all parties involved, including service providers, administrators, tenants, investors, financiers and insurance companies, are subject to the same obligations can truly sustainable corporate action be ensured.

2.1 Outlook

It remains uncertain which statutory requirements will ultimately be introduced, and which market standards will be established. In view of the increase in extreme weather events and the current social climate, which is also expressed in the Fridays for Future movement, ESG criteria are expected to become ever more important. Therefore, the following should be taken into account:

1. Regulatory developments, legislative procedures and market developments need to be continuously monitored.
2. All contracts should be reviewed for their compliance with ESG criteria and regulatory gaps should be avoided. Contractual provisions should be drafted with a view to future developments and provide for adjustment options.
3. Adopt a life cycle view as a business case: foresighted consideration and anticipation of ESG aspects at any time during the investment phase.

H Conclusion

Comprehensive knowledge of the local conditions is the key to successful real estate investments

The German real estate market still offers foreign investors very attractive conditions for a successful real estate investment. Particularly in the current market environment, there are promising opportunities driven by underlying trends, including strong economic growth, urbanisation and international migration.

Due to Germany's federal structure, the country's real estate market is much more decentralised than in other major European countries. The resulting geographic diversification potential for real estate investments is just as important as the overall value stability of German real estate and the low ownership quota of residential real estate.

German real estate law is extensive and offers investors the highest degree of legal certainty. Even if foreign investors are faced with complex fiscal conditions, they nevertheless have the opportunity to optimise their tax structure. A comprehensive and in-depth knowledge of legal and tax legislation in Germany is, however, a prerequisite for successful real estate investment.

For small and private investments, it is therefore useful to engage a notary, and possibly also a broker, for advice throughout the entire acquisition process. For larger transactions, it is important to ensure interdisciplinary assessment and coordination of all aspects related to the investment. In addition to carrying out financial due diligence, it may be prudent to perform legal, environment and technical due diligence as well. This is the only way to recognise all potential risks at an early stage and to seize all opportunities – with the goal of achieving a secure and successful real estate investment. An independent valuation of the single asset, portfolios or business enterprise will help to minimise investment risk while also providing support for tax and accounting tasks.

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