# REAL ESTATE M&A

## Germany

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Getting The Deal Through

Consulting editor
*Cleary Gottlieb Steen & Hamilton LLP*

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Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including into typical structures and processes; legal and regulatory overview, including specific regulations for cross-border combinations and foreign investors; shareholder approval considerations; taxation and acquisition vehicles; take-private transactions; due diligence; typical points of negotiation; remedies for breach of contract; financing; collective investment schemes; and recent trends.

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# Table of contents

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## Germany


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## OVERVIEW

### Typical transaction structures – public companies

What is the typical structure of a business combination involving a publicly traded real estate-owning entity?

The typical structure is an acquisition through a public takeover offer to all target shareholders. The public takeover offer can be combined with (1) market purchases ahead of the offer, (2) arrangements with anchor or major target shareholders on block trades or commitments to tender their shares into the takeover offer or (3) an issuance of new shares by the target to the buyer.

Potential buyers usually avoid the acquisition of a controlling stake (ie, up to 30 per cent of voting rights) without a takeover offer because the closing of this acquisition would trigger a subsequent mandatory tender offer and lead to substantial pricing risks due to applicable minimum pricing rules and market speculations.

*Law stated - 28 February 2023*

### Typical transaction structures – private companies

Are there any significant differences if the transaction involves a privately held real estate-owning entity?

The acquisition of a privately held real estate entity may occur through a share deal, a merger, or joint venture. A public tender offer is not required and is not possible, since a private entity is not publicly traded.

*Law stated - 28 February 2023*

### Typical transaction process

Describe the process by which public and private real estate business combinations are typically initiated, negotiated and completed.

The process of a business combination (takeover or merger) depends on the target's structure (public or private) and the type of takeover (friendly, hostile, bilateral, or auction) as well as the real estate assets.

A simplistic model of a bilateral transaction in a share deal scenario will include the following.

- Non-disclosure agreement: at first, the parties agree to a non-disclosure agreement, which restricts the sharing of confidential information between the parties.
- Indicative offer: the potential buyer (or several bidders in an auction process) submits an indicative offer, outlining the proposed terms of the transaction. If there are several bidders, the seller will analyse the different offers and rank them.
- Letter of Intent: after the seller has identified the party it wants to continue the transaction with, both parties may agree on a letter of intent, which outlines the broad terms, timeline and conditions of the transaction.
- Due diligence: the buyer conducts due diligence on the target, which may involve reviewing the target's financial and operational records, contracts (including leases), land registers and other relevant information.
- Share purchase and transfer agreement: the parties enter into a share purchase and transfer agreement, which contains the terms of the transaction and outlines the obligations of each party.

In a bilateral transaction, the parties negotiate directly with each other and the process is typically less formal and more flexible compared to a public tender offer. The parties have more control over the terms of the transaction, and the process can typically be completed more quickly.

*Law stated - 28 February 2023*

## LAW AND REGULATION

### Legislative and regulatory framework

What are some of the primary laws and regulations governing or implicated in real estate business combinations? Are there any specific regulations or laws governing transfers of real estate that would be material in a typical transaction?

In general, the following laws may be relevant in real estate M&A (depending on the nature of the business combination):

- the German Civil Code;
- the German Commercial Code;
- the German Limited Liability Companies Act;
- the German Stock Corporation Act;
- the German Securities Trading Act;
- the German Securities Acquisition and Takeover Act; and the Securities Acquisition and Takeover Offer Ordinance;
- the German Protection of Competition Act;
- the German Stock Exchange Act;
- the German Real Estate Transfer Tax Act; and
- the EU Market Abuse Regulation.

The German REIT Act contains regulations specifically relevant in case of business combinations involving German REITs.

*Law stated - 28 February 2023*

### Cross-border combinations and foreign investment

Are there any specific material regulations or structuring considerations relating to cross-border real estate business combinations or foreign investors acquiring an interest in a real estate business entity?

If a legal entity from outside of Germany intends to acquire real estate in Germany (by way of share or asset deal), this entity has to register in the German transparency register (unless it is already registered in the transparency register of another EU member state). In this register the ultimate beneficial owner of the target property has to be disclosed. According to German law, each natural person directly or indirectly holding 25 per cent or more of the shares in a legal entity is considered an ultimate beneficial owner. Without such registration in the transparency register, the foreign investment cannot be completed.

Germany has updated its foreign direct investment (FDI) screening rules by extending the list of security-relevant sectors: the Foreign Trade and Payments Ordinance was amended on 27 April 2021 to include 27 business areas where acquisitions by foreign investors must undergo security screening. Real estate investments as such are not the focus of the regulation, however when it comes to critical infrastructure like IT-related real estate (eg, data centres) or telecommunication infrastructure, FDI filings may be required. The two sets of FDI screening competencies are sector-specific (for acquisitions in specific sectors like military or IT security technology) and cross-sector (for other types of companies). The sector-specific screening applies when a non-German investor acquires 10 per cent or more of the voting rights of a target company in the specified sector. The cross-sector screening has three thresholds for acquisitions by a non-EU/EEA investor: 10 per cent of voting rights, 20 per cent of voting rights for certain sectors, and 25 per cent of voting rights for any sector. A filing is required for acquisitions in the 27 sectors listed but is optional in all other cases. The German Ministry for Economic Affairs and Climate Action has two months to open an investigation procedure after a filing, and can open an investigation up to five years after the signing of a purchase agreement if no filing has been made.

*Law stated - 28 February 2023*

### Choice of law and jurisdiction

What territory's law typically governs the definitive agreements in the context of real estate business combinations? Which courts typically have subject-matter jurisdiction over a real estate business combination?

In asset deals, German law typically applies and German courts have jurisdiction.

In share deal scenarios, the parties typically choose the law governing the real estate holding company. Therefore, in case of German real estate holding companies the parties would typically choose German law and German courts or arbitration.

Business combination/investments agreements with German listed companies are typically governed by German law and often provide for an arbitration. The takeover offer as such is German law governed and arbitration is unavailable.

*Law stated - 28 February 2023*

## APPROVAL AND WITHDRAWAL

### Public disclosure

What information must be publicly disclosed in a public-company real estate business combination?

The scope of disclosure varies greatly depending on the structure of the business combination. A small transaction on shares in a private company or real estate assets will have minimal disclosure requirements. A public takeover, however, requires substantial public disclosure.

In a public takeover, the offeror (bidder) must first disclose its decision to make a public tender offer without undue delay on online platforms, such as www.dgap.de, as well as on its own homepage. The second step is an extensive offer document that, among other things, includes information on the offeror, the target, the consideration and the

structure, and must be publicly disclosed following its approval by the Federal Financial Supervisory Authority (BaFin). The offer document must also disclose the offerors intentions for the target. Throughout the offer process, the offeror is subject to further (continuing) disclosure obligations. Additionally, a takeover may fall under the jurisdiction of the Federal Cartel Office (FCO) and must be notified to the FCO before closing.

*Law stated - 28 February 2023*

## Duties towards shareholders

Give an overview of the material duties, if any, of the directors and officers of a public company towards shareholders in connection with a real estate business combination. Do controlling shareholders have any similar duties?

In German public companies, the members of the boards owe fiduciary duties towards the company itself. They must exercise the diligence of a prudent and conscientious business person and have to act in compliance with applicable laws and in the best interest of the company (ie, act towards long-term and sustainable profitability – no maximisation of profits at all costs). The business judgment rule principles apply to entrepreneurial decisions and conveys rather broad entrepreneurial discretion. Controlling shareholders are liable for damages with regard to a public company if they induce the company to take detrimental actions. With regard to minority shareholders, a controlling shareholder is prohibited from passing bad faith general meeting resolutions (eg, approving a transaction at inadequate terms in a general meeting).

Besides these general duties, there are also a few special ones:

- In a case of a merger, the directors of the companies involved must agree on adequate consideration for shareholders.
- In a takeover transaction:
  - The management board of the offeror must treat shareholders of the target equally and to disclose extensive information relevant for the takeover offer and the target's shareholders to assess the takeover offer in an extensive offer document.
  - The management and supervisory board of the target must disclose an extensive reasoned statement on the offer including, in particular, their assessment of (1) the type and adequacy of the offered consideration, (2) the consequences of a successful transaction for the company and its employees, (3) the offeror's intentions as well as (4) the intention of the target's management and supervisory board members to accept or decline the takeover offer for their own shares.

*Law stated - 28 February 2023*

## Shareholders' rights

What rights do shareholders have in a public-company real estate business combination? Can parties structure around shareholder dissent or rejection of a real estate business combination, and what structures are available?

The rights of shareholders in a public-company business combination vary depending on the transaction's structure.

Mergers, spin-off sand changes of legal form require resolutions of the companies' shareholders' meetings and must

be approved by at least a three-quarter majority of the share capital represented at the shareholders' meeting.

In comparison, generally, a share or asset sale does not have to be approved by the seller's shareholders according to the Stock Corporation Act, unless the sale comprises all or substantially all of the target's assets. In this case, the shareholders must approve the sale with at least a three-quarter majority of the share capital represented in the shareholders' meeting.

In a public takeover, the company's shareholders' meeting does not have to approve. But the shareholders have the right to freely decide whether to accept the offer. For public takeovers, mandatory minimum pricing rules exist. The consideration has to at least amount to the higher of (1) the three months volume-weighted average stock price of the target shares during the three months' period before the announcement of the decision to launch the offer and (3) any price paid, or agreed to be paid, by the offeror for target shares in a period commencing six months before the publication of the offer document and ending at the announcement of the results of the offer.

*Law stated - 28 February 2023*

## Termination fees

### Are termination fees typical in a real estate business combination, and what is their typical size?

In Germany, termination or break-up fees are much less common than in the US market and mainly occur in bilateral real estate deals or mergers. The break-up fee must be reasonable and usually ranges between 2 per cent and 7 per cent of the transaction's equity or enterprise value. The complexity of the transaction, risks of the break-up fee ever becoming payable as well as the competitiveness of an auction process can impact the agreed amount and can justify higher (or lower) break-up fees.

In public takeover transactions, break-up fees to be paid by target company are also not overly customary but are sometimes asked for especially by US bidders. Sometimes, in public takeovers also targets may request break-up fees from bidders to address risks for transaction certainty deriving ,for example, from antitrust concerns or risks that a required general meeting or stock holder approval at bidder level will not be obtained. Target company break-up fees of around 1 per cent of the company or deal value are usually considered reasonable.

*Law stated - 28 February 2023*

## Takeover defences

### Are there any methods that targets in a real estate business combination can employ to protect against an unsolicited acquisition? Are there any limitations on these methods?

Theoretically, various methods to defend against unsolicited acquisitions are subject to debates in Germany. These include the search for alternative bidders (white-knight defence) or the launch of a counter takeover offer (pacman defence).

In practice, disapproving due diligence requests or a negative public statement by the management board are the most common takeover defences. Most of the other defence do not play a significant role. When considering defence measures, the management and supervisory board of the target must act in the best interest of the target to avoid personal liability.

*Law stated - 28 February 2023*

### Notifying shareholders

How much advance notice must a public target give its shareholders in connection with approving a real estate business combination, and what factors inform this analysis? How is shareholder approval typically sought in this context?

A shareholder approval is only required if a public company sells all or substantially all of its assets or if the transaction is structured as a legal merger or spin-off under the German Transformation Act. Any such shareholder approval must occur by a resolution of the public company's general meeting. Under the German Stock Corporation act, the minimum notice period for convening a general meeting is 30 days. In a public takeover, an approval of the takeover by the target's shareholders in a general meeting is not required.

*Law stated - 28 February 2023*

## TAXATION AND ACQUISITION VEHICLES

### Typical tax issues and structuring

What are some of the typical tax issues involved in real estate business combinations and to what extent do these typically drive structuring considerations? Are there certain considerations that stem from the tax status of a target?

The taxation varies depending on whether the business combination can be considered a direct (asset deal) or an indirect purchase of property (share deal). Within these structures it has to be distinguished between real estate transfer tax (RETT), value added tax (VAT), corporate income tax (CIT) and trade tax (TT).

The acquisition of real estate located in Germany in the form of an asset deal is generally, unless an exemption applies, taxable for RETT purposes at a rate between 3.5 and 6.5 per cent (depending on the federal state where the real estate is located).

In a share deal, RETT will be triggered if within a period of 10 years, the shareholders of the real estate holding company change (directly or indirectly) so that at least 90 per cent of the interests in the company are transferred to new shareholders or at least 90 per cent of the shares or partnership interests being (directly or indirectly) held by the same acquirer. The law, however, provides for certain (narrow) exemptions, for example, for publicly traded corporations. By lowering the limit from 95 per cent previously and doubling the holding period to 10 years and by including a provision according to which a material change in the shareholders of a corporation (directly or indirectly) also constitutes a taxable legal transaction, the real estate transfer tax treatment of share deals was significantly tightened in the year 2021. You can find the amended law on the (German) website of the Federal Ministry of Finance here and an in-depth article on the new RETT law on the European Tax blog here .

Asset deals and share deals are generally exempt from VAT. But these exemptions may be waived. Buyers should ensure that they can deduct the VAT triggered by the waiver before agreeing to a waiver.

CIT (at an aggregate tax rate of 15.83 per cent), applies to ongoing income as well as capital gains realised by corporate entities from German situs real estate. But the German tax law generally provides for a participation exemption of 95 or 100 per cent if a corporate entity sells the shares in another (real estate holding) corporate entity which may provide for tax efficient exit options.

Further, TT (at a rate of about 15 to 17 per cent) applies to income (including capital gains) stemming from German situs real estate if the respective entity is subject to German TT. Subject to rather strict prerequisites, domestic TT exemption may be available for real estate holding companies. Corporate entities that are tax resident in Germany are deemed to carry on a commercial activity via a German permanent establishment, regardless of their actual activity. Non-German entities often seek to avoid a German permanent establishment in order not to be subject to German TT. This requires careful structuring as the day-to-day management decisions may not be taken from within Germany.

*Law stated - 28 February 2023*

### Mitigating tax risk

What measures are normally taken to mitigate typical tax risks in a real estate business combination?

In share deals, the RETT burden might be mitigated by a co-investment structure, with each independent investor not exceeding the respective participation threshold of 90 per cent.

In an asset deal, there may be a secondary tax liability for taxes of the seller, which may be addressed by respective indemnities in the sale and purchase agreement that are often supported by either a proper guarantee from the seller group or by a warranty and indemnity insurance.

*Law stated - 28 February 2023*

### Types of acquisition vehicle

What form of acquisition vehicle is typically used in connection with a real estate business combination, and does the form vary depending on structuring alternatives or structure of the target company?

The most common German acquisition vehicles are limited liability companies (GmbH) and limited partnerships (GmbH & Co KG or KG). German real estate investment trusts (REITs) do exist, but are not widespread in in Germany. German limited liability companies have the advantage that they may be integrated into a tax group although they are not tax transparent in the first place so that also in a share deal scenario a consolidation with the acquisition financing may be achievable.

Foreign investors in particular often use Luxembourg or Dutch acquisition vehicles for tax structuring purposes.

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## TAKE-PRIVATE TRANSACTIONS

### Board considerations in take-private transactions

What issues typically face boards of real estate public companies considering a take-private transaction? Do these considerations vary according to the structure of the target?

A take-private transaction of a public company generally requires the company to delist from a stock exchange. In practice, such delisting usually follows a successful takeover offer. The process typically involves a controlling shareholder making a tender offer to acquire all outstanding shares at a minimum price (delisting offer). Further, a listed stock corporation may be delisted through a merger into a non-listed receiving company. Finally, a delisting can

also be effected by a squeeze-out as such. This, however, requires a stake of at least 95 per cent.

*Law stated - 28 February 2023*

### Time frame for take-private transactions

How long do take-private transactions typically take in the context of a public real estate business? What are the major milestones in this process? What factors could expedite or extend the process?

A take-private transaction usually starts with a public takeover offer to the shareholders of the public real-estate company. Such process can be completed in around three months from the public announcement of the transaction (following due diligence and negotiation of a business combination or investment agreement with the public real estate company, if any). If antitrust or other regulatory approvals are required, closing can be delayed by several months depending on the facts of the particular case. The process of a subsequent delisting of a public company from a stock exchange typically takes around three months to complete.

*Law stated - 28 February 2023*

## NEGOTIATION

### Non-binding agreements

Are non-binding preliminary agreements before the execution of a definitive agreement typical in real estate business combinations, and does this depend on the ownership structure of the target? Can such non-binding agreements be judicially enforced?

The use of preliminary non-binding agreements, such as letters of intent, is common in real estate business combinations in Germany and rarely depends on the target's ownership structure. While many preliminary agreements are not binding and cannot be enforced (eg, pure letters of intent), they still help establishing the framework for any transaction. While many preliminary are non-binding, they can certainly also contain binding and enforceable provisions (eg, confidentiality or exclusivity clauses).

In public takeover transactions, preliminary agreements with the target company are likewise common but rarely provide for extensive exclusivity periods.

*Law stated - 28 February 2023*

### Typical provisions

Describe some of the provisions contained in a purchase agreement that are specific to real estate business combinations. Describe any standard provisions that are contained in such agreements.

In a real estate business combination, the purchase agreement is a critical document that outlines the terms of the transaction and the obligations of the parties involved. Relevant provisions cover:

- Structure of the transaction or object of purchase: the agreement must outline the structure of the transaction and specify the target company or the target real estate, including the description of the property and its registration in the land register.

- Purchase price or closing conditions: the agreement must outline the purchase price and payment mechanics (locked box vs. closing accounts), due date, and closing conditions.
- Representations and warranties: the standard representations and warranties in a real estate business combination include title, leases and other material agreements, environmental matters, litigation, payment of taxes and other public fees, and compliance with building permits and zoning regulations.
- Remedies for breach of contract: the agreement typically outlines the remedies available to the parties upon a breach of contract, including compensation and potential termination of the agreement.

Besides these standard provisions, a real estate business combination purchase agreement may contain other terms specific to the transaction, such as covenants related to financing and other obligations of the parties.

In public takeover transactions, business combination or investment agreements follow different rules as these are entered into with the target company as such and not the selling shareholders. These agreements rather focus on the takeover offer, the bidder's intentions for the target, the future governance and structure of the target as well as the support of the offer by the target's management. In turn, they do not typically provide for any representations and warranties on the target company's shares or its business operations or any indemnifications regarding business risks.

*Law stated - 28 February 2023*

## Stakebuilding

Are there any limitations on a buyer’s ability to gradually acquire an interest in a public company in the context of a real estate business combination? Are these limitations typically built into organisational documents or inherent in applicable state or regulatory related regimes?

Without potential requirements for regulatory or antitrust approvals that may apply to acquisitions beyond certain thresholds, there are generally no limitations under applicable laws and articles of public companies cannot provide for any such limitations. Still, the following should be noted.

The Securities Trading Act requires disclosures to the public company and the public in case certain thresholds are reached/exceeded. The lowest thresholds are 3 per cent (for actual shares) and 5 per cent (for instruments). In case further thresholds are reached/exceeded, additional disclosures are required. When reaching the 10 per cent threshold, the acquirer must also disclose whether the investment serves strategic goals and whether the acquirer intends to influence the composition of the boards or pursues a major change in the capital structure of the company.

If a bidder acquires up to 30 per cent of the voting rights, a mandatory tender offer obligation is triggered and the bidder must offer all shareholders the acquisition of their shares.

*Law stated - 28 February 2023*

## Certainty of closing

Describe some of the key issues that typically arise between a seller and a buyer when negotiating the purchase agreement for a real estate business combination, with an emphasis on building in certainty of closing. How are these issues typically resolved?

In real estate business combinations, a key issue in the negotiation of a purchase agreement often arises around

ensuring certainty of closing. Sellers typically expect high deal/closing certainty at signing and are only prepared to accept closing conditions required by law (eg, mandatory FDI or merger control filings).

However, buyers may want to address certain due diligence findings and other risks by way of closing conditions and may for example request (1) due diligence findings to be mitigated, (2) a certain minimum percentage of a property to be let, (3) certain permits to be obtained, (4) certain contracts or warranty rights to be transferred to the target and (5) certain other structuring measures to be completed prior to closing.

For risk allocation purposes, parties typically agree on consequences including termination or rescission rights, as well as damages and sometimes break fees in case closing conditions are not fulfilled and closing does not occur by a certain longstop date.

The inclusion of conditions precedent for construction specific matters such as the granting of a building permit generally increases uncertainty of closing, but certain buyers might still request these conditions precedent when it comes to developments to mitigate the risk of acquiring a property with unfinished construction.

In public takeover transactions, closing conditions are much more standardised. They usually include regulatory approvals, a minimum acceptance threshold (usually 50 per cent plus 1 to 75 per cent), no capital measures (eg, issuance of new shares) and no insolvency. Closing conditions, the fulfilment of which is under the control of the offeror are prohibited by German takeover law.

*Law stated - 28 February 2023*

## Environmental liability

Who typically bears responsibility for environmental remediation following the closing of a real estate business combination? What contractual provisions regarding environmental liability do parties usually agree?

Responsibility for environmental remediation following the closing of the transaction can fall on the polluter, the current owner of a property, the current user of a property, but also all former owners and users of the property under the German Federal Soil Protection Act. Although the entity that has caused the pollution will primarily be held responsible, the competent authorities will determine the party responsible for decontaminating the property based on factors such as the ability to efficiently remove the contamination or financial stability. Typically, environmental liability is passed on the buyer of a real estate business except for any pollution that the seller has caused.

In public takeover transactions, typically no warranties or indemnities are given for environmental liabilities.

*Law stated - 28 February 2023*

## Other typical liability issues

What other liability issues are typically major points of negotiation in the context of a real estate business combination?

Besides environmental liability, other common liability issues include property defects (whereas it is market standard in Germany to limit or even exclude seller's liability for these defects), material adverse change, compliance with public building law, or general liability provisions such as basket and de minimis clauses. The parties typically agree on a

specific time for the transfer of risk associated with the property.

In public takeover transactions, due to transaction agreements typically lacking any warranties and indemnities, liability issues are not subject to any negotiations.

*Law stated - 28 February 2023*

### Sellers' representations regarding leases

In the context of a real estate business combination, what are the typical representations and covenants made by a seller regarding existing and new leases?

The seller usually confirms the existence and validity of the lease agreements, represents that rent payments have been made, and transfers any rent securities as required. The seller provides information on any ongoing or pending legal disputes with tenants, which are important considerations for the buyer during the due diligence. The sale of a property, whether through a share deal or an asset deal, does not affect existing leases; in case of an asset deal the new owner is bound by the existing leases as the legal successor of the seller in that regard.

In public takeover transactions, no warranties or indemnities are given on leases.

*Law stated - 28 February 2023*

## DUE DILIGENCE

### Legal due diligence

Describe the legal due diligence required in the context of a real estate business combination and any due diligence specific to a real estate business combination. What specialists are typically involved and at what point in the transaction are the various teams typically brought in?

The scope of the legal due diligence will be tailored to the requirements of each transaction. Large portfolio transaction will have a different scope than a single-asset transaction. The core real estate elements we recommend are included and that clients typically request are:

- analysis of the land register to cover any issues related to title, easements or the in rem aspects of land charges and other encumbrances;
- review and analysis of lease agreements; and
- public law aspects such as building and zoning laws, including planning permissions.

Additionally, the scope of the due diligence typically depends on the structure of the transaction. A share deal, for example, requires due diligence that also covers the corporate aspects of the target vehicle.

Apart from real estate and corporate attorneys, many deal teams include tax, funds, litigation, regulatory, and anti-trust lawyers, always depending on the nature, structure and scope of the transaction. Beyond law firms, technical, financial, tax and environmental experts will typically be involved to advise on larger real estate transactions.

Legal due diligence in public takeover transactions is usually not as in-depth as in private transactions.

*Law stated - 28 February 2023*

## Searches

How are title, lien, bankruptcy, litigation and tax searches typically conducted? On what levels are these searches typically run? What protection from bad title is available to buyers, and does this depend on the nature of the underlying asset?

The most important searches in German real estate M&A transactions will be conducted in the land register and the commercial register.

The land register covers title as well as mortgages, land charges and other encumbrances/restrictions in rem . Usually the seller provides for up-to-date land register excerpts. Otherwise, any German notary can access the land register, as long as there is a legitimate interest to obtain the information. In most cases, being a potential buyer constitutes legitimate interest, at least if negotiations are ongoing. The land register offers strong protection from bad title, as whoever is registered as owner of real estate in the land register can transfer title.

The German commercial register provides information on German companies, its management and its shareholders as well as a changelog of any recent changes. Since August 2022, the access to the commercial register is free of charge and registration.

The German commercial register offers less protection from bad title perspective than the land register.

*Law stated - 28 February 2023*

## Representation and warranty insurance

Do sellers of non-public real estate businesses typically purchase representation and warranty insurance to cover post-closing liability?

In Germany, representation and warranty insurance is not typically being taken out by sellers, in particular, if the sellers are German market players or if the transaction volume is on the low end. However, mainly driven by PE investors, buy-side W&I policies are continuing to gain popularity as a way for buyers to secure their claims arising from representations and warranties agreed in the acquisition agreement. In particular, private equity funds and other institutional investors aiming for a clean exit and a quick and full distribution of proceeds typically push for W&I concepts in their disposal processes.

In public takeover transactions, W&I insurance does not play a role in Germany.

*Law stated - 28 February 2023*

### Review of business contracts

What are some of the primary agreements that the legal teams customarily review in the context of a real estate business combination, and does the scope vary with the structure of the transaction?

Especially in all share deal scenarios, the legal due diligence scope typically covers a wide range of key agreements such as asset management agreements, property management agreements, construction agreements, neighbouring agreements, joint venture agreements, lease agreements as the main source of revenue, and acquisition and disposal agreements. The scope of the review will vary based on the structure of the transaction and the importance of the agreements to the transaction and the buyer's intentions.

*Law stated - 28 February 2023*

## BREACH OF CONTRACT

### Remedies for breach of contract

What are the typical remedies for breach of a contract in the context of a real estate business combination, and do they vary with the ownership of target or the structure of the transaction?

Typical remedies for a breach of contract include the right to terminate/rescind the contract (typically available only prior to closing), the right to claim damages, and the imposition of contractual penalties (the latter being rare in German M&A). Sellers typically try to limit their liability by way of exclusions, limitations (caps, de-minimis, deductible/threshold) and short limitations periods.

That said, while sellers retaining substance following closing may be willing to offer certain remedies, private equity and other institutional sellers with the aim of liquidating and distributing proceeds may not, and W&I insurance concepts can be considered in these cases.

*Law stated - 28 February 2023*

## FINANCING

### Market overview

How does a buyer typically finance real estate business combinations?

Most real-estate business combination financing is dominated by private debt and commercial banks rather than mortgage lending banks. A very common structure is to put in place a (intercompany) bridge loan for the payment of the purchase price for an asset or a real estate owning company. Bridge loans are a type of short-term debt instrument that can be used to finance the acquisition of real estate before the buyer secures long-term financing. Once the transaction is closed, typically, a permanent financing is established, either by way of bonds issued by the company or holding level company or by way of asset-based lending on the real estate owning property company level.

It remains to be seen how the currently rising interest rate of the European Central Bank will affect the structure of real estate financings in the future.

*Law stated - 28 February 2023*

## Seller's obligations

What are the typical obligations of the seller in the financing?

Generally, sellers will have no other obligation than to support the granting of a land charge as security for the financing party. Providing an authorisation to charge the property is typically sufficient for this purpose.

Still, broader obligations might apply to share deals especially in situations where a property owning company or its parent is acquired and where the seller remains in control of the target until the shares are transferred at closing. In these cases, the seller's assistance is needed to implement the security package prior to closing.

*Law stated - 28 February 2023*

## Repayment guarantees

What repayment guarantees do lenders typically require in the context of a property-level financing of a real estate business combination? For what purposes are reserves usually required in the context of property-level indebtedness?

Usually, no repayment guarantees are provided as the financing is limited recourse. Thus, no reserves are required by the lenders from the outset but are built in a scenario where financial covenants are breached and cash traps are implemented. Even so, other securities are typically granted, such as a land charge (in connection with a corresponding security purpose agreement), account pledges, share pledges over the shares in the property-owning company and further contractual obligations of third parties and group companies involved in the structure (such as duty-of-care agreements and subordination agreements).

*Law stated - 28 February 2023*

## Borrower covenants

What covenants do lenders usually insist on in the context of a property-level financing of a real estate business combination?

The lenders will normally insist on certain financial covenants, such as the following.

- a specific loan-to-value ratio (the average loan-to-value is 60 to 75 per cent, but can also be higher);
- an interest-cover ratio (a rate of 3.0x or better is preferred, a rate of at least 2.0x is considered the minimum acceptable amount); and
- a debt-service-coverage ratio (typical requirements range from 1.20x to 1.40x).

Additionally, information undertakings for the monitoring of the property and the provision of financial statements, and further property undertakings (eg, maintenance, management of the property itself and as an asset, and maintenance of appropriate insurance) all aim to protect the cash flows and condition of the property that is essential to the lenders.

*Law stated - 28 February 2023*

### Typical equity financing provisions

What equity financing provisions are common in a transaction involving a real estate business that is being taken private? Does it depend on the structure of the buyer?

The equity financing provisions depend on which portion the financing bank is willing to take, which in turn depends on the value of the property and the remaining term of the lease (the longer the lease, the more the lender will be willing to finance).

*Law stated - 28 February 2023*

## COLLECTIVE INVESTMENT SCHEMES

### REITs

Are real estate investment trusts (REITs) that have tax-saving advantages available? Are there particular legal considerations that shape the formation and activities of REITs?

REITs are available in Germany as a possible way to invest in real estate. To be considered a REIT, a real estate company has to comply with the rules outlined in the German REIT Act. For instance, German REITs may be structured only in the legal form of a stock corporation and limitations apply regarding the types of property they can invest in. Immovable assets must account for at least 75 per cent of the REIT's assets and REITs need to distribute 90 per cent of the annual profits and maintain an equity ratio of at least 45 per cent. Further, no shareholder must hold more than 10 per cent in a REIT, and at least 15 per cent of the shares need to be in free float.

*Law stated - 28 February 2023*

### Private equity funds

Are there particular legal considerations that shape the formation and activities of real estate-focused private equity funds? Does this vary depending on the target assets or investors?

Generally, real estate-focused private equity funds qualify as alternative funds and are supervised by the Federal Financial Supervisory Authority (BaFin). They are regulated by the Capital Investment Code (KAGB), which defines the level of regulations according to the classification of the investors and the value of the assets under management, rather than the target asset.

*Law stated - 28 February 2023*

## UPDATE AND TRENDS

### Key developments of the past year

Are there any other current developments or emerging trends that should be noted?

Apart from the RETT reform,which had substantial effects on the structuring of real estate businesses, ESG continues to be a relevant topic on every level of real estate business combinations: energy-saving and CO2 net-zero policies are the new normal, ‘green buildings’ generate a higher rent over comparable non-green properties and the regulatory requirements continue to tighten both in the EU and the US. You can find an in-depth market report from CBRE on ESG and real estate here .

*Law stated - 28 February 2023*

# Jurisdictions

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|---|---|
| **Germany** | Latham & Watkins LLP |
| **India** | AZB & Partners |
| **Japan** | TMI Associates |
| **Mexico** | Mijares Angoitia Cortés y Fuentes SC |
| **Nigeria** | Olajide Oyewole LLP |
| **Poland** | WKB Wiercinski Kwiecinski Baehr |
| **Switzerland** | MLL Meyerlustenberger Lachenal Froriep Ltd |
| **United Kingdom** | DAC Beachcroft |
| **USA** | Cleary Gottlieb Steen & Hamilton LLP |
| **Vietnam** | YKVN |