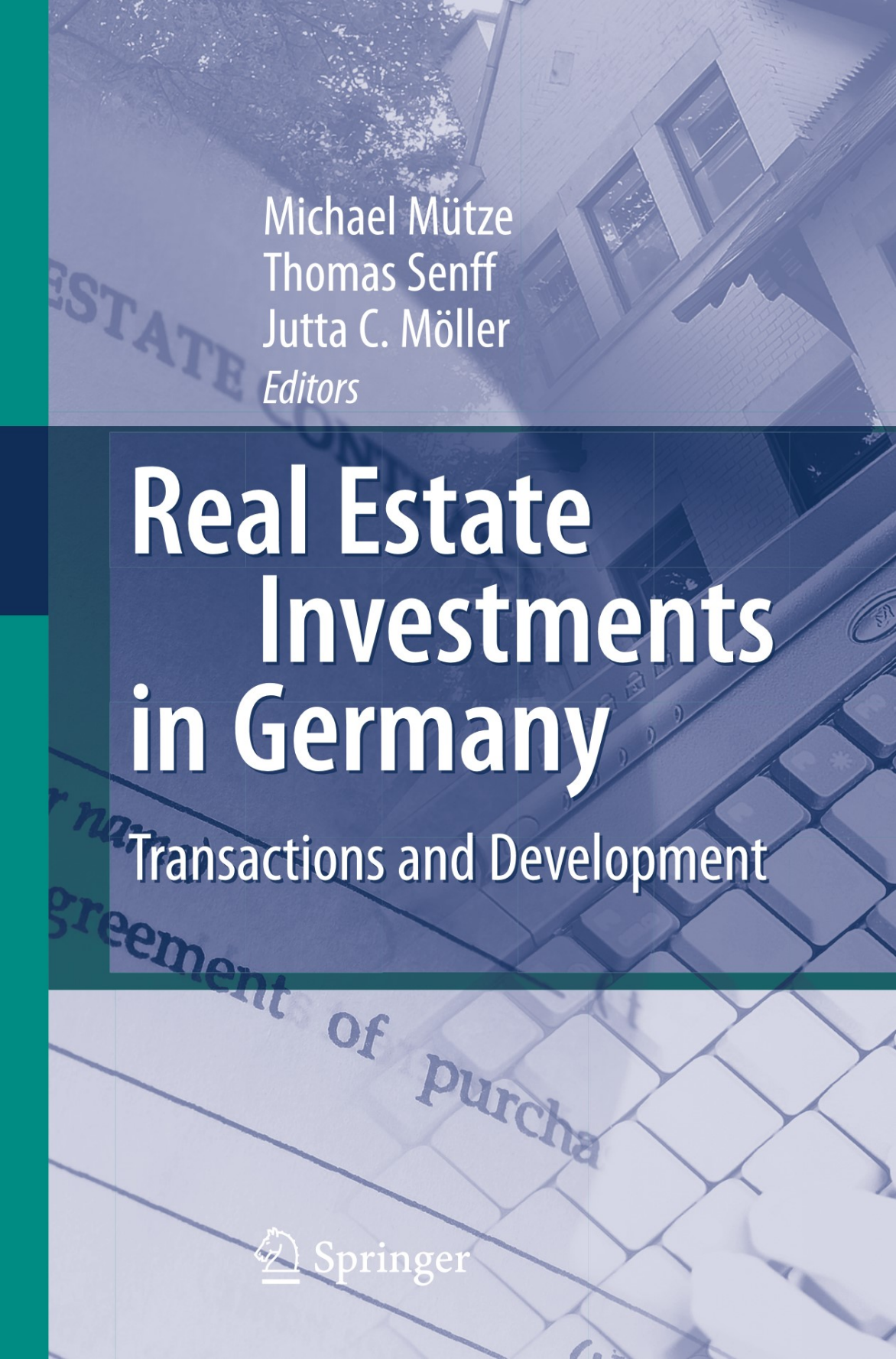


Michael Mütze
Thomas Senff
Jutta C. Möller
Editors

Real Estate Investments in Germany

Transactions and Development

Springer

Real Estate Investments in Germany

Michael Mützе · Thomas Senff
Jutta C. Möller
Editors

Real Estate Investments in Germany

Transactions and Development

Springer

Dr. Michael Mütze
Dr. Thomas Senff
Dr. Jutta C. Möller

Mütze Korsch
Rechtsanwaltsgesellschaft mbH
Trinkausstraße 7
40213 Düsseldorf

muetze@mkrg.com
senff@mkrg.com
moeller@mkrg.com

Corr. 2nd printing 2008

ISBN 978-3-540-72178-9 e-ISBN 978-3-540-72179-6

DOI 10.1007/978-3-540-72179-6

Library of Congress Control Number: 2007928726

Production: le-tex publishing services oHG, Leipzig
Cover design: WMXDesign GmbH, Heidelberg

Printed on acid-free paper

9 8 7 6 5 4 3 2 1

springer.com

Preface

International real estate investors are shaping events on the German real estate market to an ever greater extent. The reason for the increasing interest of foreign investors in the German real estate market is primarily the property prices which are still low by international comparison and promise above-average returns. The proportion of foreign investors in the transaction volume on the German real estate market suddenly jumped to over 50% in 2005 and this trend has continued in 2006 at an ever increasing rate.

The idea behind writing a book in English about real estate investments in Germany was therefore born from practical experience in advising foreign investors. In our opinion it is essential for an investor to know the special legal and tax characteristics and the economic parameters of the German real estate market in order to be in a position to make a sound investment decision. Against this background this book is not to be viewed as a scientific study; the aim of the authors and publishers is to familiarise foreign investors in a comprehensible and practical manner with legal and tax aspects and the economic factors prevailing on the German real estate market.

Düsseldorf, April 2007

Michael Mütze
Thomas Senff
Jutta C. Möller

Table of Contents

List of Contributors

List of editors

Mütze, Michael, Dr.
Dr. Michael Mütze is partner at Mütze Korsch Rechtsanwaltsgesellschaft mbH. His area of practice include private construction, public procurement and real estate law. He has been specializing in these areas of law since becoming a lawyer in 1981 and so has long-standing experience in advising building companies, architects, civil engineers, project developers and investors.

Real estate transactions, commercial leases, public procurement, contracts on planning and construction, project development, project management and public-private partnerships (PPP) are the focal points of the Practice Group Real Estate which he manages at the Düsseldorf office of Mütze Korsch Rechtsanwaltsgesellschaft mbH.

Senff, Thomas, Dr.
Dr. Thomas Senff is partner at Mütze Korsch Rechtsanwaltsgesellschaft mbH. He is member of the real estate team which specializes in transfer of real estate, leasing, public procurement, planning and building contracts at the Düsseldorf office of Mütze Korsch Rechtsanwaltsgesellschaft mbH. He focuses on advising building companies, project developers, investors, architects and civil engineers. He has substantial practical experience in the field of construction and real estate law.

Möller, Jutta C., Dr.
Attorney at law in Düsseldorf, Germany – Senior Associate at Mütze Korsch Rechtsanwaltsgesellschaft mbH. Dr. Jutt C. Möller has long-standing experience in representing investors, developers and construction firms in major construction projects. Her areas of expertise include public law with a focus on zoning law and public procurement as well as PPP. Moreover, she regularly publishes and lectures on construction and public procurement law.

List of authors

Abel, Marcel, Certified Expert (Dipl.-Sachverständiger, DIA)
Associate Director and member of the management of the Düsseldorf branch of Jones Lang LaSalle International Real Estate Consulting GmbH.

He is working for Jones Lang LaSalle in Düsseldorf since 1999. His area of responsibility is the office letting, whereby his main focus lies with the acquisition, support and letting of major projects. Previously, he was managing the division industry letting at Jones Lang LaSalle in Düsseldorf. Further, he is a member of the appraiser committee for land value of the regional capital Düsseldorf since 2005.

Bovelett, Hans-Gert, Dr.
Dr. Hans-Gert Bovelett is partner at Mütze Korsch Rechtsanwaltsgesellschaft mbH. Since his admission to the bar he has specialized in construction and real estate law both as advisor as well as litigator. His practice focuses on contract law and on legal advice involving all facets of construction projects. In addition to his considerable seminar work Dr. Bovelett has been a lecturer in construction contract law at the University of Siegen for over 5 years.

Hohage, Uwe, Dr.
Tax Consultant and Attorney at Law in Düsseldorf, Germany - manager in the tax and legal department of PricewaterhouseCoopers AG. His areas of expertise include corporate restructuring and international tax. He provides tax and legal advice to large international companies and distribution companies, as well as to mid-sized businesses.

Hoth, Carsten, Dr.
Attorney at Law in the law firm of Mütze Korsch Rechtsanwaltsgesellschaft in Düsseldorf, Germany. He focuses on corporate finance. Moreover, he has an exquisite knowledge in the organisation of closed funds. He also advises companies and institutional investors in order to optimize their methods of financing legally and economically.

Kowalsky; Alexandra Asako
Attorney at Law in the law firm of Mütze Korsch Rechtsanwaltsgesellschaft in Düsseldorf, Germany. She focuses on advising companies and corporate groups – domestic and foreign- on the formation of companies and subsidiaries, the structuring of companies and M&A. She has substantial experience in advice on corporate and commercial law concerning limited companies and their shareholders. She has been working 4 years in the tax and legal group at PricewaterhouseCooper AG and has also gained experience in mainly international tax planning during that time.

Meyer-Hofmann, Bettina, Dr.
Attorney at law in Düsseldorf, Germany – partner in the law firm of Mütze Korsch Rechtsanwaltsgesellschaft mbH. Her practice focuses on real estate and public procurement law. Her clients includes major industrial companies investors, local authorities and hospitals. Dr. Meyer-Hofman has considerable experience in drafting and negotiation real estate contracts and in developing and realizing European public procurement procedures including their legal review.

Richrath, Borris, Dr.
Attorney at Law in Cologne, Germany - senior associate in the law firm of Mütze Korsch Rechtsanwaltsgesellschaft mbH. He works for the real estate law team. He is involved in major building projects as well as project development, management and realisation advising on all aspects of real estate law including architect´s/engineer´s law and commercial rent and leasehold.

Runte, René, Dr.
Attorney at law in Düsseldorf, Germany – senior associate in the law firm of Mütze Korsch Rechtsanwaltsgesellschaft mbH. He offers long term experience in construction and real estate law. His field of practice cover all aspects of real estate, starting with the planning stages, the construction, the acceptance and the time of warranty up to the transfer of property.

In addition to private construction law he has expert knowledge on architects and civil engineers law, public construction law and the law of apartment ownership.

Schnädter, Helmut, Dr.
Tax consultant and Attorney at Law in Düsseldorf, Germany - partner in the tax and legal department of PricewaterhouseCoopers AG. He has many years of experience in all areas of tax law, in particular in corporate taxation, working with both German and international clients, including French and English speaking companies and subsidiaries.

Wunderlich, Stefan, Dipl.-Wirtsch.-Ing.
Managing Director of HSG Technischer Service GmbH in Neu-Isenburg, the third largest FM firm in Germany with annual sales of more than 500 million Euros. HSG-group provides professional facility management services to a variety of well-known national und international clients and is a subsidiary of the Bilfinger Berger AG.

Abbreviations

AC	Appeal court
AG	Aktiengesellschaft
AGB	Allgemeine Geschäftsbedingungen
AGBG	AGB-Gesetz
AP	Award panel
approx.	approximately
ArbStättV	Arbeitsstättenverordnung
BauGB	Baugesetzbuch
BauNVO	Baunutzungsverordnung
BauO NRW	Bauordnung NRW
BauR	Baurecht
Bay ObLG	Bayerisches Oberstes Landesgericht
BBodSchG	Bundesbodenschutzgesetz
BetrKV	Betriebskostenverordnung
BFH	Bundesfinanzhof
BGB	Bürgerliches Gesetzbuch
BGH	Bundesgerichtshof
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
BMF	Bundesministerium der Finanzen
bn	Billion
BörsG	Börsengesetz
BStBl	Bundessteuerblatt
BVerfG	Bundesverfassungsgericht
BVerwG	Bundesverwaltungsgericht
BVerwGE	Entscheidung des Bundesverwaltungsgerichts
CC	Commercial Code
CL	Client
CO	Contructor
cf.	confer
CFM	Commercial Facility Management Services
CITA	Corporate Income Tax Act
DB	Der Betrieb (Zeitschrift)
DCF	discounted cash flow
DTT	Double Taxation Treaty
DVBl	Deutsches Verwaltungsblatt
e.g.	exempla gratia
EGBGB	Einführungsgesetz zum BGB

EnWG	Energiewirtschaftsgesetz
€	Euro
ErbbauVO	Verordnung über das Erbbaurecht
ErbbRVO	Erbbaurechtsverordnung
etc.	et cetera
EuGH	Europäischer Gerichtshof
EU	Europäische Union
FIDIC	International Federation of Consulting Engineers
FM	Facility Management
GAAP	Generally Accepted Accounting Principles
GBO	Grundbuchordnung
GbR	Gesellschaft bürgerlichen Rechts
GG	Grundgesetz
GmbH	Gesellschaft mit beschränkter Haftung
GMP contract	Guaranteed Maximum Price Contract
G-REIT	German Real Estate Investment Trust
GWB	Gesetz gegen Wettbewerbsbeschränkungen
HeizKV	Heizkostenverordnung
HGB	Handelsgesetzbuch
HOAI	Honorarordnung für Architekten und Ingenieure
i.e.	id est
IAS	International Accounting Standards
IBR	Immobilien- und Baurecht (Zeitschrift)
IDW	Institut der Wirtschaftsprüfer
IFM	Infrastructural Facility Management Services
IFRS	International Financial Reporting Standards
IMR	Zeitschrift für Immobilien, Miet- und Wohnungseigentumsrecht
ITA	Income Tax Act
KG	Kommanditgesellschaft
KGaA	Kommanditgesellschaft auf Aktien
KPIs	Key Performance Indicators
KWG	Kreditwesengesetz
LOI	Letter of Intent
LTA	Land Tax Act
m	Metre
m^2	square metre
MaBV	Makler- und Bauträgerverordnung
MBO	Musterbauordnung
Mio.	million
MRVerbG	Mietrechtsverbesserungsgesetz
NJW	Neue Juristische Wochenschrift
NJW	Neue Juristische Wochenzeitschrift
NJW-RR	NJW-Rechtsprechungs-Report
No.	Number
NV	nicht veröffentlicht

NVwZ	Neue Zeitschrift für Verwaltungsrecht
OHG	Offene Handelsgesellschaft
OLG	Oberlandesgericht
p.a.	per annum
para.	paragraph
PBefG	Personenbeförderungsgesetz
PE	Permanent Establishment
PFIs	Private Financial Initiatives
PPP/PPS	Private Public Partnerships
qtr	quarter
REIT	Real Estate Investment Trust
REITS	Real Estate Investment Trusts
RETT	Real Estate Transfer Tax
ROI	Return on Investment
s. e.	Suspensive effect
seq.	sequens
TFM	Technical Facility Management Services
TITA	Trade Income Tax Act
TKG	Telekommunikationsgesetz
VAT	Value Added Tax
VerkProspG	Verkaufsprospektgesetz
VgV	Verordnung über die Vergabe öffentlicher Aufträge
VOB/A	Verdingungsordnung für Bauleistungen Teil A
VOB/B	Verdingungsordnung für Bauleistungen Teil B
VOB/C	Verdingungsordnung für Bauleistungen Teil C
VOF	Verdingungsordnung für freiberufliche Leistungen
VOL/A	Verdingungsordnung für Leistungen Teil A
VÜA	Vergabeüberwachungsausschuss
VwGO	Verwaltungsgerichtsordnung
VwVfG	Verwaltungsverfahrensgesetz
WertR 2006	Wertermittlungsrichtlinien 2006
WertV	Wertermittlungsverordnung
WM	Wertpapier-Mitteilungen (Zeitschrift)
ZfBR	Zeitschrift für deutsches und internationales Baurecht

Chapter 1 Zoning Law

I. Introduction

In Germany a building permit is required to develop a project or refurbish an existing property after purchase. The requirements for obtaining a building permit are contained in building regulations. Each federal state has its own regulation. However, building regulations are standardized. Pursuant to these standard rules, every project which involves construction, change, change in use or structures being demolished must comply with the specifications of zoning law and building regulations.

This chapter will first deal with the requirements under zoning law. Zoning law covers so-called land-use planning and distinguishes two levels of detail: The first level is the land utilisation plan which is a preparatory land-use plan; the second level is the development plan which is the legally binding land-use plan. As a special type of land-use plan, is the project and property development plan "project and property development plan" *(Vorhaben- und Erschließungsplan)* which was introduced as a project-related development plan into the Federal Building Code as an amendment by the 1998 German Building and Regional Planning Act.

Zoning Law has the following objectives:

- Development and administrative function:
  Preparation and control of orderly urban development
- Co-ordination and integration function:
  Consideration of all aspects important for urban development in accordance with Section 1 paras. 5 to 7 BauGB,
- Determination of the content and restrictions of (land) ownership
- Principle of orderliness
  Principle: Urban development primarily controlled by land-use plans.

> **Practical advice:** As becomes obvious the functions of the land-use plan, the law seeks to prevent scattered and dispersed housing estates and the populating of the outlying areas.

Land-use planning is one of the major functions of local government. The purpose of this is that land-use planning not only gives the municipality the opportunity but also the obligation to control urban development in the area of the municipality. Therefore, the municipality can, within the framework of the law,

exercise its planning jurisdiction, which is a constitutional right pursuant to Section 28 (2) Federal Constitution (cf. Voß/Buntenboich, Das neue Baurecht in der Praxis, margin No. 80).

II. Land Utilisation Plan

The land utilisation plan *(Flächennutzungsplan)* is the comprehensive municipal development plan and relates to land usage in the area of a municipality. To this extent, it represents the internal administrative basis for urban development. The land utilisation plan contains the municipality's activities, projects and intentions for the area in both drawing and, where applicable, text form. The plan incorporates and co-ordinates higher-level plans relating to the municipality area, in particular regional and sectoral planning. Moreover, the function of the land utilisation plan is to determine higher-detail plans, i.e. the legally binding land-use plans. In order to ensure that the land utilisation plan is up to date, Section 5 para. 1 sentence 3 BauGB provides that it is reviewed and, if necessary, updated at intervals of 15 years.

Practical advice: In contrast to the development plan, the land utilisation plan is limited to outlining the main features of land usage. However, it does show exact boundaries. Therefore, only areas with the relevant details in text form are shown in the drawing section of the land utilisation plan.

1. Possible and Typical Stipulations in a Land Utilisation Plan

On the one hand, the land utilisation plan regulates its own scope of application. On the other, however, it also contains the specifications regarding the development of proposed areas, infrastructure and any other use of areas.

a) Possible Stipulations: Physical Scope of Application

As a rule, the land utilisation plan must apply to the entire area of the municipality. The following exceptions are possible:

- Utilisation plans for parts of the area:

  These are only permitted in the following cases:
  Substantive utilisation plans for parts of the area: Section 5 para. 2 lit. b BauGB; this standard was newly introduced into the Federal Building Code in 2004 and permits the preparation of such utilisation plans for parts of the area to show so-called concentration zones (legal consequences of Section 35 para. 3 sentence 3 BauGB).

- Parts of the municipal area may be excluded from the planning in accordance with Section 5 para. 1 sentence 2 BauGB.

Precondition: The main characteristics of the nature of land utilisation in the municipality may not be affected and planning for the areas in question is intended at a later date.

Practical advice: The possibility of removing parts of the municipal area from the plan permits individual areas to be left out of the planning stipulations without this affecting neighbouring areas and their use. As a result, the preparation of the land utilisation plan as a whole is not jeopardised by delays caused by difficulties with individual parcels of land within the land utilisation plan.

- Removal of physical areas or substantive parts of the land utilisation plan from the approval procedure.

  Where reasons for refusing approval for certain parts of the land utilisation plan in accordance with Section 6 para. 2 BauGB cannot be eliminated, it is possible to exclude areas of the land utilisation plan.

Example: Air pollution measurements have still to be conducted in a specific part of the municipal area, which could prevent the preparation of the land utilisation plan. The ability to remove parts of the land utilisation plan from the approval procedure may accelerate the preparation of the land utilisation plan for the remaining area.

- Advance approval of areas and substantive parts of the land utilisation plan in accordance with Section 6 para. 4 sentence 1 BauGB.

b) Typical Stipulations in a Land Utilisation Plan

According to Section 5 para. 1 sentence 1 BauGB, an important aspect of the land utilisation plan is the determination of the determination of the type of use of a municipality's area based on the intended urban development. Thus the land utilisation plan contains determinations and to this extent differs from the development plan which – as a by-law – makes legally binding stipulations. Section 5 para. 2 BauGB contains a list of possible determinations. This list can be divided into three sub-groups:

- areas designated for development (No. 1),
- public and private infrastructure (No. 2),
- other uses of areas (Nos. 3 to 10):
  - areas for certain types of transport (No. 3),
  - areas for public utilities and waste and sewage disposal (No. 4),
  - green areas (No. 5)
  - areas to which restrictions on use apply or areas designated for precautions against harmful environmental effects (No. 6),
  - water bodies and areas to be kept clear in the interest of flooding and drainage (No. 7),

- areas for earth deposits, excavations and the quarrying of minerals (No. 8),
- agricultural land and woodland (No. 9) as well as
- areas for measures to protect, conserve and develop the soil, nature and the landscape (No. 10).

Further detail on the determination of the areas designated for development in accordance with Section 5 para. 2 No. 1 BauGB is contained in the German Town Planning Regulations (BauNVO). Here, a difference is made in Section 1 para. 1 BauNVO between the following building areas which are all identified in the land utilisation plan by corresponding capital letters: residential building areas (W), mixed building areas (M), commercial building areas (G) or special building areas (S). Furthermore, a distinction is made in Section 1 para. 1 BauNVO between the areas designated according to the special nature of their building use: small estate areas (WS), purely residential areas (WR), general residential areas (WA), special residential areas (WB), mixed areas (MI), core areas (MK), commercial areas (GE), village areas (MF), industrial areas (GI) and special areas (SO).

If the land utilisation plan stipulates the general extent of use for building, it will in general contain:

- the floor-area ratio and
- the cubic index for building structures.

Practical advice: The above-mentioned abbreviations for the areas designated in the plan are essential to understand a land-use plan. Equally important are the drawing notations in accordance with the Ordinance on Drawing Notations (PlanZV). Land utilisation and development plans can be scarcely understood without knowledge of the abbreviations and the drawing descriptions according to this Ordinance.

The determinations provided in Section 5 para. 2 No. 2 BauGB on the public and private infrastructure, i.e. facilities for the provision of goods and services, relate to the so-called amenities serving the general public, e.g. schools, churches, buildings for similar purposes as well as sports areas and playgrounds.

Another large number of types of use are contained in Section 5 para. 2 Nos. 3 to 10 BauGB; the individual uses are listed above as keywords.

Practical advice: In Section 1 a para. 3, the Federal Building Code (*BauGB)* provides for the possibility of determining areas in the land utilisation plan as counterbalance areas, i.e. as areas to compensate for intrusions into or impact on nature and the landscape caused by the land-use plan. Moreover, according to Section 5 para. 1 lit. a BauGB, areas can also be assigned, in whole or in part, where such intrusion is to be expected. In the context of major building projects, the so-called compensation measures are an interesting option for the use of areas still undeveloped or to be developed in the near future.

The land utilisation plan may contain designations, subsequent amendments and notes as so-called other contents. These notes describe findings material to urban development which must be considered in the development planning.

2. Procedure to Establish and Challenge a Land Utilisation Plan

The formalised procedure for preparing plans is more or less the same for the land utilisation plan and the development plans. The only difference to be mentioned is that the procedure for the development plan is more detailed as this plan – in contrast to the land utilisation plan – must be passed as a local by-law. The individual procedural stages of the land-use plan are based on Section 2 et seq. BauGB. They can be shown as follows:

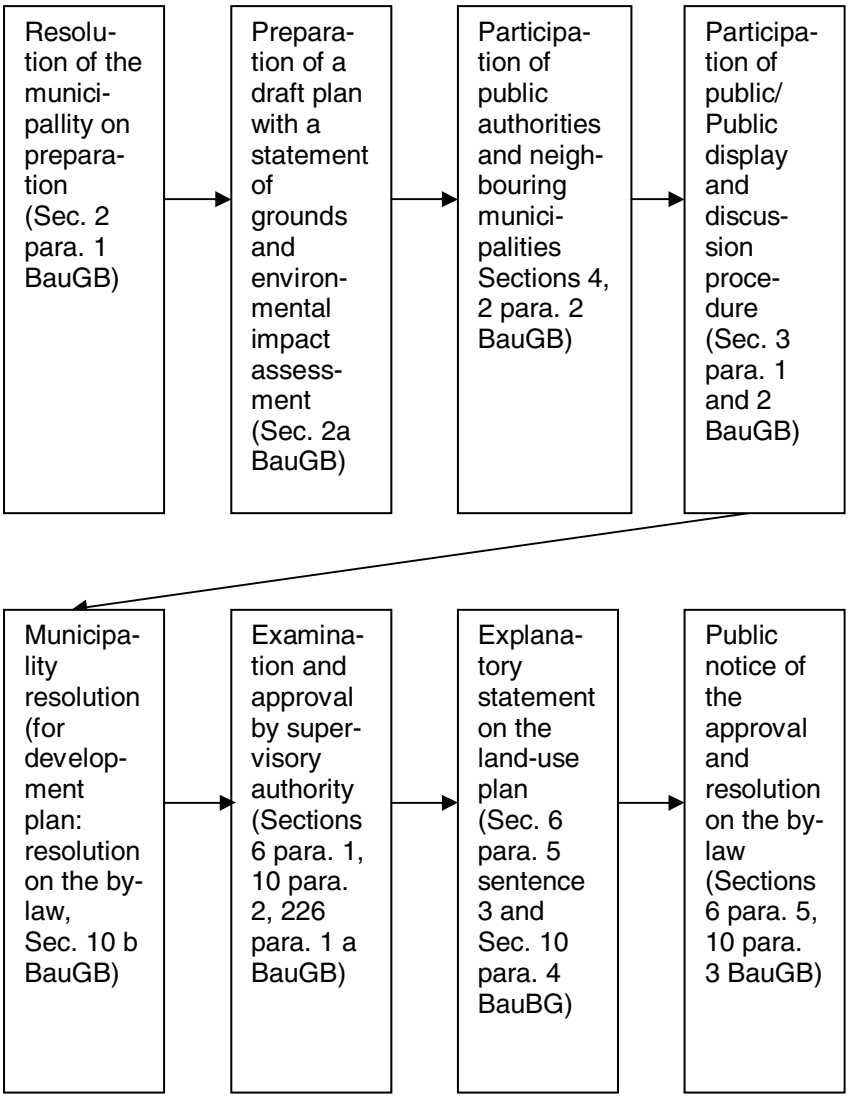


Figure 1. Procedural stages of the land-use plan

a) Resolution on the Preparation of a Plan

As a rule, the procedure for the land-use plan starts with the resolution by the municipality on the preparation of a land-use plan. The constitutional principals of due-process requires that the resolution on the preparation of the plan with sufficient clarity indicates for which physical area a procedure for land utilisation or development planning is to be initiated.

The resolution on preparation must be publicly announced in the manner customary in the municipality.

Practical advice: The resolution on the preparation of a plan is of major importance because it is the precondition for an amendment freeze (Section 14 BauGB), the postponement of building applications (Section 15 BauGB) and the advance permissibility of projects (§ 33 BauGB).

b) Draft Plan with Environmental Impact Assessment

Since 2004, an environmental impact assessment according to Section 2 para. 4 BauGB in conjunction with the Annex to the BauGB must be conducted as an integral part of the land-use plan procedure. The intention is to integrate the environmental considerations in the planning process. Probable environmental effects of the planning have to be determined, described and assessed. Section 1 para. 6 No. 7 BauGB sets out environmental requirements that may be taken into consideration at this stage.

This environmental impact assessment must, if possible, be taken regard of in the draft planning stage.

c) Participation Procedure

The draft land-use plan is prepared by the offices which, according to the internal distribution of functions, are responsible in the planning municipality. The draft plan must be accompanied by a statement setting out the underlying considerations. According to Section 2a sentence 2 No. 2 BauGB, the result of the environmental impact assessment is part of this statement; it includes the results of the environmental impact assessment according to Section 2 para. 4 BauGB.

d) Public Participation

The public participates in two different phases:

- 1st phase: Participation at an early stage (Section 3 para. 1 BauGB),
- 2nd phase: Formal disclosure of the draft land-use plans with the statement of setting out the underlying considerations (Section 3 para. 2 BauGB).

In this context, the public is defined as any natural or legal person who is affected or otherwise has an interest in the land-use plan. The necessary public notification comprises the objectives, effects and alternatives of the plan and must be made as early as possible, i.e. as soon as the plan is sufficiently detailed to be discussed. Participation frequently takes the form of a public hearing.

Formal disclosure of the land-use plan requires a public announcement, the details of which are based on Section 3 para. 2 sentence 2 BauGB and public display of the draft plan. In this way private interests are to be made known to the planning municipality. The draft plan has to be displayed for one month. The announcement of the display is intended to encourage the citizens to participate in the planning procedure and express their concerns and ideas.

Repeated display is required if the draft of the land utilisation or development plan has changed or been supplemented as a result of the suggestions received during the first display period. However, during the renewed display only the revised or supplemented parts of the draft plan may be objected to. The duration of the second display may be shortened and it is also possible to restrict those allowed to participate to a limited group of addressees affected by the amendments/ supplements (Section 4 a para. 3 sentences 2 to 4 BauGB).

e) Resolution by the Municipality

Public participation is followed by a resolution by the municipality. Here, a difference has to be made: A mere declaratory resolution of the local council is sufficient for the land utilisation plan whereas the development plan must be resolved as a local by-law in accordance with Section 10 para. 1 BauGB. The body which is responsible for the resolution is determined in accordance with local government law. As a rule, the city/town council will be responsible. It decides in a meeting open to the public. According to state regulations, council members must not participate in the passing of any resolution, including for local by-laws, if they are biased. If they do, the council resolution is null and void.

f) Examination and Approval by a Supervisory Authority

In principle, the land-use plan decided on by the municipality must be submitted to the higher administrative authority for examination (Sections 6, 10 para. 2, 246 para. 1 a BauGB). Examination and approval by a supervisory authority are performed in different ways for land utilisation plans and development plans. In either case comments not taken into account must be accompanied by a statement by the municipality (Section 3 para. 2 sentence 6 BauGB): Given the different legal nature of the land utilisation plan and the development plan, a distinction has to be made:

- Land utilisation plan

  According to Section 6 para. 1 BauGB, approval by the higher administrative authority is required for the land utilisation plan. Here, the approval procedure's sole purpose is to examine the legality of the plan (Section 6 para. 2 BauGB). The approval authority is not permitted to examine whether the land utilisation plan is suitable. As a result, approval may only be denied if the land utilisation plan was not prepared procedurally correct or is not in compliance with the legal provisions. The higher administrative authority must decide on approval within three months (Section 6 para. 4 sentence 1 BauGB). Unless approval is refused within this period and grounds are stated for this

refusal, approval is deemed to have been granted (Section 6 para. 4 sentence 4 BauGB). Approval must always be granted if the land utilisation plan is in compliance with laws.

- Development plan

  In view of the two-stage procedure for the land-use plan, the development plan generated from a land utilisation plan does not require approval from a supervisory body. There is one exception: Development plans mentioned in Section 8 para. 2 sentence 2, para. 3 sentence 2 and para. 4 BauGB, which have been prepared. Contrary to the so-called "order of development" (fundamentally two stages of the land-use plan: 1. land utilisation plan, 2. development plan), these development plans are prepared without a prior land utilisation plan. For this reason they require approval by the higher administrative authority.

g) Public Notice

After successful examination by the supervisory authority the land-use plan has been passed. The municipality is then obliged to put it into force and thus to complete the planning procedure. In accordance with Section 6 para. 5 BauGB, the land utilisation plan is put into force by publication by the municipality in the locally customary manner. The publication contains a note when and by whom the land utilisation plan has been approved. By contrast, the development plan must be promulgated since it is a municipal by-law. Section 10 para. 3 BauGB provides for a two-stage procedure for this purpose which stipulates the following steps:

- Final notice
- Provision of the development plan for examination.

h) Amendment/Supplement to or Revocation of Land-use Plans

If land-use plans are to be revised, supplemented or revoked, the previously described regulations for preparing the plan the first time must always be applied.

Practical advice: Section 13 BauGB provides for a simplified procedure according to which amendments and supplements to land-use plans of minor scope and importance permit a fast-track procedure. These amendment and supplement options according to Sections 1 et seq. BauGB must be distinguished from the so-called supplementary procedure pursuant to Section 214 para. 4 BauGB where any defects determined in land-use plans can be rectified.

III. Development Plan

Once the first stage of land use planning has been completed with the publicised land utilisation plan, the second stage commences with the preparation of the development plan *(Bebauungsplan)*. For details concerning the undeveloped land refer to the explanations in Chapter 3, sectione II.

The development plan therefore represents the second type of land use planning.

1. Responsibility to Prepare a Development Plan

The development plan is generally issued by the municipality as a by-law. The legality examination of development plans by the supervisory authority is only partly conducted in an approval procedure. The independent development plan (Section 8, para. 2, sentence 2 BauGB), which is developed in a parallel procedure in accordance with Section 8, para. 3, sentence 2 BauGB, and the advance development plan (Section 8, para. 4 BauGB) require such approval in accordance with Section 10, para. 2, sentence 1 BauGB.

2. Possible and Typical Stipulations in a Development Plan

There are various types of development plans which differ in their contents and in their dependence on a land utilisation plan as well as in the time when they are prepared. The following types of development plans deserve mention:

- the qualified development plan (Section 30, para. 1 BauGB);
- the non-qualified development plan (Section 30, para. 2 BauGB);
- the project-related development plan (Section 30, para. 2 BauGB);
- the development plan prepared from the land utilisation plan (Section 8, para. 2 BauGB);
- the development plan prepared in the parallel procedure (Section 8, para. 3, sentence 1 BauGB);
- the advance development plan (Section 8, para. 4, sentence 1 BauGB) and
- the independent development plan (Section 8, para. 2, sentence 2 BauGB).

The forms of development plan probably of interest in practice are the first three mentioned in the above list.

The contents of the first two forms of development plan, the qualified and the non-qualified development plans, differ.

The contents of development plans are characterised by three features: the stipulations, the designation of areas and the subsequent provisions.

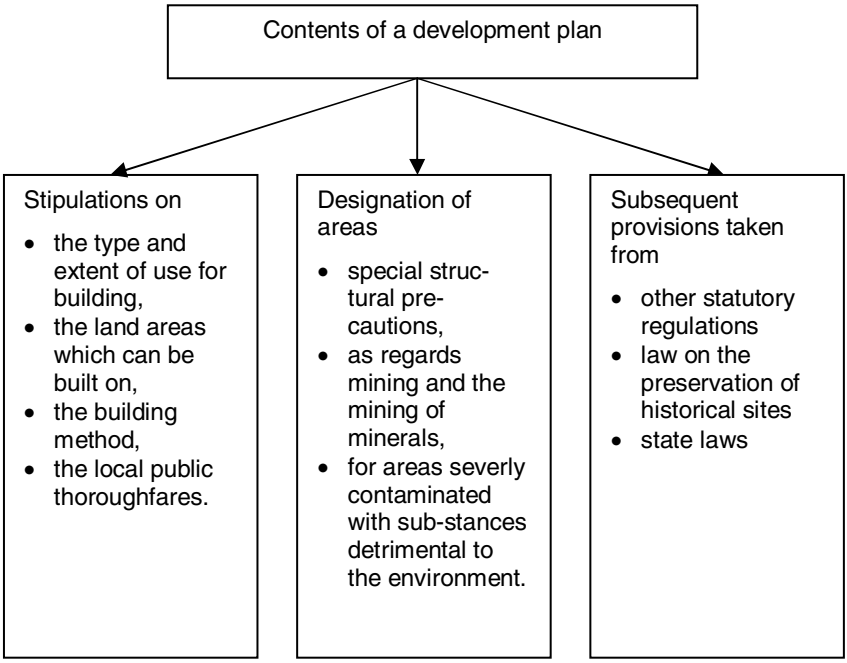


Figure 2. Contents of a development plan

The stipulations constitute the main contents of the development plan as they are legally binding on urban development in accordance with Section 8, para. 1, sentence 1 BauGB. The aim of the stipulations is to manage the use for building and other uses of the land in the planning area. They always have a specific reference to the local circumstances. In particular, they contain statements about the type and extent of use for building, the land areas that can be built on, the building method, the local public thoroughfares and other specific stipulations, for example on the areas designated for communal needs (sports and playing amenities, children's playgrounds, parking spaces, garages etc.).

As already mentioned, the types of development plan also differ as regards their contents. For example, a qualified development plan contains at least stipulations on the type and extent of use for building, the land areas that can be built on and the local public thoroughfares (Section 30, para. 1 BauGB). Building projects in the area covered by this type of development plan are admissible provided that they do not conflict with the stipulations of the development plan. As a result, the municipality can regulate a development in the planning area covered by this type of development plan with final effect.

In contrast to this type of plan, a non-qualified development plan does not contain the minimum requirements listed in Section 30, para. 1 BauGB. Thus a distinction between these types of plan is made on the basis of what one of them does not contain.

Practical advice: The non-qualified development plan is used, for example, when the location of a motorway is to be determined. However, it must be noted that owing to the insufficient stipulations of the non-qualified development plan, Section 34 BauGB is used as a supplementary criterion within a cohesive built-up district and Section 35 BauGB in outlying areas.

3. Public Measures to Secure a Development Plan

The crucial factor is that not only natural and legal persons but also authorities and other public institutions are bound by the specifications of the development plan. Authorities and public institutions may only deviate from the plan under the conditions laid down in Section 37 BauGB. Moreover, there are exceptions for the planning authorities mentioned in Section 38 BauGB.

Practical advice: Owing to its binding nature both for natural and legal persons and for the authorities and other public institutions (Sections 29, 30 BauGB), the development plan represents the normative criterion for the permissibility of projects in the planning area. To this extent, it is the basis for other measures necessary to achieve orderly urban development in the planning area.

4. Procedure for Establishing and Challenging a Development Plan

As the land utilisation plan and the development plan are prepared in accordance with more or less the same procedures, reference is made to the statements on the preparation of land use plans in section 2.2. of this chapter.

As far as the preparation of a development plan is concerned, this procedure normally starts in practice on the initiative of the municipality, after an appropriate application to the local council or planning committee but also in reaction to suggestions made by local residents. However, an inquiry by investors may also set the plan preparation procedure in motion (cf. Stüer, Der Bebauungsplan, p. 189). In response to this initiative, the local council then develops a possible concept for use for the areas to be covered by the plan.

The development plan may relate to only a single plot of land but as a rule it covers several plots of land.

As part of the notice of the resolution on the preparation of a plan, the municipality is obliged to give the planning area a brief designation (not only a number). The brief designation chosen is generally a reference to the local name of the area to be planned.

As part of the preparation of the draft plan, the municipality may also rely on the draft project submitted by the future developer for a major project which is to be implemented in the area covered by the plan. According to a ruling of the

Federal Administrative Court (BVerwG, ruling dated 28 August 1987 – 4 N 1.86 –, DVBl. 1987, p. 1273), the municipality's considerations are not flawed merely because the development plan comes from the investor. The development plan itself does not necessarily contain flawed considerations even if the municipality has not taken an independent decision on the need for alternative project drafts although government offices or municipal bodies involved have demanded such alternatives. However, these circumstances may, in certain cases indicate flawed considerations (Mannheim Higher Administrative Court, ruling dated 23 July 1998 – 3 S 960/97).

IV. Areas not covered by the Development Plan

Federal German law provides two possibilities for permitting development outside the areas covered by development plans by distinguishing the so-called interior zone and the so-called outlying area: Firstly, Section 34 BauGB provides for the possibility of a so-called "plan replacement" allowing development in the so-called unplanned interior zone in municipalities which have not yet prepared a development plan and where the preparation of the development plan is also not necessary. Secondly, Section 35 BauGB provides the possibility of developing the outlying area under strict preconditions stipulated in that Section.

1. Interior Zone

The question of whether a plot of land belongs to the interior zone or is to be viewed as land in the outlying area in accordance with Section 35 BauGB is highly relevant in practice as development of the outlying area is very restricted and it is on the other hand often possible to implement a construction project through the development of the unplanned interior zone (refer also to Stollmann, Öffentliches Baurecht, 2005, p. 162 et seq.).

In order to ascertain the permissibility of projects in the unplanned interior zone, the following requirements must be systematically examined in accordance with Section 34 BauGB:

- Firstly, it is crucial whether the project relates to built-up developed areas and whether Section 34 BauGB can be applied at all;
- Then it must be examined whether the municipality has made use of the possibility, in accordance with Section 34, para. 4 BauGB, and has designated, developed or supplemented the area of application of the undeveloped interior zone by means of a by-law. The by-laws referred to in Section 34 BauGB are BauGB instruments for drawing the boundaries between the interior zone and the outlying area in transitional locations of urban development (cf. Stollmann, Öffentliches Baurecht, p. 169 et seq.);
- Provided the nature of the immediate surroundings of the construction project corresponds to one of the building areas provided for in the BauNVO (Sections

2 to 9) the project must comply with this type of building area (Section 34 para.2 BauGB);
- The permissibility of development in the unplanned interior zone is finally to be examined in accordance with Section 34, para. 1, para. 3 and para. 3 a BauGB.

The development of an unplanned interior zone is therefore only to be considered if the project relates to cohesively developed districts but is outside the area covered by a qualified or project-related development plan. The criterion of a district presupposes a complex development of a certain significance, also in terms of numbers, in the sense of an organic housing estate structure (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 223). The aim of the law is to ensure a clear differentiation from the so-called dispersed housing estates or merely scattered developments.

Development cohesion exists when the area is being successively developed and the whole development gives the impression of being a closed unit (cohesion) even though there still may be some gaps between the buildings. For example, the Federal Administrative Court has ruled that gaps between the buildings due to building hindrances do not necessarily conflict with the assumption of cohesive development (BVerwGE 31, 20 et seq.).

Practical advice: The argument that the land to be developed is located in a non-qualified or non-project-related interior zone may often be crucial for permissibility of the development. It is worthwhile examining the numerous rulings on the delimitation of cohesive development for the case in question. For example, even building structures which are no longer used for the original purpose and which are therefore no longer grandfathered are taken into account in the assessment of development cohesion (BVerwG, NVwZ 2003, p. 211).

Provided the above-mentioned physical scope of application is opened up, by-laws enacted in accordance with Section 34, para. 4 BauGB permit certain areas which would otherwise belong to the outlying area to be designated as land that can be developed in the interior zone. These by-laws are therefore often also termed "small development plans".

Practical advice: The possibility of creating building rights by enacting the by-laws in accordance with Section 34, paras 4 to 6 BauGB may be of interest to investors. In contrast to development plans, the by-laws need not be developed from the land utilisation plan (in the case of a supplement).

The law provides for the following by-laws:

- Delimitation by-law pursuant to Section 34, para. 4, sentence 1, No. 1 BauGB which is used exclusively for the determination of the boundary between the outlying area and the interior zone (cf. Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 229);

- Development by-law pursuant to Section 34, para. 4, sentence 1, No. 2 BauGB which permits the designation of developed areas in the outlying area as built-up districts which have been developed cohesively pursuant to Section 34 BauGB;
- Supplementary by-law pursuant to Section 34, para. 4, sentence 1, No. 3 BauGB according to which individual areas of the outlying area can be incorporated into the areas which have been developed cohesively. However, a precondition for this is that these areas are suitably characterised by the nature of the use of the buildings in the adjoining area.

If no by-law has been passed, it is necessary for the permissibility of a project in the interior zone in accordance with Section 34, para. 1 BauGB that

- the project blends in with the characteristic features of the immediate surroundings,
- the public infrastructure has been secured,
- the requirements placed on healthy living and working conditions are met and
- the overall appearance of the locality is not impaired.

The provisions of Section 34, para. 1, sentence 1 BauGB provide for a project to be permissible if it blends in with the characteristic features of the immediate surroundings in terms of the type and scope of use for building, the building method and the land area which is to be built on. Court rulings have also established that the principle of "blending in" is always satisfied if the project remains within the framework characterised by the development of its surrounding area in every respect (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 224). Furthermore, reference is made to the term "blending in" within the framework of the principle of “showing consideration for others” *(Rücksicht-nahmegebot)*. The project must show the necessary consideration for the immediate surroundings (BVerwG, ZfBR 2002, 69; BVerwG, BauR 2002, p. 1827).

In a de facto building area which falls within one of the categories of the German Town Planning Regulations (BauNVO), the permissibility of the project must be assessed according to whether it would be regarded as permissible in the building area if these regulations were applied (Oehmen/Bönker, Einführung in das öffentliche Baurecht, margin No. 280). Provided that the immediate surroundings of the building project cannot be assigned to one or several buildings areas according to the German Town Planning Regulations, the permissibility examination according to Section 34, para. 1 BauGB applies.

Practical advice: On the basis of the *Europarechtanpassungsgesetz Bau 2004*, an amendment to the Federal Building Code to bring it in line with European law, introduced a new Section 34, para. 3 BauGB was introduced, which also permits major projects without a development plan. However, no detrimental consequences on the central shopping areas in the municipality or other municipalities must be expected from these major projects (exclusion of so-called long-range negative effects).

The requirement not to impair the characteristic features of the locality relates to the urban development effects of a project. Here, a larger area than the "immediate surroundings" is to be considered (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 225). This precondition will, however, rarely be an obstacle to the permissibility of a project in the unplanned interior zone. According to rulings of the Federal Administrative Court, the features of a locality are worthy of protection if they cannot be found anywhere else and a special character is assigned to them (BVerwG, NVwZ 2000, p. 1169, 1170).

Section 34, para. 3a BauGB is designed to allow concessions to be made above all for small-sized commercial or trade enterprises which already exist and which, for example, are planning extensions or renovations. Therefore, with this provision the law created a possibility of deviating from the requirement of "blending in". Implementation of the measures is made easier as in these cases the need to prepare a (project-related) development plan may be dispensed with.

2. Outlying area

The Federal Building Code does not contain a positive definition of the outlying area but a negative definition in that these are areas which are not covered by the scope of application of a development plan or situated in the built-up interior zone. The purpose of the law is to protect the outlying area against development as far as possible. The outlying area is to be retained particularly because of its importance for nature, the given use of the soil and as a recreation area for the general public (Stollmann, Öffentliches Baurecht, p. 184).

The first thing is to determine whether the project is located in the outlying area at all and whether Section 35 BauGB therefore applies. In the next step, a distinction must be made between the following categories when determining the permissibility of a project:

- privileged projects pursuant to Section 35, para. 1 BauGB
- permissibility of other projects in accordance with Section 35, para. 2, sentence 5 BauGB
- so-called "partially privileged projects" pursuant to Section 25, para. 4 BauGB.

In Section 35, para. 1 BauGB, the statute contains an exhaustive list of projects which are always in the outlying area. These include:

- projects which serve forestry or agricultural activities (Section 35, para. 1, No. 1 BauGB) or
- projects which serve market gardening purposes (Section 35, para. 1, No. 2 BauGB)
- are only possible at this location (Section 35, para. 1, No. 3 BauGB) or
- are only to be carried out in the outlying area because of their requirements, effects or special function (Section 35, para. 1, No. 4 BauGB),
- are intended for research, development or use of wind/water energy (Section 35, para. 1, No. 5 BauGB)

- are intended for the production of biomass to produce energy as part of certain forms of business operations (Section 35, para. 1, No. 6 BauGB) or
- are intended for nuclear energy uses (Section 35, para. 1, No. 7 BauGB).

These privileged projects are permissible if they do not conflict with public interests, adequate public infrastructure does or will exist and the project does not conflict with the stipulations of a non-qualified development plan.

All other projects, i.e. those which are not covered by Section 35, para. 1 BauGB, are permissible only if they in no way negatively impact on public interests. Therefore, it is much more difficult to get such projects according to Section 35, para. 2 BauGB through than privileged projects pursuant to Section 35, para. 1 BauGB. However, the applicant has a legal entitlement to be given permission for his project if the actual preconditions exist. To this extent, the formulation that other projects may be permitted in individual cases does not mean the approval authority is granted any discretion (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 240).

The public interests which the projects according to Section 35, para. 1 BauGB must not conflict with and which must not be negatively affected by other projects in accordance with Section 35, para. 2 BauGB are listed in Section 35, para. 3, sentence 1 BauGB. According to this list, which is not, however, exhaustive, a conflict with public interests exists when a development project:

- contravenes the representations of a land utilisation plan (No. 1),
- contravenes the representations of a landscape plan or other environmental protection plans (No. 2),
- may give rise to harmful environmental impacts (No. 3),
- requires an inappropriate level of expenditure on transport and other infrastructure facilities (No. 4),
- is in conflict with nature conservation, protection of topsoil, sites of historical interest, preservation of the countryside, or detracts from the character of the locality and the landscape (No. 5),
- conflicts with measures to improve the agricultural structure or represents a danger to water supply and distribution (Nr. 6),
- provides reason to suppose it may lead to the creation, consolidation or expansion of dispersed housing estates (No. 7) or
- disturbs the functional operation of radio and radar installations (No. 8).

In addition to the public interests contained in this list, a recent ruling of the Federal Administrative Court has stated that the so-called planning requirement is another substantial public interest (BVerwG, BauR 2003, p. 55). An applicant may fail to obtain permission for an outlying area project if the project triggers a need for co-ordination which can only be accommodated if the project is considered as part of a formal plan (cf. Erbguth, NVwZ 2000, p. 969). The court ruling largely applies to the scope of the project. The crucial factor is how the project blends in with the existing surroundings in terms of its substance and its effects.

The so-called privileged or "partially privileged" projects pursuant to Section 35, para. 4 BauGB cover projects where certain public interests mentioned in

Section 35, para. 3 BauGB cannot result in their being inadmissible. These projects are therefore also permissible even if they

- contravene the representations of the land utilisation plan,
- contravene the representations of a landscape plan,
- detract from the natural character of the landscape or
- raise concern about the creation, consolidation or expansion of dispersed housing estates.

All other public interests mentioned in Section 35, para. 3 BauGB still lead to a rejection of the project.

The privileged or "partially privileged" projects in Section 35, para. 4 BauGB comprise:

- a change in the use of a building which serves forestry or agricultural activities,
- the rebuilding of a permitted building of the same type at the same place which was destroyed by fire, acts of God or other extraordinary circumstances,
- the extension of a residential building by up to max. 2 apartments,
- the structural extension of a permissibly erected commercial building if the extension is reasonable in relation to the existing building and activities (cf. Oehmen/Bönker, Einführung in das öffentliche Baurecht, margin No. 312 et seq.).

Section 35, para. 2 BauGB clarifies that other projects may only be permitted if the existence of public infrastructure is provided for. However, it must be remembered that the requirements placed on the existence of infrastructure facilities are somewhat higher in the case of Section 35, para. 2 BauGB than in the case of the privileged projects pursuant to Section 35, para. 1 BauGB (cf. Stollmann, Öffentliches Baurecht, p. 194).

The municipality can issue a by-law for a developed area in the outlying area by means of an outlying area by-law in accordance with Section 35, para. 6 BauGB. This developed area may, however, not be characterised by predominantly agricultural use and must have a significant amount of residential development. The crucial factor is that, in accordance with Section 35, para. 6, sentence 4, No. 1 to 3 BauGB, the by-law must also be compatible with the preconditions mentioned there, in particular orderly urban development. This means that Section 35, para. 6 BauGB does not form the basis for the granting of a building permit if it otherwise did not exist (Stollmann, Öffentliches Baurecht, page 207).

In particular in the context of outlying areas, the legal concept of grandfathering may become relevant. Here, grandfathering is understood to mean, as a consequence of the constitutional right of freedom of ownership (Article 14, para. 1, sentence 1 of the Basic Law (GG)), the protection of approved uses against later changes in the law (Oehmen/ Bönker, Einführung in das öffentliche Baurecht, margin No. 319). However, it must be noted that a project which does not satisfy the requirements of Sections 34 and 35 BauGB cannot also be covered by grandfathering, either.

Practical advice: Grandfathering is often used as an argument of last resort for the approval of projects in the unplanned interior zone or in the outlying area. However, it must be noted here that court rulings on grandfathering are highly restrictive, particularly to prevent circumvention of the provisions in Sections 34 and 35 BauGB.

V. Other Public Zoning Plans

Other planning instruments which deserve mention are the possibility of the project-related development plan based on general urban planning legislation (Sections 1 to 135 c BauGB) and the instruments for implementing urban redevelopment projects based on special urban planning legislation (Sections 136 to 151 BauGB), which replace the general provisions according to the principle of speciality. This also includes the preparation of a development plan.

1. Urban Development Plan

Redevelopment law according to Sections 136 to 164 BauGB serves to offer the municipalities the possibility of eliminating urban planning anomalies for individual areas.

Section 140 BauGB provides a list of activities for preparation of urban redevelopment measures. Those worth mentioning are preparatory investigations (No. 1), the formal designation of the redevelopment area (No. 2), determination of the aims and purposes of the redevelopment (No. 3), the necessary building plans (No. 4) and discussion of the proposed redevelopment (No. 5).

The redevelopment measures can be performed after the preparations. As a further measure, Section 166, para. 1, sentence 2 provides for the preparation of a development plan. These development plans, which are used for urban redevelopment measures, represent a special regulation in relation to the general urban planning instruments and therefore take precedence over them. Thus, attention must be paid to the measures for the performance of the redevelopment work which the local authorities have already planned in the redevelopment areas.

2. Project and Infrastructure Development Plan

The planning-law instrument of the project-related development plan according to Section 12 BauGB is of great interest, especially for investors (referred to as "project developers" *(Vorhabenträger)* in the Federal Building Code). The project-related development plan is designed to facilitate and speed up planning through close co-operation between municipalities and private investors (Oehmen/Bönker, Einführung in das öffentliche Baurecht, p. 12). This is a special development plan

to which the material provisions and those provisions regulating procedure in Section 1 et seq. BauGB apply in addition to the special preconditions in accordance with Section 12 BauGB and to all other development plans.

The project-related development plan is used for specific building projects, including large-scale projects, and mainly comprises three elements:

- the project and infrastructure development plan,
- on the basis of which a municipality by-law is passed.
- A so-called performance contract then links the project and infrastructure development plan to the by-law by establishing mutual rights and obligations and, in addition, ensuring prompt implementation of the building project by setting performance deadlines (cf. Erbguth/Wagner. Grundzüge des öffentlichen Baurechts, p. 170).

First of all, the investor prepares a project and infrastructure development plan on his own responsibility and at his own expense. For this purpose, he commissions a planning or architect's office which drafts a plan in close consultation with the municipality. This project and infrastructure development plan then becomes the subject of the project-related development plan on the basis of the resolution of the municipality. However, the crucial factor is that the project and infrastructure development plan should only have contents which are comparable with those of a development plan. The plan may therefore rely on the provisions of the German Town Planning Regulations. This is, however, not mandatory owing to the provisions in Section 30, para. 2 BauGB embracing the project-related development plan according to Section 12 BauGB.

Practical advice: The project developer (investor) is also required to be either the owner or at least someone entitled to dispose of the plots of land for which he has prepared plans. The municipalities require documents, for example the latest land register extracts, to prove his entitlement to dispose of all plots of land in the planning area. Furthermore, the municipality often requires evidence of the project developer's financial standing.

On the basis of the project and infrastructure development plan, the municipality, as the holder of planning sovereignty, then passes the project-related development plan as a by-law within the meaning of Section 10, para. 1 BauGB. This project-related development plan gives the investor the building right for his project (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 173).

The third element of the project-related development plan, the performance contract, is an urban development contract (cf. see Chapter 1, section 6.2.2). This contract connects the project-related development plan passed as a by-law with the project and infrastructure development plan. In the performance contract, the investor undertakes vis-à-vis the municipality to implement the project he is planning within a certain period. Moreover, he bears the planning and infrastructure development costs in whole or in part in accordance with Section 12, para. 1, sentence 1 BauGB. Furthermore, details on the implementation and

realisation of the project can also be laid down; in some cases, performance deadlines are agreed. The municipality undertakes, in return, to enact the by-law.

Practical advice: The municipality's obligation laid down in the performance contract to perform the by-law procedure and therefore to produce the project-related development plan is not the same as the municipality's obligation to take over the contents of the project and infrastructure development plan submitted by the investor. However, the municipality may make itself liable for damages. For this reason, the performance contract is concluded as shortly as possible before the issuing of the project-related development plan.

The procedure comprises the following steps.

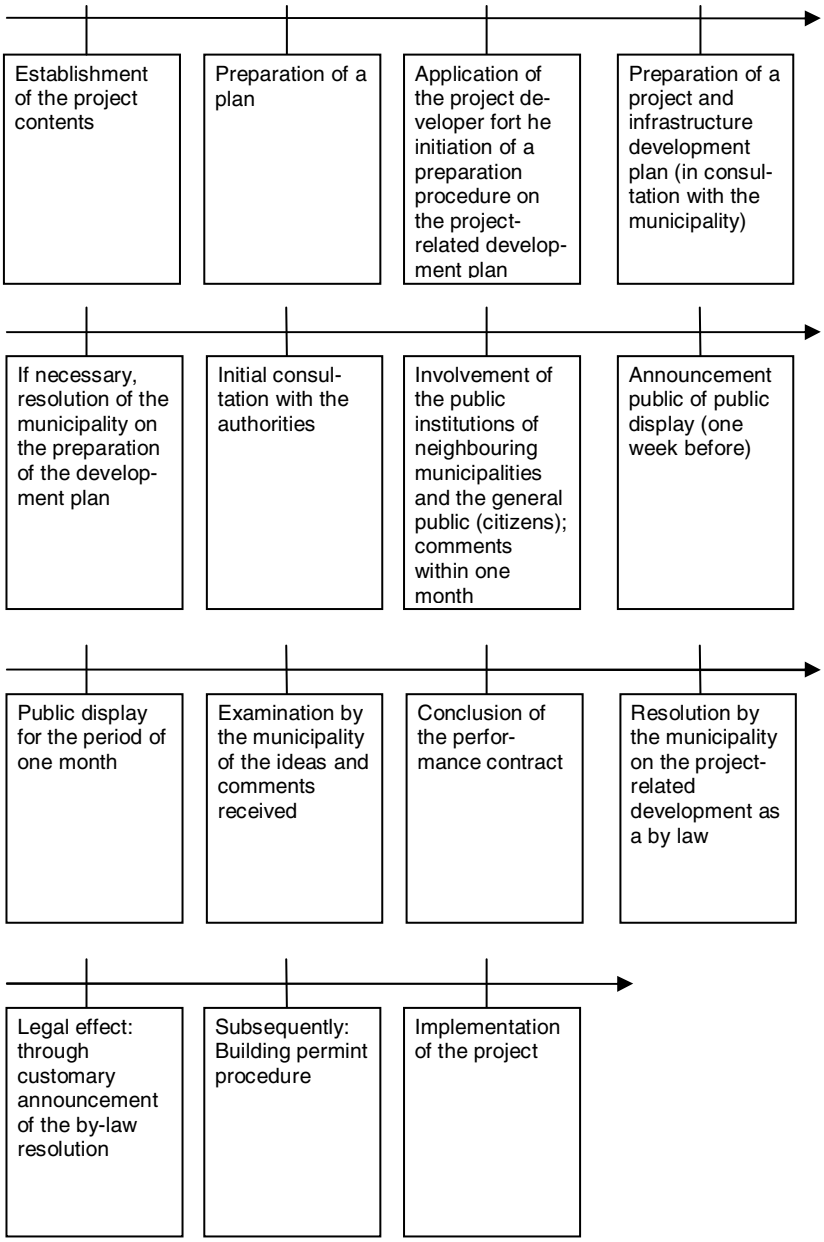


Figure 3. Procedure

Individual steps in the procedure illustrated above may overlap time-wise or be implemented at the same time.

VI. Public Law Contracts in Zoning Law

Zoning law is not solely dominated by unilateral sovereign measures. Section 11 BauGB and Section 124 BauGB grant the municipality the power to conclude urban development contracts. These are becoming increasingly important in the light of an increasing trend of privatisation and the local authorities' urgent need for cash.

1. What is a Public Law Contract?

In principle, German administrative law is governed by a superior/subordinate relationship between an authority and a citizen. Accordingly, the rule is that the authority unilaterally passes measures, so-called administrative acts, vis-à-vis the citizen which the latter then has to observe. Public law contracts are the exception to this principle in that they create a situation where citizens and authorities have equal rights and conclude agreements like private persons. The instruments of the public law contract are regulated in Section 54 VwVfG. Section 11 BauGB represents a special case in relation to this regulation and empowers the municipality to conclude urban development contracts (Oehmen/Bönker, Einführung in das Öffentliche Baurecht, p. 112). Section 11, para. 1 BauGB contains a list of suitable subjects for urban development contracts whereas paragraphs 2 to 4 standardise form requirements which are to be placed on the urban development contract.

2. Types of Public Law Contracts and Typical Provisions

The types of contract described in Section 11, para. 1 BauGB are merely a list of examples which is by no means exhaustive. Urban development contracts are permissible for the entire scope of application of urban development law provided the contents regulated in the contract are relevant to land law (Stüer, Der Bebauungsplan, p. 432).

a) Agreement to Set Up a Plan

According to the provisions of the Federal Building Code, it is possible to conclude a public law contract on the provision of local public infrastructure. According to Sections 123 to 135 BauGB, the provision of local public infrastructure for a plot of land means the measures necessary for a socially compatible use of built-up areas, for example the provision of

- local, public roads, paths and spaces,
- green spaces,
- playgrounds,
- parking spaces for motor vehicles,
- plants and facilities for the public supply of water and energy,
- sewage treatment plants and
- protection against detrimental weather influences (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 205 et seq.).

These infrastructure facilities under urban development law therefore do not cover the necessary measures on the building land itself and the supra-regional infrastructure facilities. The so-called "development measures" *(Erschließungsmaßnahmen)* for municipal amenities (schools, nursery schools, hospitals, swimming pools etc.) are also not covered by the provision of local public infrastructure under urban development law.

The infrastructure contract is regulated in Section 124 BauGB and supplemented by the provisions of Section 11 BauGB. It grants the municipality the power to delegate by contract the provision of infrastructure to a third party. A full infrastructure contract is characterised in that an enterprise of the municipality undertakes the provision of the infrastructure of a certain area in its own name and for its own account and transfers the complete infrastructure facilities to the municipality (Saarlouis Higher Administrative Court, ruling dated 7 November 1988; file No.: 1 R 322/87). By contrast, with a pre-financing contract the municipality undertakes the provision of infrastructure itself or awards a corresponding contract. The investor merely pre-finances the costs of the municipality necessary for the performance of the infrastructure measures. The municipality reimburses these costs to the enterprise after levying the recoupment charges in accordance with the contract (Oehmen/Bönker, Einführung in das öffentliche Baurecht, p. 114).

The infrastructure contract serves to guarantee the provision of the infrastructure of the plots of land. However, it is a matter in each individual case to determine which measures the parties lay down for this purpose. The contractually stipulated work must, in accordance with Section 124, para. 3 BauGB, always be objectively related to the infrastructure and be commensurate with the circumstances. According to 124, para. 2, sentence 1 BauGB, the subject matter of an infrastructure plan may be infrastructure installations within a certain area of the municipality designated for infrastructure improvement irrespective of whether they qualify under federal or state law for the collection of recoupment charges.However, the infrastructure contract must be limited geographically to a certain building area or objectively to a certain type of infrastructure installation (Battis/Krautzberger/Löhr, Kommentar zum BauGB, Section 124, margin No. 5).

Practical advice: The crucial feature of an infrastructure contract, however, is always the assumption of the infrastructure costs by the developer. The term infrastructure costs in Section 124, para. 2, sentence 2 BauGB makes clear that this also means those costs which exceed the local public infrastructure expenditure according to Section 128 BauGB. Moreover, paragraph 2, sentence 3 of this Section stipulates that Section 129, para. 1, sentence 3 BauGB, according to which the municipalities have to bear at least 10% of the legitimate infrastructure expenditure, must not be applied.

b) Agreement to Implement the Plan

The performance contract, which is based on Section 11, para. 1, sentence 2, No. 1 BauGB, is of practical importance. The subject matter of such a contract is always the preparation or implementation of urban development measures by the municipality's contract partner at its own expense. According to No. 1, these include the re-ordering of land boundaries, soil remediation and other preparatory measures, the drawing-up of the urban development plans and, if necessary, the environmental impact assessment. As already outlined in connection with the project-related development plan (Chapter 1, section 5.2), the responsibility of the municipality for the statutory plan preparation procedure remains unaffected. Only the technical preparation of the urban development plans is transferred to third parties. If the subject matter of the urban development contract is the re-ordering of the land boundaries , the contract replaces the provisions of the statutory reallocation procedure and the statutory boundary regulations (Stüer, Der Bebauungsplan, p. 437).

If the contract relates to urban development planning, land utilisation plans, development plans and other urban development by-laws can be drawn up on the basis of this contract. The preparation of environmental impact assessments, noise abatement expertises, pollution control expertises or other specialised reports can be transferred to a private third party through the performance contract.

Practical advice: According to Section 11, para. 2, sentence 2, No. 1 BauGB, an agreement can also be reached in which the municipality's contract partner can assume all the costs.

c) Cost-sharing Agreement

Apart from the above types of contract which can always include a cost arrangement stating that one of the contracting parties has to pay the costs relating to the agreed subject matter of the contract, either in whole or in part, the municipality and the other contracting party can conclude urban development contracts which solely regulate the assumption of costs or other expenses. According to Section 11, para. 1, No. 3 BauGB, such costs may be those which the municipality incurs or has incurred for urban development measures and represent a precondition or consequence of the planned project.

In this context, the assumption of costs, above all infrastructure costs, can be stipulated. Such costs comprise in particular costs and expenses which the municipality incurs for urban development measures as well as installations and facilities which serve the general public (Stüer, Der Bebauungsplan, p. 440). Examples which deserve mention are the erection of schools, nursery schools, sewage treatment plants or other municipal facilities.

Practical advice: The precondition for such contractual regulations is, however, that the infrastructure measure resulting in the costs is directly related to the building project. An agreement to assume costs which are not incurred as a result of the project is, by contrast, not permitted (BVerwG, ruling dated 14 August 1992; file No. 8 C 19/90).

3. Legal Requirements for Public Law Contracts

Urban development contracts are subject to certain requirements. As these are public law contracts within the meaning of Section 54 VwVfG, the provisions of Sections 54 to 61 VwVfG can be applied. In accordance with Section 62 VwVfG, also the other provisions of the Administrative Procedure Law and, mutatis mutandis, the German Civil Code can be applicable.

In contrast to the provisions of civil law, the most important provisions of the German Administrative Procedure Law with their special statutory nature have, however, already been incorporated into Section 11 BauGB. In terms of civil law, the provisions on agency and authority (Section 164 et seq. BGB) as well as on the capacity to enter into legal transactions and file declarations of intent (Sections 104 et seq. and 116 et seq. BGB) (Kopp/Ramsauer, Kommentar zum VwVfG, Section 62, margin No. 12) must be observed. Section 59 VwVfG contains the circumstances which lead to the invalidity of a public law contract. These include above all the non-observance of the written form which Section 11, para. 3 BauGB stipulates for the urban development contract and Section 124, para. 4 BauGB for the infrastructure plan. In accordance with Section 59, para. 1 VwVfG in conjunction with Section 125 BGB, this shortcoming results in the invalidity of the contract.

Furthermore, in accordance with Section 11, para. 2 BauGB, the agreed work must be commensurate with the overall circumstances. An exchange is appropriate if it satisfies the principle of commensurability and was individually negotiated between the parties. Consequently, the contractual arrangement must not be the result of a structural imbalance between the municipality and the other contracting party and the economic exchange must be appropriate. Various guidelines of the German legislators can be used to determine the commensurability of individual cases, e.g. the statutory provisions of building law.

Chapter 2 Building Regulations

I. The Requirement to Obtain a Building Permit

In Germany the erection, alteration, change in use and demolition of a building structure always requires a building permit in accordance with state building regulations. These fall under the jurisdiction of the German states, each of which has issued its own state building regulations. However, in order to standardise the building regulations, the working group of the state ministries responsible for building, housing and residential estates (ARGEBAU) has issued specimen building regulations (MBO), which the federal states have largely adopted. The state building regulations regulate the issuing of building permits in the following provisions:

Specimen building regulations	Sections 72, 63, 64
Baden-Württemberg	Section 58 in conj. with Sections 17 LBOVVO
Bavaria	Sections 72, 73
Berlin	Sections 62, 40 a
Brandenburg	Sections 68, 57, 70 para. 1
Bremen	Sections 74, 67
Hamburg	Section 69 in conj. with Section 1 HmbWoBauErlG
Hesse	Sections 64, 57, 58
Mecklenburg-Western Pomerania	Sections 72, 63
Lower Saxony	Sections 75, 75 a
North Rhine-Westphalia	Sections 75, 68
Rhineland Palatinate	Sections 70, 66
Saarland	Sections 77, 67
Saxony	Sections 70, 62 a
Saxony-Anhalt	Sections 77, 67
Schleswig-Holstein	Sections 78, 75
Thuringia	Sections 70, 62 a

A building permit contains the declaration of the building control authority that the building project does not conflict with the provisions of public law. Moreover, it permits the developer to implement the building project and "releases the project for construction". If the statutory requirements have been met, the developer has a

right to the building permit. The permit is not valid for an indefinite period but expires within a period of one to four years, depending on the regulations of the particular state, unless work has started on the implementation of the project.

1. "Projects" Requiring a Building Permit

The requirement to have a building permit relates exclusively to building structures. The term 'building structures' is legally defined in Section 2 para. 1 of the state building regulations. According to this definition, building structures are installations joined to the ground and made of building products. According to these regulations, a connection to the ground also exists if the installation rests on the ground by virtue of its own weight (Reichel/Schulte, Handbuch Bauordnungsrecht, p. 153). The term 'structure' is vague, not very informative and can lead to delimitation difficulties. For example, when determining the contents of this definition, the objective and purpose of the building regulations in particular must be taken into account. Their objective is to regulate typical dangers which may stem from building structures and may have social or cultural consequences or an impact on urban development.

To avoid any uncertainty, the state building regulations list installations which are to be regarded as building structures within the meaning of this law, regardless of their actual material nature.

2. Exceptions to the General Rule

Accordingly, the developer always needs a building permit for the erection, alteration, change in use and demolition of building structures. In view of the fact that the building permit procedure sometimes takes a very long time, all state building regulations do, however, provide for fast-track procedures in certain cases. Some projects therefore only require a notification or exemption procedure or merely a simplified permit procedure whereas other projects do not require a building permit at all. However, all this simply makes the procedures easier by dispensing with or simplifying the building permit procedure and does not mean that the building project does not have to comply with the requirements of substantive building law. The projects which can be handled using simplified procedures have to comply with the provisions of zoning law and building regulations just as projects generally requiring a permit do. The following procedural simplifications are provided for in the building regulations:

- A notification or exemption procedure provided for in the state building regulations covers projects which provide for the erection or alteration of residential buildings of low and sometimes medium height. In most state building regulations, the provision of parking spaces, garages and other building annexes is covered by this privileged status.

- Most state building regulations also provide for the so-called simplified permit procedure, also intended to speed up the building work. This is designed for residential building projects which do not fall under the notification and exemption procedure, agricultural buildings and other single-storey buildings.
- Finally, all state building regulations provide for permit-free projects. These are projects of minor structural significance, for example, awnings and patios as well as parking spaces without roofs and buildings up to a certain size without habitable rooms.

II. Laws and Regulations the Project Must Comply with

As can be seen from the wording of the state building regulations, a building permit must be granted if the building project does not contravene any public law regulations. The yardstick here is all public law regulations containing requirements on buildings and other building structures. These include:

- the provisions of zoning law,
- the respective state building regulations,
- all other public law regulations for which no special permit procedure has to be conducted, in particular regulations relating to nature conservation, the protection of historical sites, air and water pollution control.

1. Zoning Law

The question of whether a plot of land may in principle be built on depends on zoning law. The urban development permissibility of a building project is derived from Sections 29 to 38 BauGB and depends on the planning area in which the area to be developed is situated. The Federal Building Code contains three different areas:

- the scope of application of a qualified (Section 30, para. 1 BauGB) or a project-related (Section 30, para. 2 BauGB) development plan,
- the cohesively developed district which does not have a qualified plan (Section 34 BauGB),
- the outlying area (Section 35 BauGB).

In principle, the areas of Sections 30, paras 1 and 2, and Section 34 BauGB are designated as building areas whereas the outlying area in accordance with Section 35 BauGB is, in principle, to be kept free of building structures.

The application of Section 30 et seq. BauGB presupposes that the project in question is covered by Section 29 BauGB. This is always the case when the structure is artificially connected to the ground in a manner intended to be permanent and, in terms of its function and size, makes it necessary to have a binding land use plan which regulates its permissibility (BVerwGE 44, 59, 60 et seq.).

Once the scope of application of these provisions has been established, it must then be determined whether a development plan exists for the area in which the project is to be implemented and, if this is the case, whether a project-related or a qualified development plan exists. In the end, the project is permissible if it does not contravene the stipulations of the development plan. If the project is located in the unplanned area according to Sections 34 and 35 BauGB, the permissibility of the building project is to be judged by the requirements laid down in these provisions.

2. Building Health and Safety Rules

Furthermore, the planned building project must comply with the provisions of the building regulations.

The state building regulations contain both material and procedural provisions. These serve to safeguard public safety and order and avert specific risks which exist in connection with construction work. In this connection, the building regulations impose requirements relating to administrative aspects on the individual plot of building land and on the erection, alteration, change in use and demolition of building structures. Moreover, the building regulations include provisions which serve to prevent the appearance of the area being ruined and lay down social and ecological standards.

a) General Duty of Care

All state building regulations contain a general clause corresponding to Section 3 para. 1 MBO (specimen building regulations). It reads:

> "Building structures as well as other installations and facilities are to be arranged, erected, altered and maintained so that public safety or order, in particular life, health and the natural resources are not endangered."

This general clause serves as a "catch all clause" and is always applied when no specific building regulation requirements are standardised in other provisions of the state building regulations. The key importance of this clause is that it has the character of a hazard clause in that it aims to prevent buildings and other installations as well as building activities from posing a risk to public safety and order, in particular life, health or natural resources (Reichel/Schulte, Handbuch Bauordnungsrecht, p. 193). On the one hand, this clause standardises statutory preconditions for the permissibility of building projects and may even mean that a permit for the project cannot be issued. On the other hand, the general clause contains material legal requirements whose non-observance may also be grounds for intervention according to the scope of authority of formal building law.

b) Individual Health and Safety Rules

The building regulations, as legislation for averting building-specific dangers, contain four material regulatory complexes in addition to procedural provisions:

- setback regulations,
- parking spaces and garages,
- protection against ruining the appearance of the area and
- social and ecological standards.

Setbacks are areas in front of outside walls of buildings which have to be kept clear of other buildings and building structures (Oehmen/Bönker, Einführung in das öffentliche Baurecht, margin No. 328). The regulations on setbacks serve to preserve peaceful neighbourly coexistence by preventing people from looking in and nuisance from noise. Moreover, buildings and other building structures are not to be built too closely together. The aim of this is to ensure sufficient light, ventilation and sun in the rooms in the buildings. Moreover, undeveloped plots of land for the necessary facilities such as parking spaces, children's playgrounds, access roads and paths are to be allowed for already in the planning stage of buildings (Reichel/Schulte, Handbuch Bauordnungsrecht, p. 234). The depth of the setbacks is laid down in the state building regulations. It largely depends on the height of the building. The higher a building is, the larger the area around it which has to be kept clear must be.

Practical advice: According to most state building regulations, however, garages, roofed parking spaces, retaining walls and enclosures are permitted within the setbacks. Moreover, the building permit authority may allow exceptions under certain conditions and, in individual cases, waive the setback requirement on request.

All state building regulations contain provisions on parking spaces and garages. For example, building structures may only be erected, altered or put to a different use if enough parking spaces and garages of sufficient size and of a suitable nature are provided (cf. Section 48, para. 1, sentence 1 MBO). These regulations are intended to relieve congestion on public thoroughfares and prevent traffic hazards due to parked vehicles. The number and size of the parking spaces to be provided depend on the type and number of existing and expected vehicles and are dealt with in more detail in statutory and administrative regulations. These contain reference figures for the parking spaces required which the developer or investor can use as a basis. The developer can be exempted from his obligation to provide parking spaces and garages in individual cases. If the provision of parking spaces is not possible for legal or actual reasons, the developer can pay a certain sum of money, in accordance with a by-law, to the municipality where the building area is located. However, this is entirely at the discretion of the building authority.

Practical advice: A waiver of the parking space penalty may also be provided for in the public law contract through which the municipality undertakes to waive the obligation to provide parking spaces and the developer undertakes to pay the penalty.

The building regulations are also intended to prevent the appearance of the area being ruined. Therefore, building structures are to be designed so that their shape, size, material and colour blend in with their surroundings and do not ruin the character of the roads, locality and landscape. Court rulings define the “ruining” of an area as "ugliness which not only disturbs but also offends the aesthetic perception of the beholder" (BVerwGE 2, 172).

Provisions which serve to create and maintain social and ecological standards are another element of building regulations. They are intended to promote favourable conditions for social cohesion and to maintain a certain living standard, such as by providing green areas, children's playgrounds and communal amenities.

c) Public Land Charges

The purpose of a public land charge is to safeguard public needs in individual cases by encumbering a plot of land to a greater extent than is possible by applying the civil law standards in Germany. As a rule, the public land charge serves to eliminate the public law hindrances to a building project. It is therefore the public law counterpart to the possibility of a land easement existing in German civil law.

A public land charge is provided for in all state building regulations with the exception of Bavaria and Brandenburg. It offers the land owner the possibility, by means of a declaration to the building control authority, to voluntarily undertake public law obligations to perform, tolerate or desist from certain actions in connection with his land which he would not normally be obliged to do, tolerate or desist from under public law (Stollmann, Öffentliches Baurecht, p. 228). The contents of a public land charge are regulated, for example in North Rhine-Westphalia, in Section 83, para. 1, sentence 1 BauO NRW.

The entry of public land charges is often a pre-condition to the granting of a building permit (Oehmen/Bönker, Einführung in das öffentliche Baurecht, p. 109).

Practical advice: Public land charges are frequently used to make the land owner undertake an obligation regarding boundary development, the take-over of a setback on neighbouring land, a playground, the preservation of part of a building or parking spaces.

In contrast to a public law contract, this is merely a unilateral public law declaration which has to be submitted to the building control authority. However, it must comply with the requirement for a written statement. As the public land charge is intended to guarantee a certain permanence for satisfying public law requirements, it cannot be revoked until the building control authority waives the public land charge (e.g. Section 83, para. 3 BauO NRW).

Practical advice: The public land charge cannot be revoked simply by a renewed agreement between the land charge grantor and the beneficiary. As the public land charge only expires if the building control authority waives it, any agreement to a public land charge should be considered carefully.

3. Other Laws Considered in the Building Permit Procedure

In addition to the special provisions of building law, the building permit authority examines all public law regulations relating to the building project. These include in particular:

- preservation of historical sites,
- regional and state planning,
- air pollution regulations,
- road law (bans on building extensions),
- railway law (bans on building extensions),
- occupational safety and health in the building industry,
- waste law,
- forestry law (distances to forest edges),
- water law,
- hygiene (e.g. in hospitals, stables and barns for animals, food processing enterprises) and
- animal protection.

III. Procedure

Before a building project which requires a building permit can be implemented, the building permit must actually have been obtained. Therefore, the developer must initiate a building permit procedure in which the project is examined for its legality. These procedure regulations are standardised in the state building regulations.

1. Competent Authority to Grant Building Permits

The organisation of the building control authorities is the responsibility of the federal states themselves. For example, Brandenburg, Mecklenburg-Western Pomerania, the Saarland, Schleswig-Holstein, Berlin, Bremen and Hamburg have a two-stage authority structure and all other states a three-stage structure (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 318). The lower building control authority in each case is always responsible for the enforcement

of the building regulations and, as a consequence, for the issuing of building permits. This is the district or city borough.

2. The Stages of the Building Permit-issuing Process

In order to obtain a building permit, the developer must first file a building application. Depending on the federal state in question, this must be filed with the lower building control authority or the municipality. The building application must be filed in writing. Moreover, all necessary documents (building documents) which the authority requires to process the application and assess the building project must be enclosed with the application (Stollmann, Öffentliches Baurecht, p. 221). What documents this involves depends on the regulations in the federal state in question but normally the following documents are required:

- general plan,
- site plan,
- building drawings,
- building descriptions,
- technical verifications (stability, fire, heat and sound protection) as well as
- calculation of the cubic volume.

These building documents are to be signed by the so-called concept author but both the concept author and the developer have to sign the building application itself.

The developer is the person who initiates, implements and pays for the building project, regardless of the ownership situation or any other authorisation. The developer of the project and the owner of the land can therefore be different people (Oehmen/Bönker, Einführung in das öffentliche Baurecht, margin No. 215).

The developer has a large number of duties when he is preparing the building project. For example, he must appoint a concept author, a contractor and a site manager to supervise and implement the project and inform the building control authority of the start of work, completion of the building shell and the final completion of the approved project. The concept author has to prepare the building documents and is responsible for ensuring that his draft is complete and usable. People who are suitable for this function are stipulated in the state building regulations. As a rule, these are architects and engineers, and for certain projects also site engineers, masters of the masonry, joinery, concrete or reinforced concrete trades.

If the developer is refused a building permit, he is not barred from filing a new application for a permit for the same building project.

The municipality or the building control authority initially examines the documents received for their completeness before it checks the project for reconcilability with building law and any other public law.

3. Building Permit, Conditions and Collateral Obligations

If the building control authority reaches the conclusion that no public law provisions stand in the way of the planned building project, it grants the building permit to the developer. This building permit gives the developer the right to implement his building project and then to use it in accordance with the permit. This permit and the project also remain effective if, after the permit has been issued, the legal situation changes and the project contravenes the new laws or regulations (Stollmann, Öffentliches Baurecht, p. 223 et seq.; Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II., p. 144 et seq.).

In many cases, building permits contain so-called collateral clauses. The permissibility of these collateral clauses depends on general administrative procedure law. According to Section 36, para. 1 VwVfG, an administrative act to which a right exists may only contain a collateral clause if it is permitted by a statutory provision or if it is intended to ensure that the statutory preconditions of the administrative act are observed. The purpose of these additional provisions is to allow the building permit authority not to reject the building permit if it conflicts with public law hindrances which can be eliminated but to issue the permit subject to the necessary collateral clauses (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 157).

There are various types of collateral clause. A differentiation may be crucial in individual cases for determining the correct appeal. Section 36, para. 2 VwVfG lists the various types. The "modified requirement" developed from court rulings is not mentioned in this regulation but it is the most widespread in practice (BVerwGE 36, 145, 153). It changes the quality of the building permit granted and means the rejection of the building permit originally applied for and, at the same time, the issuing of a new permit which was not applied for (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 158). The modified requirement is not a real requirement pursuant to Section 36, para. 2, No. 4 VwVfG as it is inseparable from the actual building permit and cannot therefore be contested in isolation in administrative or court proceedings (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 328). The other collateral clauses listed in Section 36, para. 2 VwfG can always be contested separately if these collateral clauses can be separated from the remaining building permit without the contents of the permit being changed (Reichel/Schulte, Handbuch Bauordnungsrecht, p. 792).

4. Enforcement of Law (Demolition Orders etc.)

The building control authorities are not only responsible for monitoring the observance of building law by taking preventive action such as issuing building permits. They also have to take repressive action in the event of infringements (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 74 et seq.). The building regulations contain various instruments to re-create a status compliant with building law. Depending on the state regulations, there are either special statutory provisions for these individual instruments or the legal basis can be found in a general

clause in building regulations (cf. Section 61, para. 1, sentence 2 BauO North Rhine-Westphalia). The classic forms of intervention by the authorities are:

- a prohibition of use,
- an order to discontinue work and
- a demolition order.

These powers of intervention by the authorities are subject to various preconditions depending on the severity of the case. Many orders under building regulations require so-called formal or alternatively material illegality; others even demand these in combination.

A building project is formally illegal if, although it required a building permit, the building was erected without one (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 187). This may also be the case if the holder of the building permit deviates from the permit granted. By contrast, material illegality arises when the building project cannot be approved because it infringes material building regulations and did not comply with material law for a considerable period either.

A prohibition of use by the building control authority can be considered if it is not the building structure that is illegal as such but merely its specific use. This administrative action presupposes formal illegality of the project. However, court rulings do not agree on whether there must be material illegality as well. According to the prevailing opinion, however, formal illegality is sufficient (Kassel Higher Administrative Court, ruling dated 10 November 1994; file No.: 4 TH 1864/94).

The order to discontinue work, on the other hand, is used to prohibit an illegal building project at an early stage. The authorities may take this action if, during implementation of the project, the holder of a building permit deviates from the approved building documents or if not all preconditions required for the start of construction have been fulfilled in spite of the issuing of a building permit (Stollmann, Öffentliches Baurecht, p. 247). The order to discontinue work presupposes formal illegality.

A demolition order is the strongest possibility for intervention given to the authority. When issuing a demolition order, it instructs the addressees of this order to completely remove or demolish his building (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 337). In view of the severity of this administrative intervention, the issuing of a demolition order is only possible in the case of formal and material illegality.

5. Challenging Decisions of the Authority

In order to challenge decisions of the authority, the developer has various possibilities of seeking legal protection. These are regulated for the whole country in the Rules of the Administrative Courts. What action he takes depends on what he wants to achieve.

a) Preliminary Procedure

Any appelant must initially challenge decisions of the authority in objection proceedings in order to prevent the authority's action becoming final. The objection is to be filed in accordance with Section 70, para. 1, sentence 1 VwGO, within one month of the addressee being notified of the administrative decision. The filing of the objection may either be made in writing or by giving a statement orally on the record at the authority which issued the order. The objection and the action for avoidance (see below) are characterised in that they have a so-called "suspensive effect" (*Suspensiveffekt*) according to Section 80, para. 1, sentence 1, VwGO. This means that the authority may not implement the action ordered while the objection proceedings are running but must wait for a final ruling. After the objection has been lodged, the authority has two possibilities: If it considers the objection to be justified, after reviewing the legal situation, the objection is granted in accordance with Section 72 VwGO. If, however, the authority considers it to be unjustified, it refers the objection to the next higher authority. It in turn issues a ruling on the objection in accordance with Section 73, para. 1 VwGO by means of which the addressee is notified that his objection has not been granted indicating the reasons why the authority considers it to be unfounded. In this case the only course open to the citizen is to institute legal proceedings against the authority's action before the administrative court.

b) Administrative Court Procedure

If the building permit authority refuses to issue a building permit to the developer although the statutory preconditions are fulfilled, the developer can apply to the administrative court for an action by public procedure against a public authority to compel the performance of an administrative act for one's benefit *(Verpflichtungsklage)* in accordance with Section 42, para. 1 VwGO for granting a building permit. In this procedure, the court in question examines whether a claim to the issuing of the building permit is justified (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 312 et seq.). The crucial time applying to the judging of the case is the legal position at the time of the last hearing.

If, however, the developer has received an intervention order under building regulations, e.g. a demolition order, he can have this order revoked with an action for avoidance in accordance with Section 42, para. 1 VwGO before the administrative court (see Stollmann, Öffentliches Baurecht, p. 266). In this case, the court examines whether the contested order was unlawful and has in- fringed the plaintiff's rights.

Both types of action have by and large the same preconditions for admissibility:

The plaintiff must be entitled to take action in accordance with Section 42, para. 2 VwGO. As a consequence, he has, in the case of an action to compel performance, the chance to explain why he feels he has a claim to the issuing of a building permit. In an action for avoidance, on the other hand, he must claim that his rights were possibly infringed by the order issued by the building permit authority. As another precondition for admissibility of the action before an administrative court, the plaintiff must have unsuccessfully conducted preliminary pro-

ceedings in accordance with Section 68 et seq. VwGO before filing the action. Furthermore, both types of action have to be lodged in writing at the latest one month after delivery of the ruling on the objection in accordance with Sections 74 and 82, para. 1 VwGO. The action must designate the plaintiff, the defendant and the object of the plaintiff's claim in accordance with Section 82, para. 1, sentence 1 VwGO. There is no statutory requirement for the action for avoidance and the action to compel performance to be presented by a lawyer before the administrative court. The parties may therefore represent themselves in the first instance.

c) Injunctive Relief

In building law, the action procedures described above tend to play a minor role. In order to avoid the lengthy procedures which such court proceedings involve, it is advisable for the parties to seek temporary legal protection in order to reach a quick decision.

A distinction must be made between the applications in accordance with Section 80, para. 5 and Section 80a and those in accordance with Section 123 VwGO. An application according to Section 80, para. 5 and Section 80a VwGO is admissible if the main issue involves the contestation of an administrative decision (Finkelnburg/Ortloff, Öffentliches Baurecht, Vol. II, p. 317). If the applicant, on the other hand, wants to oblige the authority to intervene or wants to have a legal relationship established between those involved, the application according to Section 123 VwGO (Finkelnburg/Ortloff loc. cit.) is admissible. Both applications are to be filed with the local administrative court responsible. They are not bound by any time limits and the parties do not have to be represented by a lawyer.

> **Practical advice:** In the proceedings according to Sections 80, para. 5, 80a and 123 VwGO, the court decides by a ruling. This ruling can be contested by making an appeal within a period of two weeks according to Section 147, para. 1, sentence 1 VwGO. According to Section 146, para. 4 VwGO, the appeal has to be substantiated within one month from the announcement of the decision.

Special importance is attached to this "fast-track" legal protection if a neighbour wants to defend himself against the building permit issued to the developer. It makes little sense for the neighbour to lodge an objection against this building permit and file an action for avoidance as the law provides in Section 212 a BauGB (in conjunction with Section 80, para. 2, No. 3 VwGO), legal remedies of neighbours against building permits do not, in general, have any suspensive effect (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 412). This would mean for the neighbour that the developer is allowed to continue with his building project while a decision is being made on the neighbour's action. In order to avoid this, the neighbour can file an application according to Sections 80a, 80, para. 5 VwGO with the authority or administrative court responsible to suspend enforcement. Such an application is justified when a so-called summary examination of the factual and legal position during which no evidence is heard shows that the

building permit is obviously unlawful and injures the neighbour in respect of standards which protect third parties (see 3.5.4 below on this point). In these cases the interest of the neighbour in the suspension of the enforcement of the building permit prevails over the interest of the developer in the immediate use of the building permit. Conversely, the application of the neighbour in accordance with Sections 80 a, 80, para. 5 VwGO must be rejected if it turns out that the building permit is lawful and the rights of the neighbour are not infringed.

Nevertheless, if the building control authority has refused to issue a building permit to the developer, he cannot apply for an injunction to issue a building permit in accordance with Section 123, para. 1 VwGO by means of temporary relief. This would mean anticipating the merits of the case which is inadmissible according to consistent court rulings (cf. BVerfG DVBl. 1999, p. 1204, 1206 et seq.; BVerwG NJW 2000, p. 160 et seq.), the consequences and any disadvantages of which could no longer be eliminated in proceedings on the main issue.

Temporary relief, on the other hand, is important for the developer if he wants to quickly contest any action under building control law. If the building control authority, for example, issues a demolition order against him, which is declared enforceable immediately, he can contest this with an application for a court injunction in accordance with Section 80, para. 5 VwGO. The aim of this application for a court injunction is to re-create the suspensive effect, which has arisen through the order for immediate execution, of the objection which has to be lodged prior to the application being filed. In this case, too, the application is justified if the interest of the developer in the suspension of the execution outweighs the building control authority's interest in enforcement (Oehmen/Bönker, Einführung in das öffentliche Baurecht, p. 138). This in turn is the case when the order contested by the developer proves to be unlawful (Oehmen/Bönker, loc. cit).

As the administrative court responsible merely conducts a summary examination, it may happen that the legality of the action contested cannot be judged reliably. In these cases the administrative court considers the conflicting interests thoroughly (Erbguth/Wagner, Grundzüge des öffentlichen Baurechts, p. 414).

d) Challenging Building Permits Granted to Third Parties

German administrative law is governed by the legal principle that the addressee of an administrative act which is to his disadvantage is always entitled to seek legal remedy whereas third parties can only contest orders of an authority only affecting them indirectly under special circumstances.

Protection of neighbours in building law also has its peculiarities. Of particular importance here are the objection and the action for avoidance by a neighbour against the building permit issued to a developer. In contrast to an objection or a court action by the developer, the authority or court responsible does not examine the lawfulness of the administrative act issued but only whether the neighbour has been injured in respect of standards which protect third parties through the issuing of the administrative act (BVerwG, NJW 1978, p. 554; ZfBR 1993, p. 92). These are standards which, in addition to protecting the general public, are also intended to protect individual interests of those affected and which govern and delimit this

group of people. Whether this is the case or not depends on the purpose of the provision in question allowing for the resultant differing interests. Court rulings have recognised a neighbour-protecting effect for the following regulations:

Provisions of building regulations:

- the general clause in building regulations (general duty of care, 2.2.1 above),
- the provisions on setbacks,
- the provisions on the non-disturbing positioning of parking spaces and garages,
- the provisions on the set-up of building sites, the stability of building structures, the protection against damp, corrosion, pests, fire, heat, sound and vibration.

Provisions of zoning law:

- Section 34, para. 1 BauGB,
- Section 31, para. 2 BauGB and
- Section 15, para. 1 BauNVO.

According to court rulings, the following provisions have no effect of protecting third parties:

- the provisions of the building regulations on protection against ruining the appearance of the area,
- the general objectives of land use planning arising from Section 1 BauGB as well as
- the stipulations on the scope of the use of the building.

Furthermore, it must be noted, as regards the protection of third-party rights, that the suspensive effect which always arises with a objection and action for avoidance does not apply if the objection or action is filed by a third party, as in this case the neighbour, in accordance with Section 212 a BauGB. Consequently, the developer may continue to pursue his building project while the decision on the objection or the neighbour's action is being taken.

Practical advice: In these cases the neighbour is advised to seek additional temporary relief and to file an application in accordance with Section 80 para. 5 VwGO in order to re-instate the suspensive effect of his action.

Chapter 3 Profitability Aspects of the Investment

I. The Real Estate Market in Germany

1. General Aspects of the German Market

The Federal Republic of Germany is a federalist country with 16 federal states. Owing to this structure, Germany does not have any economic monocultures but economic polycultures. In the real estate industry, we therefore talk of five **major office centres** (*Immobilienhochburgen*) in Germany, which are all, without exception, in the old West Germany, i.e. in states which were already part of the Federal Republic of Germany before German Reunification.

Figure 1. Source: Jones Lang LaSalle

The development of office space at these five locations will be analysed using the following indicators:

- **Take-up** (*Flächenumsatz*)
- **Vacancy rate** (*Leerstandsrate*)
- **Prime rent** (*Spitzenmiete*)

a) Period from 1989 to 2000

After the fall of the Wall in 1989, a large number of grants were channelled into the eastern part of Germany and subsidy programmes initiated. However, despite these subsidies and an initial building and investor boom, the take-up/transaction volumes and rents in the east German conurbations of Leipzig and Dresden were far lower than in the five established west German centres.

The early nineties were marital bliss on the German real estate markets. In 1991/1992, prime rents hit record levels which were only reached again in many cities at the start of the 21st century. After this boom, prime rents fell rapidly and continuously. However, the take-up rates, which also reached record levels at the same time, picked up again much more quickly than prime rents and, after a brief decline, started to rise again steadily. German Reunification also had a marked effect on both the west and east German real estate markets. The positive development of the economy fuelled by strong domestic demand was also reflected in the demand for commercial real estate. On the supply side, investors rushed to meet the demand. Building projects appeared to be an attractive investment, especially in eastern Germany. There, rents in the major cities rose in 1993 to the west German level as a result of the shortage of space. Subsidy programmes and additional depreciation options offered by the German government prompted not only institutional investors but also a large number of private investors to invest in eastern Germany.

The general economic downswing reached Germany later than other countries. It was not until 1993 that gross domestic product fell in real terms by 1.1%, hitting the real estate markets with the usual time lag. The drop in demand led to falling take-up rates and declining rents on all German real estate markets. The cities in eastern Germany were particularly hard hit. The "investment boom" created surplus capacities, followed by a drop in monthly rents to € 10/m². For this reason, vacancy rates of more than 22.3% in Leipzig and 13% in Dresden are normal, even today.

The years from 1995 to 2000 were dominated by an initially slow but nonetheless steady upswing on the west German real estate market. Take-ups rose sharply in the five major office centres of Berlin, Dusseldorf, Frankfurt, Hamburg and Munich. However, these take-ups were mainly due to companies moving to new premises and less to real absorption. Therefore, the vacancy rate hardly fell at all. The 1990s were characterised by a considerable thinning-out in peripheral areas. After their old lease contracts had expired, many companies moved from the outskirts into the inner cities to new offices with a better standard of fixtures and fittings. Here, the rents were still relatively low.

In **1997,** vacancy rates also started to fall appreciably, initially in city-centre locations but later in the suburbs as well. As the economy continued to recover and demand rose, the typical effect of the real estate cycle was also felt in this period. During the real estate recession in 1993/95, only a few new building projects had been planned and implemented. Therefore, during the upswing phase, at a time when the chances of letting a new project were very good, there was, in some areas, a shortage of space on offer since no new buildings had been erected during the recession phase in the real estate cycle. **By 2000 take-up exceeded vacant space in four of the five major centres**. The reasons for this were the ever improving economy, the continuing structural change towards a service society and the boom in the information and communications industries (telecommunications, new economy). Good, modern offices were in short supply at the end of the outgoing millennium and so some of the companies wanting to rent office space had no choice but to either pack people more closely together in the space they already had or to rent space in properties which were in the planning or construction stage. Some of the pre-lets were for buildings which were not due for completion until 2003/2004 – a small but possibly crucial difference to comparable cycles in the past on the real estate market's way into the next phase of its cycle. The development of rents kept pace with the positive trend in take-up. Prime rents rose in the major office market locations from 1995 to 2000. For example, prime rents of about € 46 per square metre per month plus service charges were fetched in Frankfurt. The remarkable aspect was that prime rents rose in almost all cities, particularly in 2000. The whole of Germany proved to be a landlord's market in the years from 1999 to 2000.

Table 1. Development of take-up, vacant space and prime rents

1996 – 2000

Berlin	1996	1997	1998	1999	2000
Take-up m²	425,000	512,000	369,000	386,000	513,000
Vacant space m²	1,040,000	1,300,000	1,320,000	1,299,000	1,239,000
Prime rent €/m²/ month	25.50	24.00	24.50	27.00	30.50

Dusseldorf	1996	1997	1998	1999	2000
Take-up m²	152,000	277,000	232,000	328,000	342,000
Vacant space m²	351,000	484,000	427,000	350,000	240,000
Prime rent €/m²/ month	19.50	21.50	21.50	21.50	22.50

Table 1. (cont.)

Frankfurt	1996	1997	1998	1999	2000
Take-up m²	477,000	350,000	630,000	530,000	697,000
Vacant space m²	668,000	783,000	610,000	480,000	179,000
Prime rent €/m²/ month	33.00	33.00	36.00	40.00	46.00

Hamburg	1996	1997	1998	1999	2000
Take-up m²	205,000	280,000	302,000	460,000	560,000
Vacant space m²	664,000	696,000	693,000	500,000	289,000
Prime rent €/m²/ month	24.50	24.50	24.50	24.50	25.50

Munich	1996	1997	1998	1999	2000
Take-up m²	330,000	490,000	595,000	696,000	1,085,000
Vacant space m²	411,000	346,000	259,000	248,000	95,000
Prime rent €/m²/ month	25.50	26.50	27.50	29.00	31.00

Source: Jones Lang LaSalle

b) Period from 2001 to 2006

2001

2001 was a turbulent year for the real estate market as there could be still no talk of a recession despite the unmistakable downward trend. Thanks to the momentum from the record-breaking year 2000, the second-best take-up figures (approx. 2.8 million m² of office space for all five cities) in the past 15 years were recorded in the five major office centres. This year marked a turning point in the cycles of the office markets in Berlin, Dusseldorf, Frankfurt/Main, Hamburg and Munich. In the uncertain climate, decisions to extend space or rent were postponed, plans already approved were revised and caution was the order of the day on the market. In 2001, vacancy rates well exceeded the figures for 2000. At 109%, the sharpest rise in vacancy volume was seen in Munich but nevertheless the vacancy rate there was still low at 1.3%. Munich was the only city in Germany with a vacancy rate under the 2% mark. 2001 was the start of a trend which continued in the years to follow. The vacancy volume rose steadily for the first time since 1997 as the number of newly completed buildings increased. Furthermore, about 5.4 million

m² of office space was expected to be completed in 2002 and 2003. This had a considerable impact on the supply side with Munich and Frankfurt/Main showing the biggest rises in new office space for let. The first signs of the ensuing tenant's market were seen.

The phase of economic weakness in Germany now also had a noticeable effect on developments on the office markets as evidenced by rents, which fell slowly but surely. Moreover, demand also weakened at the same time. Companies' searches for space were geared more to the long term but at that time there were no signs of a rapid decline in take-up or a recession scenario.

2002

2002 was a difficult year for the office market. The golden years were over. However, the economic parameters in the Federal Republic of Germany opened up new expansion and investment opportunities for companies. As a result, the office market was starved of some of its oxygen because capital was invested elsewhere. There was a marked fall in take-ups in the five major office centres. In a ten-year analysis, 2002 was an average year for the real estate industry. At around 2 million m², the cumulative take-up figure for all five cities was 8% above the ten-year average (1992-2001: 1,855,400 m²). However, comparing 2002 with the average for the previous five years, it was the worst year with take-ups dropping by 19%. **From 2002 onwards, vacancy space exceeds take-up was the order of the day**. At the end of the 4th quarter, 3.3 million m² of office space was available at short notice. This was almost two-thirds more than one year before. The dismal and uncertain economic prospects prompted project developers and investors to postpone their planned projects (new building activities).

A new phenomenon at that time was **subletting** (*Untervermietung*). Sublet space also impacted on the markets. In the five cities, there was a total of 1.07 million m² of office space for sublet. This provided an additional supply of office space at considerably lower prices. During the previous real estate crisis in the mid-1990s, virtually all the vast supply of office space for let had been attributable to newly completed buildings. However, in those years companies also had expansion plans so take-up rose parallel to the volume of vacant space. This was not the case in 2002.

Therefore, landlords came under massive pressure to reduce rents. The tough competition for potential tenants (tenant's market) produced another phenomenon: landlords started to offer prospective tenants incentives to rent their properties. Therefore, companies were able to exploit this market situation to rent space at favourable conditions.

There were double-digit percentage falls in rents. For example, in Dusseldorf rents dropped by 10 % and Frankfurt by 12 %. Only in Munich did the prime rent remain stable.

2003

Hopes of an economic recovery in 2003 were nourished by the revival of the American economy. However, the German economy stagnated with zero growth as a result of weak domestic demand. German companies initiated extensive restructuring programmes. As workforce numbers were reduced, the amount of sublet space in the five major office centres increased.

In 2003, office space take-up for the five cities totalled 1.94 million m².

The tenant's market continued in 2003 and 2004, offering companies the chance to cut their costs considerably by moving to other premises and to negotiate higher incentives.

In all five cities, the cumulative vacancy rate (excluding sublet space) rose by almost 53% compared with the previous year and totalled about 5.3 million m². The worst hit of the major office centres was Dusseldorf with a vacancy rate of around 11.2%. Although Munich still had without a doubt the lowest vacancy rate, it was catching up and at the end of the year its figure stood at around 7%.

The situation on the market for sublet space stabilised at a high level in 2003. Vacancy volumes including sublet space gradually reached the one-million square metre mark.

Prime rents had fallen by an average of 10%. At 18%, the drop was particularly sharp in Frankfurt (down to € 35/m²). 2004 was the first year after 2000 when the economic performance of German industry rose by 1.7%.

For the first time since 2001, there was an increase in the number of people employed.

2004

In 2004, office space take-up in the five major office centres was at a very low level of 1.9 million m².

For the first time, there was a north-south divide in terms of take-up. In Hamburg, take-up rose by 40% and in the Dusseldorf region by just under 18% compared with the previous year. At just under 37%, Frankfurt/Main suffered the sharpest drop (330,000 m² of space let). This was the worst figure since 1995. The effect was noticeable in the city, particularly owing to the lack of typical major property lets.

Vacancy volumes increased as newly completed buildings came on the market. Including sublet space, a total of approx. 7.5 million m² of office space was standing empty in the five major office centres in 2004. This corresponded to an increase of 1.1 million m² over the previous year.

The prime rent fell in all cities in 2004 as a result of the large amount of space available. For example, in Frankfurt it dropped by 6%. While rents decreased, the choice of space increased. The large number of buildings of very good quality (first-class standard) and the continued willingness of the owners to grant rent incentives such as the payment of removal costs and rent-free periods paved the way for new lets.

2005

The German economy grew in 2005. Companies made large profits for the first time, the long-awaited upswing in the domestic economy started to pick up speed. The number of people in work in Germany rose substantially compared with the previous years.

The office letting market bottomed out and started to recover in 2005. The amount of office space available in Germany fell sharply. In 2005, 40% fewer buildings were completed in the five major office centres than in 2004.

In spite of the fall in the number of new buildings being constructed, the vacancy volume in 2005 was 7.7 million m², including sublet space. This was a record high. For the first time companies started to look at the quality of the empty office space and, with the market situation as it was, they took the chance to leave their poor-quality rented premises, which did not have a very high standard of fixtures and fittings, and move to properties with higher-quality fixtures and fittings (first-class) at favourable conditions.

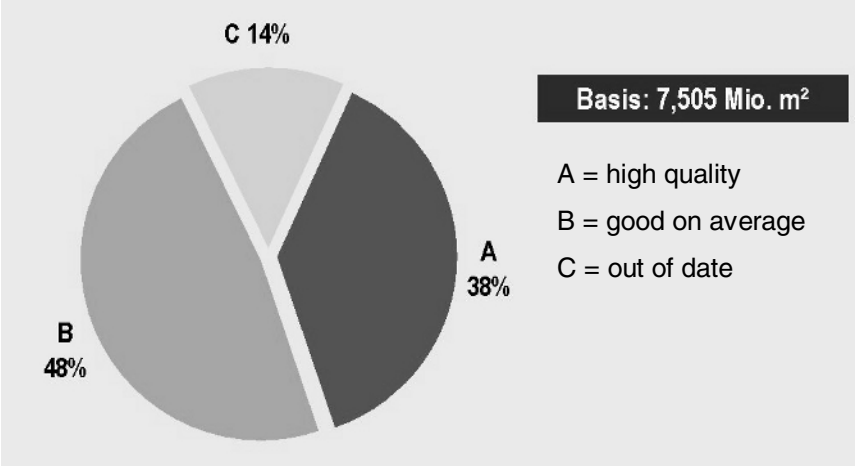


Figure 2. Vacancy volume including sublet space according to quality *

Basis = 7.505 million m²

* for the five locations Berlin, Dusseldorf, Frankfurt, Hamburg, Munich,
As at: 3rd quarter 2006 Source: Jones Lang LaSalle

The cumulative vacancy rate for all five major office centres was approx. 2.4% higher than the previous year. The sublet space phenomenon scarcely played a role any more.

The office space take-up for the five office centres totalled about 2.25 million m² in 2005, an increase of around 18% over 2004.

At 43%, the percentage increase in take-up was highest in the city of Frankfurt whereas take-up fell in Dusseldorf by 9% and in Hamburg by 4%. Rents remained stable in 2005 but there were two regional changes: Hamburg was the only city of the five office centres to see the prime rent increase by 5% to € 20.50/m² per month. The dramatic decline in rents in the city of Frankfurt am Main was halted with a prime rent of € 32/m² per month then being attained.

Up to the 3rd quarter 2006

Sustained strong demand for office space was recorded in all five German office centres in the first three quarters of 2006. Real estate of high quality (first-class fixtures and fittings) was very popular in all cities. Major leases (for over 15,000 m² of office space) were on the increase in all cities for the first time in two years.

Office space take-up in the five major office centres during the first three quarters of 2006 totalled approx. 1.6 million m². Since the number of leases signed fell in all centres apart from Dusseldorf, where there was a rise of 20.5%, total space take-up was down by about 9.4% on the same period in 2005.

The cumulative vacancy rate in all five major office centres decreased by 2.9% compared with 2004, corresponding to a vacancy volume of 7.5 million m² including sublet space.

The Dusseldorf office market is also on the road to recovery. Slight rises in rents and a higher average rent confirm the steady upward trend. The rise in vacant space has been stopped. The decline in the vacancy rate is ensuring positive net absorption, not just in Dusseldorf. In future, there will be an end to the phenomenon of sublet space which we have seen throughout Germany. The rent reductions on these sublet spaces may in some cases be quite substantial but the leases are now generally very short. In future, the major criterion will be the standard of fixtures and fittings and this will play an increasingly important role in space absorption and developments on the market.

Prime rents rose on average by 4.7%, for example in Frankfurt by 3.1%.

Table 2. Development of take-up, vacant space and prime rents

2001 to the 3rd quarter 2006

Berlin	**2001**	**2002**	**2003**	**2004**	**2005**	**3rd qtr 2006**
Take-up m²	424,600	402,900	362,200	363,300	484,200	283,200
Vacant space m²	1,029,300	1,232,900	1,525,200	1,701,400	1,702,700	1,725,600
Prime rent €/m²/ month	28.00	24.00	21.00	20.50	20.50	20.50

Table 2. (cont.)

Dusseldorf	**2001**	**2002**	**2003**	**2004**	**2005**	**3rd qtr 2006**
Take-up m²	398,500	307,400	237,600	279,100	254,100	220,000
Vacant space m²	279,900	651,100	922,900	1,002,900	1,035,100	1,041,900
Prime rent €/m²/ month	25.50	23.00	21.00	20.50	20.50	20.50

Frankfurt	**2001**	**2002**	**2003**	**2004**	**2005**	**3rd qtr 2006**
Take-up m²	607,600	465,000	520,100	330,000	472,900	335,000
Vacant space m²	265,000	925,100	1,545,000	1,902,300	2,022,200	1,969,800
Prime rent €/m²/ month	48.50	42.50	35.00	33.00	32.00	33.00

Hamburg	**2001**	**2002**	**2003**	**2004**	**2005**	**3rd qtr 2006**
Take-up m²	410,000	322,700	317,000	444,500	424,900	312,500
Vacant space m²	295,100	782,900	1,003,900	1,051,900	1,088,400	1,078,600
Prime rent €/m²/ month	25.50	20.50	19.50	19.50	20.50	21.50

Munich	**2001**	**2002**	**2003**	**2004**	**2005**	**3rd qtr 2006**
Take-up m²	917,300	509,800	501,600	481,200	595,200	458,800
Vacant space m²	198,800	933,600	1,385,200	1,865,300	1,859,000	1,689,200
Prime rent €/m²/ month	32.00	31.50	29.50	27.50	27.50	28.50

Source: Jones Lang LaSalle

2. Development of Rents and Returns

a) Office Space

In the Federal Republic of Germany, **office space** (*Büroflächen*) is only deemed to be such when it complies with the minimum requirements for use as an office. The statutory basis for satisfying the requirements is the **German Workplace Ordinance** (*Arbeitsstättenverordnung – ArbStättV)* dated 25 August 2004.

An area where typical desk activities are or can be performed and which is traded on the office space market, i.e. can be let as office space, is deemed to be office space. This also includes the space used in the private and public sectors, space converted into offices as well as office space which can be let separately in mixed-used buildings, especially in business parks.

Short-term rental cycle (*Jones Lang LaSalle Immobilienuhr*), **2nd quarter 2006**

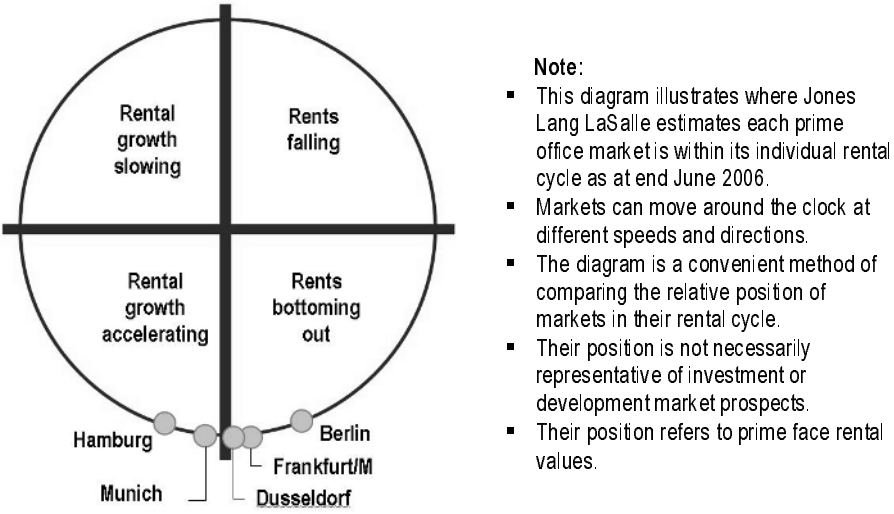


Figure 3. Short-term rental cycle, 2nd quarter 2006
Source: Jones Lang LaSalle

Completed office space and office space in the pipeline

In the following table office space is divided into the following categories and analysed.

- Speculative (*spekulativ errichtet*)
  Space is created and offered for the letting market
- Pre-let (*Vorvermietung*)
  This is space which has already been pre-let and is no longer available to the market.
- Owner-occupiers (*Eigennutzer*)
  Space provided for the user's own needs and therefore not available to the letting market.

Table 3. Completed office space (2003 - 2005) and office space in the pipeline (2006 – 2008)

Completed office space (2003 - 2005) and office space in the pipeline (2006 – 2008)						
Berlin	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Speculative	218,200	154,800	69,200	113,100	25,800	23,000
Pre-let	14,100	15,300	48,500	25,600	12,400	8,400
Owner-occupier	19,900	83,200	35,900	14,500	12,500	0
Total	252,200	253,300	153,600	153,200	50,700	31,400
Dusseldorf	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Speculative	72,000	53,100	22,800	53,800	21,200	17,600
Pre-let	136,600	45,600	50,700	53,200	23,500	18,500
Owner-occupier	46,700	25,000	31,400	11,500	0	14,700
Total	255,300	123,700	104,900	118,500	44,700	50,800
Frankfurt	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Speculative	433,600	97,100	129,500	63,600	11,400	43,500
Pre-let	172,000	102,000	48,500	44,100	18,000	6,900
Owner-occupier	13,000	0	0	120,500	4,100	0
Total	618,600	199,100	178,000	228,200	33,500	50,400

Table 3. (cont.)

Hamburg	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Speculative	159,900	78,200	70,600	81,500	178,100	36,700
Pre-let	52,800	79,900	102,800	99,700	70,300	11,400
Owner-occupier	31,500	17,600	31,400	13,600	17,100	10,000
Total	**244,200**	**175,700**	**204,800**	**194,800**	**265,500**	**58,100**

Munich	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Speculative	283,600	276,200	53,800	50,700	278,300	114,800
Pre-let	280,400	169,800	73,100	36,200	32,700	0
Owner-occupier	52,100	134,300	53,500	35,800	2,900	51,200
Total	**616,100**	**580,300**	**180,400**	**122,700**	**313,900**	**166,000**
As at 30.06.2006						Forecast

Source: Jones Lang LaSalle

Prime yield

The following table shows the **prime yield** (*Spitzenrendite*) in the office space segment. It represents the net initial yield in percent of a top-quality building in a prime location. It shows the ratio of the net rental income at the time of purchase to the total purchase price including incidental acquisition costs.

Table 4. Prime yield (%)

Prime yield (%)	**2003**	**2004**	**2005**	**Q2 2006**
Berlin	5.0	5.25	5.25	5.00
Dusseldorf	5.3	5.50	5.50	5.25
Frankfurt	5.0	5.40	5.30	5.25
Hamburg	5.0	5.50	5.25	5.00
Munich	5.0	5.00	5.00	4.60

Source: Jones Lang LaSalle

Outlook

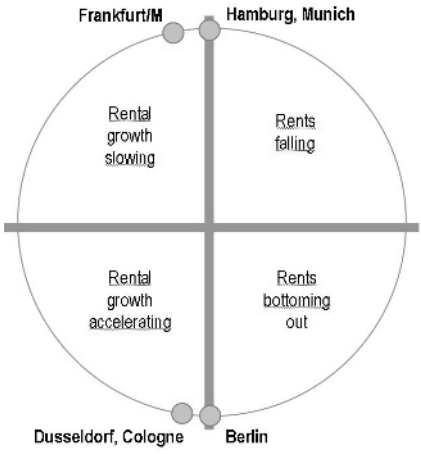
Table 5. Forecast for the short-term office space rental cycle

Rents	↗
Take-up	↑
Vacancy rate	↘

b) Retail Space

In the Federal Republic of Germany, the provisions of the **German Workplace Ordinance** also apply in the **retail space** (*Einzelhandelsflächen*) segment to the normal use of this space. High-quality retail space is sales space in top-class locations in every city. As a rule, comparative data in Germany apply to prime rents for ideal retail space with a size of about 100 m² on the ground floor, without steps and columns and with a rectangular layout. The following prime rents relate to a standard lease contract (without percentage rent provisions) on the respective market and correspond to the net rent without service charges, incentives and local taxes.

Short-term rental cycle, 2nd quarter 2006



Note:

- This diagram illustrates where Jones Lang LaSalle estimate each Retail market is within its individual rental cycle as at end June 2006.
- Markets can move around the clock at different speeds and directions.
- The diagram is a convenient method of comparing the relative position of markets in their rental cycle.
- Their position is not necessarily representative of investment or development market prospects.
- Their position refers to net rent for a virtual shop in high streets, 100 sq. m. sales space ground floor, without steps and column-free frontage approx. 6 m.

Figure 4. Short-term rental cycle, 2nd quarter 2006
Source: Jones Lang LaSalle

Retail space - Prime rents per m² and month

Table 6. Retail space - Prime rents per m² and month

2003 to 3rd quarter 2006				
Prime rents €/m²/month	2003	2004	2005	3rd qtr 2006
Berlin	200.00	175.00	180.00	180.00
Dusseldorf	190.00	185.00	185.00	190.00
Frankfurt	194.00	200.00	220.00	220.00
Hamburg	200.00	200.00	200.00	200.00
Munich	230.00	230.00	230.00	230.00

Source: Jones Lang LaSalle

Prime yield

The following table shows the prime yield in the retail space segment. This represents the net initial yield in % of a building of top quality in a prime location. It shows the ratio of the net rental income at the time of purchase to the total purchase price including incidental acquisition costs.

Table 7. Prime yields

Prime yield (%)	**2003**	**2004**	**2005**	**3rd qtr 2006**
Berlin	6	6	5.25	5
Dusseldorf	6	5.75	5.75	5.5
Frankfurt	5.75	5.75	5.5	5
Hamburg	6	5.75	5.5	5
Munich	5.75	5.25	5.25	4.25

Source: Jones Lang LaSalle

Outlook

Table 8. Forecast for the short-term retail space rental cycle

Rents	↗
Take-up	→
Vacancy rate	→

c) Distribution Space

The following statements relate to **distribution space** (*Logistikflächen*) where typical storage activities are or can be performed and which are traded on the logistics market, i.e. can be let as logistics space.

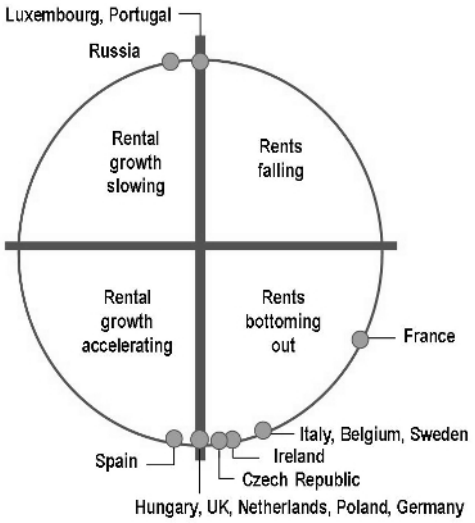
Typical ideal building criteria for a distribution warehouse based on the **multi-user-warehouse** (*Multi-Mieter-Lagerflächen*), which is popular among investors, include:

- Single-storey building
- Building height 8-12 m (min. 8 m to bottom edge of headers)
- Column spacing as wide as possible within the >12.5 m grid, e.g. 25 x 25 m
- Design load-bearing capacity of floor > 5,000 kg/m²
- Large number of ramps and one large ground-level door per section (at least one ramp for 1,000 m² of warehouse space)
- Access on two sides of handling centres
- Manoeuvring/apron area with a minimum length of 35 m
- Capable of being divided up for multiple users
- Sprinkler system/ESFR sprinklers
- Gas-fired heating
- Site fully fenced
- Sufficient parking space for cars, trucks and trailers
- Office space 5 – 10 %
- 45 – 60 % of site developed
- The building should have a minimum size of 10,000 m²

Compared with the annual take-up in 2004, this represents an increase in take-up of approximately 13%, which shows that growth is still possible and that Germany is continuing to establish itself as a logistics centre.

A breakdown of the total take-up into owner-occupier and rental take-up reveals that owner-occupier take-up is more or less insignificant in the five major conurbations – 94% of the take-up achieved there is from letting. Outside these cities, owner-occupiers have traditionally been mainly responsible for take-up in the past since, for example, retail or industrial companies often build their warehouses near their head offices or manufacturing sites.

Short-term rental cycle, 2nd quarter 2006



Note:

- This diagram illustrates where Jones Lang LaSalle estimates each warehousing market is within its individual rental cycle as at end of June 2006
- Markets can move around the clock at different speeds and directions.
- The diagram is a convenient method of comparing the relative position of markets in their rental cycle.
- Their position is not necessarily representative of investment or development market prospects.

Figure 5. Short-term rental cycle, 2nd quarter 2006
Source: Jones Lang LaSalle

Distribution spaces / Take-up

Table 9. (2003 to 2005 and change 2005/2004 in %)

Take-up	2003 m²	2004 m²	2005 m²	Change 2005 / 2004 in %
Berlin region	149,000	216,400	137,500	-36
Dusseldorf region	95,000	216,000	158,600	-27
Frankfurt region	252,800	187,700	220,200	17
Hamburg region	242,300	426,400	313,200	-27
Munich region	152,500	163,500	223,500	37

only deals > 4,000 m²
Source: Jones Lang LaSalle

Logistics stock (*Logistikflächen-Bestand*)

The warehouse space meets the following criteria:

- It is suitable for logistics operations
- It is at least 8,000 m² in size
- It has a clear height of at least 6.5 m and
- was built after 1985

Table 10. Logistics stock

Logistics stock	m²
Berlin region	2,378,400
Dusseldorf region	888,000
Frankfurt region	2,763,600
Hamburg region	2,757,600
Munich region	1,176,000

As at April 2006
Source: Jones Lang LaSalle

In light of sustained demand, the stock of such warehouse space is expected to increase further in the next few years. In the five major conurbations alone, new inquiries for warehouse space with a volume in excess of 2.3 million m² were recorded in 2005. There was great interest (almost 1.6 million m²) particularly in warehouse space larger than 5,000 m². The Frankfurt am Main and Hamburg regions were especially in demand; about two-thirds of the large-volume inquiries referred to these regions.

Demand for inexpensive distribution warehouses in line with market requirements is currently outstripping supply.

Rents

Rents in Germany are very competitive compared with other European countries, given the great variation in land prices depending on the location. The fierce competition among investors and developers of distribution warehouses has led to a fall in rents in the recent past.

Rental band for warehousing > 5,000 m² in the regions

Table 11. Rental band for warehousing > 5,000 m² in the regions

	Prime rent € min.	Prime rent € max.
Berlin region	2.00	4.50
Dusseldorf region	2.80	5.00
Frankfurt region	3.50	5.80
Hamburg region	2.75	5.50
Munich region	3.50	6.50

As at: 31.12.2005
Source: Jones Lang LaSalle

Prime rents for warehousing ≥ 5,000 m²

Table 12. Prime rents for warehousing ≥ 5,000 m²

	1999	2000	2001	2002	2003	2004	2005
Berlin region	5.62	6.14	5.62	5.00	4.50	4.50	4.50
Dusseldorf region	5.37	5.11	5.11	4.85	5.00	4.90	5.00
Frankfurt region	5.62	6.14	6.14	6.20	6.20	6.20	5.80
Hamburg region	4.86	4.93	5.62	5.50	5.50	5.50	5.50
Munich region	6.65	6.39	6.39	6.40	6.30	6.20	6.50

Source: Jones Lang LaSalle

Development of warehousing * Prime yields ≥ 5,000 m²

Table 13. Development of warehousing * Prime yields ≥ 5,000 m²

	1998	1999	2000	2001	2002	2003	2004	2005
Berlin region	8.00	8.00	8.00	8.00	8.00	8.00	8.00	7.50
Dusseldorf region	8.00	8.00	7.75	8.00	8.00	8.00	8.00	7.25
Frankfurt region	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.00
Hamburg region	7.25	7.00	7.00	7.00	7.00	7.00	7.50	7.30
Munich region	7.50	8.00	7.50	8.00	8.50	7.75	7.75	7.10

Source: Jones Lang LaSalle

After years of stability, yields started to move again in 2005. The huge investment pressure among investors, the very low interest rates and the banks' willingness to lend led to a fall in prime yields from approx. 7.8 % to around 7 % and a shortage of supply. These are net initial yields (net annual rent at the time of purchase relative to the overall investment cost incl. purchaser's cost).

Outlook

Table 14. Forecast for the short-term logistics rental cycle

Rents	→
Take-up	↑
Vacancy rate	↘

II. Criteria for the Purchase Price

1. Purchase Price and Market Value

The **purchase price** (*Kaufpreis*) agreed between the seller and the buyer on the acquisition of land, buildings or real estate projects is only identical to the **market value** (*Marktwert*) of the purchased property in exceptional cases. The calculation of the market value, the aim of which is to obtain an optimum approximation to the purchase price achievable on the real estate market, is performed using various valuation methods based on objective valuation criteria. On the other hand, the actual purchase price is also influenced by the contracting parties' subjective motives and ideas about the value of the property, and furthermore depends to a large extent on the conditions and the spread of risk in the purchase contract.

Nevertheless, the professionally assessed market value of a property is an important basis for purchase price negotiations and any agreement between the contracting parties on the purchase price.

The market value of a property is defined as follows in Section 194 of the Federal Building Code (*Baugesetzbuch – BauGB*):

> "The market value is defined as the price which would be achieved in an ordinary transaction at the time when the assessment is made, taking into account the existing legal circumstances and the actual characteristics, the general condition and the location of the property or other object valued without consideration being given to any extraordinary or personal circumstances."
> [Convenience translation into English]

This legal definition, which is recognised in Germany as the basis for the **valuation of real estate** (*Wertermittlung*), lays down the following criteria for the valuation:

- The market value is governed by the price which could be achieved at the time of the valuation. This valuation therefore relates to a specific date (so-called valuation date, *Wertermittlungsstichtag*).
- The market value is governed by the following characteristics of the land and the buildings on the land which determine its value.
  - Legal circumstances
  - Actual characteristics
  - Other conditions
  - Location of the land
- The market value is governed by the price which would be achieved "in an ordinary transaction". Special situations which are uncharacteristic of the relevant market under normal circumstances must therefore be disregarded in the valuation.
- The market value is governed by the price which could be achieved "without consideration being given to any extraordinary or personal circumstances". Special interests of the seller (e.g. liquidity needs) or of the buyer (e.g. anticipated ROI) or special relationships between the seller and the buyer (e.g. member company of the same Group) must therefore be disregarded in the valuation.

The concept of determining the market value on the basis of Section 194 BauGB is identical to the calculation of the so-called **fair value** (*beizulegender Zeitwert*) in accordance with the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS):

- According to IAS 40 No. 38 (2006) the fair value of investment property shall reflect market conditions at the balance sheet date.
- According to IAS 16 No. 6 (2006) the fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

- According to IAS 16 No. 32 (2006) the fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

In addition to the term of market value, German law contains several other **definitions of value** (*Wertbegriffe*) which are important for certain valuation purposes (cf. Kleiber in Kleiber-Simon-Weyers, Verkehrswertermittlung von Grundstücken, 3rd Edition, 1998, 93 et seq.). Worth highlighting in this connection are the definitions of value and valuation methods of tax law (e.g. assessed value, *Einheitswert*), accounting law (e.g. replacement value, *Wiederbeschaffungswert*), the mortgage banks (e.g. loan value, *Beleihungswert*), the insurance industry (e.g. insurance value, *Versicherungswert*) and company valuation (e.g. net asset value, *Liquidationswert*). However, as regards the valuation of real estate, the market value determined on the basis of Section 194 BauGB is also of key importance here as the starting point of the valuation.

2. Determinants of the Market Value

a) Undeveloped Land

aa) Land Value

The value of undeveloped land (*unbebaute Grundstücke*) is determined by the land value (*Bodenwert*). The factors which are of crucial importance in Germany in the determination of the land value (*wertbeeinflussende Merkmale*) are contained in Sections 4 and 5 of the Federal Valuation Ordinance (*Wertermittlungsverordnung – WertV*).

According to Section 4 WertV, the condition and the development of the land are important factors influencing the value. A difference is made here between agricultural and forestry areas, potential development land (*Bauerwartungsland*), land zoned for development in a local plan (*Rohbauland*) and land ready for development (*baureifes Land*).

Moreover, according to Section 5 WertV, the following characteristic conditions of the land are of key importance for the valuation of real estate:

- Type and extent of use for building (Section 5 [1] WertV)
  - The permissibility of a building project on land which is located within the area covered by a **development plan** (*Bebauungsplan*) is regulated in Section 30 BauGB. The type and extent of use for building are derived in this case from the specifications of the development plan.
  - The permissibility of a building project on land which is not located in the area covered by a development plan but within built-up areas is regulated in Section 34 BauGB. The type and extent of use for building must, in this case, blend with the characteristic features of the immediate surroundings.
  - The permissibility of a building project on land which is located in the outlying area (*Außenbereich*) is regulated in Section 35 BauGB. Building

projects in the outlying area are only permissible under very stringent conditions.
- Special provisions apply to the permissibility of a building project on land which is located in the area covered by development rules (*Entwicklungssatzung*) in accordance with the provisions of Section 165 et seq. BauGB or in the area covered by a redevelopment order (*Sanierungssatzung*) in accordance with the provisions of Sections 136 et seq. BauGB.
- The basis for the explanations and stipulations of the type and extent of use for building in development plans is the **German Town Planning Regulations** (*Baunutzungsverordnung - BauNVO*) in the version applicable since 27 January 1990.

For details, refer to the explanations in Chapter 1, sections III. IV. and V.

- Rights and encumbrances on the land (Section 5 [2] WertV)
  - Encumbrances on the land are generally of a private law nature. Provisions on this can be found in Sections 1018 et seq. BGB for easements (*Dienstbarkeiten*), Sections 1094 et seq. BGB for rights of pre-emption (*Vorkaufsrechte*), Sections 1105 et seq. BGB for charges on land (*Reallasten*), Sections 1113 et seq. BGB for mortgages (*Hypotheken*), Sections 1191 et seq. BGB for land charges (*Grundschulden*) and Sections 1199 et seq. BGB for annuity charges (*Rentenschulden*). Land encumbrances of this nature must be entered in the **land register** (*Grundbuch*) to become legally effective and can therefore be seen in a land register extract (*Grundbuchauszug*) which is issued, on application, by the German local court (*Amtsgericht*) responsible for keeping the land register in its function as the land registry (*Grundbuchamt*). Each plot of land is given a separate land register sheet in the land register which contains, in the inventory (*Bestandsverzeichnis*), information on the land and its size, details on the ownership in the first section (*Abteilung I*), details on the encumbrances in the second section (*Abteilung II*) and details on the mortgage liens in the third section (*Abteilung III*).
  - However, encumbrances on the land may also be of a public law nature. Worth highlighting in this context is the possibility of the existence of a public land charge (*Baulast*) which arises by means of a declaration of the land owner to the building control authority and contains restrictions on the development of land. To become legally effective, public land charges must be entered in the **land charges register** (*Baulastenverzeichnis*) which is kept by the building control authority and can be viewed there. Moreover, obligations under public law may also be based on a contract under public law which the land owner or his legal successor has concluded with the local authority responsible.
- Charges and fees under public law (Section 5 [3] WertV)
  - The obligation to pay charges may arise in particular from the **provision of infrastructure** (*Erschließung*) on land for which the local authorities are responsible. According to Sections 127 et seq. BauGB, the local authorities

are entitled to collect charges (*Erschließungsbeitrag*) to recoup expenditure on public infrastructure on the basis of a by-law of the local authority (*Erschließungssatzung*). In accordance with Section 134 (1) BauGB, the person who is the owner of the land at the time the demand for payment is issued is liable to pay the charges.

- The land owner's obligation to pay charges (e.g. for road construction) or fees (e.g. refuse collection) may also arise from other **by-laws of a local authority.** The laws of the German states on the collection of taxes, fees and charges by the local authorities and local government associations (*Kommunalabgabengesetze*) are the legal basis for such by-laws.

- Waiting time until the land is used for building (Section 5 [4] WertV)

  The waiting time until the land is used for building depends on what period of time will probably elapse before the fulfilment of the legal and factual conditions for the permissibility of a building project.

- Condition of the land (Section 5 [5] WertV)

  The following characteristic conditions in particular govern the state and actual features of a plot of land:

  - Size and shape of the land
  - Local pollution
  - Actual and potential use
  - Condition of the soil

  A comprehensive **subsoil expertise** (*Bodengutachten*) must always be obtained to determine the soil condition. In this way the investor not only obtains important information on the quality of the soil and its suitability as building land but **soil contamination** (*Altlasten*) may also be discovered; under German law – in particular in accordance with the provisions of the **German Soil Protection Act** (*Bundesbodenschutzgesetz - BBodSchG*), it is not only the polluter but also the land owner who is also liable for its remediation.

- Location characteristics of the land (Section 5 [6] WertV)

  The location characteristics which are important for the land value include in particular the traffic links, the neighbourhood, the residential and business location and the environmental influences. Moreover, in addition to these micro-location criteria, the macro-location of a plot of land is, of course, also important.

The above characteristic conditions of land are not only of key importance for the valuation of real estate and therefore for the purchase price but may also have a fundamental impact on the **investor's decision to purchase** even in a very early stage of the purchase negotiations. This applies in particular to the location characteristics of a plot of land, the possibilities of its use for building and the rights and encumbrances on the land. It is therefore recommended to examine these characteristic conditions of land at the start of the purchase negotiations

during the first stage of the **due diligence examination**. The purchase negotiations should only be continued and the time and money invested in a comprehensive due diligence examination if the results of this preliminary examination indicate that the land is interesting for the investor.

bb) Development Costs

As part of **project development,** the purchase price which an investor is prepared to pay for undeveloped land is primarily governed by the project development costs. In this case the crucial factor is not the abstract land value but the question of what maximum purchase price the investor can pay if he is to implement a certain project economically. Here, the **residual method of valuation** (*Residualwertverfahren*) is generally applied to determine the land value (cf. Kleiber in Kleiber-Simon-Weyers, Verkehrswertermittlung von Grundstücken, 3rd Edition, 1998, 1404 et seq. / Niehaus in Schäfer-Conzen, Praxishandbuch der Immobilien-Projektentwicklung, 2002, 45).

When this valuation method is applied, the forecast market value of the land after completion of the project is taken first. The **residual value** (*Residualwert*) is the value remaining after deduction of the total investment costs (with the exception of the land costs)

- Incidental land acquisition costs
- Building costs
- Incidental building costs
- Financing costs
- Marketing costs

and the profit expected from the project development. The costs for preparing the land for development which may be incurred on the construction side (e.g. demolition costs), in the geotechnical field (e.g. remediation of soil contamination) and on the infrastructure side (e.g. infrastructure charges) may also have to be deducted. The residual value is discounted for the duration of project development and completion of the project and the result is the economically acceptable land value.

As regards land acquisition costs, **incidental land acquisition costs** (*Grunderwerbsnebenkosten*) of 5 to 6% of the land price can be expected in Germany. The crucial factors in this case are the cost of notarisation of the land purchase contract amounting to approx. 1% of the land price, the court costs for the legal changes in the land register of about 0.5% of the land price and the land transfer tax to be paid by the buyer of currently 3.5% of the land price. In addition, there are the costs of a valuation expertise and the costs of the land survey if these costs are not borne by the seller. There is also the broker's commission if the contract stipulates that this has to be paid by the buyer; in Germany the broker's commission to be paid by the buyer is normally 3% of the land price plus VAT.

The **incidental building costs** (*Baunebenkosten*), which are to be put at 15 to 20% of the building costs in Germany, must also be borne in mind when calculating the building costs. The crucial factors here are the planning costs for

architects, stress analysts, engineers and independent experts, the fees for the building permit and any costs incurred for project management. The architects, stress analysts, engineers and independent experts are paid on the basis of a special Fee Regulation (*Honorarordnung für Architekten und Ingenieure – HOAI*). The fees for obtaining a building permit, which are set by the building authority on the basis of state regulations, depend on the total building shell costs which are calculated on the basis of the cubic content and a certain building shell value for the type of building in question. The remuneration for a project controller can be freely agreed and, as a rule, is 1 to 1.5% of the building costs.

b) Developed Land

The value of developed land (*bebaute Grundstücke*) is governed by the **land value** (*Bodenwert*) and the **building value** (*Gebäudewert*). The factors influencing the value (*wertbeeinflussende Merkmale*) which are of key importance in the determination of the building value are contained in Section 5 (5) sentence 2 WertV.

In accordance with Section 5 (5) sentence 2 WertV, the building value is primarily governed by the condition of the building structures. Here, the type of building, the year of construction, the building method, the building design, the size, the standard of fixtures and fittings, the structural condition and the revenue (gross income/net income) are of major importance. The examination of these assessment criteria generally requires a multidisciplinary **due diligence examination** which must also include the criteria for assessing the land value.

In preparation for a real estate transaction, special emphasis is placed on an assessment of the **rental income** (*Mietertrag*). Only when the investor has accurate information on the present and future rental income attainable can he correctly estimate the economic risks and opportunities of a property and the expected return on investment (*Rendite*).

- The present **lease contracts** (*Mietverträge*) must initially be examined for their legal effectiveness and their compliance with written form requirements. Moreover, the credit standing of the tenants and the key economic data of the lease contracts are important:
  - Agreements on rents and rent escalation clauses (indexing, graduated rent etc.)
  - Agreements on the term of the lease including extension options and contractual rights to terminate the lease
  - Agreements on the payment of management costs, land tax, insurance and costs of upkeep
  - Agreements on the obligations of the tenant as regards renovation, maintenance and restoring the building to its original condition
  - Agreements on a rent deposit (e.g. guarantee)
  - Agreements on the right to sublet
- The present lease contracts must be examined to ascertain whether the rent currently charged is in line with the **market rent** (*Marktmiete*). If the market rent has clearly been exceeded, it must be assumed that it will not be possible to

sustain this level of rental income in the future – i.e. after the end of the present lease contracts. If the rent is considerably lower than the market rent, the marketability of the real estate must be examined and, if necessary, the building improved by investments (refurbishment, modernisation, space optimisation etc.).

- The **vacancy rate** (*Leerstandsrate*) must also be taken into account in the examination of the rental income which can be attained in the future. If vacancies are caused by the condition of the building and its standard of fixtures and fittings, investments may be necessary to improve the marketability of the real estate. If vacancies are due to economic reasons, changing the marketing strategy (e.g. granting incentives) may lead to a reduction in vacancies.
- When examining the rental income which can be achieved in the future, the prospective investor must also check to determine whether and to what extent the real estate has potential for an **increase in value** (*Wertsteigerung*). Conversion work to create new rented space and changing the existing space into rented areas of higher quality can be considered. Realising the potential for an increase in value may play an important role in improving the income situation.

Special factors apply to the acquisition of a building which was erected on the basis of a ground lease agreement (*Erbbaurechtsvertrag*). Details are regulated in the **German Ordinance on Ground Leases** (*Verordnung über das Erbbaurecht - ErbbauVO*) dated 15 January 1919 – last amended by the law dated 22 May 2005. The ground lease (*Erbbaurecht*) is defined as follows in Section 1 (1) ErbbauVO:

> "A plot of land can be encumbered in such a way that the person in whose favour the encumbrance is made has the saleable and inheritable right to have a building on or under the surface of the land (ground lease)."
> [Convenience translation into English]

The encumbrance of land with a ground lease is entered in the second section of the land register (*Grundbuch*) as a first-ranking encumbrance. At the same time, a special land register sheet (so-called leasehold register, *Erbbaugrundbuch*) is created for the ground lease which shows the main contents of the lease. A ground lease is generally concluded for a certain period (e.g. 50 years) and can be encumbered with a mortgage. The leaseholder (*Erbbauberechtigter*) is normally obliged to pay a ground rent in return for the land owner granting the ground lease; this ground rent can be compared with a lease payment and generally amounts to 3 to 5 % p.a. of the land value. When the ground lease expires, the leaseholder receives compensation for the building in accordance with Section 27 ErbbauVO.

When a building which has been erected on the basis of a ground lease agreement is valued, the special aspects and conditions of this agreement must be allowed for by appropriate deductions. The **remaining term of the ground lease** is particularly important for an investor because the calculation of the ROI and the payback of the investment depends on this. An examination must also be conducted to determine whether extension and ground lease renewal options are available. The right of the land owner to terminate the ground lease agreement

prematurely and to demand the retransfer of the ground lease (so-called reversionary claim, *Heimfallanspruch*), should be limited to those cases where the leaseholder has committed a serious breach of the agreement.

3. Determination of the Market Value

a) National Valuation Methods

aa) General Aspects

Section 199 (1) of the Federal Building Code (*Baugesetzbuch - BauGB*) authorises the German government to issue regulations to ensure application of the same principles for the determination of market values and for the acquisition of the data required for the valuation of real estate. The **Federal Valuation Ordinance** (*Wertermittlungsverordnung – WertV*) dated 6 December 1988 – last amended by a law dated 18 August 1997 – was passed on this legal basis; the text is reproduced in **Appendix I**. With regard to the general procedural principles and the definitions of terms (Sections 2-7 WertV), this Ordinance is based on the legal definition of the market value contained in Section 194 BauGB. Accordingly, Section 3 (1) WertV also contains in particular the provision that the determination of the market value must be based on the general values on the real estate market at the time to which the valuation relates (so-called valuation date, *Wertermittlungsstichtag*).

The Federal Valuation Ordinance is supplemented by the **German Administrative Regulations for Valuation** in the revised version dated 1 March 2006 (*Wertermittlungsrichtlinien 2006 – WertR 2006*) which contain a host of definitions and notes on the determination of the market value of undeveloped and developed land and of land rights. The application of these administrative regulations for valuation is designed to ensure an objective determination of the market value of real estate according to uniform principles and procedures which are in line with market requirements. There are other administrative regulations on valuation for determining the market value of land used for forestry purposes as well as agricultural land and enterprises.

Important information for determining the market value of real estate is obtained from the activities of the **committees of valuation experts** (*Gutachterausschüsse*) which are formed in Germany on the basis of Section 192 BauGB for the area of individual regional authorities (cities and districts). These committees of valuation experts initially have the duty, in accordance with Section § 193 (1) BauGB, to produce **valuation reports** (*Wertermittlungsgutachten*) when authorities, courts, judicial authorities or property owners apply for such a report. Moreover, in accordance with Section 193 (3) BauGB, the committees of valuation experts have the task of compiling **data on purchase prices** (*Kaufpreissammlung*) stipulated in Section 195 BauGB and determining the **standard land values** (*Bodenrichtwerte*) laid down in Section 196 BauGB by evaluating the purchase prices compiled and obtaining other data required for the valuation; this includes in particular the determination of the **property interest rates** (*Liegenschaftszinssätze*) representative of the local property market.

The standard land values which are determined for every district always relate to undeveloped land or, in the case of developed land, the value which would be obtained if the land were undeveloped. The standard land values, which relate to one square metre of the land area, are compiled in **standard land value maps** (*Bodenrichtwertkarten*) which, in accordance with Section 196 (1) BauGB, are decided on by the committees of valuation experts at the end of every calendar year and made accessible to the general public in accordance with Section 196 (3) BauGB.

In accordance with Section 11 (1) WertV, the property interest rate is the average interest rate, usual in the market, which is charged on the market value of real property. The property interest rates are determined by the committees of valuation experts and published in the **property market report** (*Grundstücksmarktbericht*), which is updated every year. The basis for determining the property interest rates is, according to Section 11 (2) WertV, the purchase prices of comparable properties (*Vergleichsobjekte*) and the remaining life expectancy (*Restnutzungsdauer*) of the building.

As administrative regulations, the Federal Valuation Ordinance and the German administrative regulations for valuation **do not apply directly** to private legal relations. Nevertheless, these regulations are generally recognised in Germany as the basis for the valuation of real estate and are also used by civil courts when an appraisal is obtained to assess the market value of a property. The Federal Court of Justice (*Bundesgerichtshof*) found on this point, in a ruling dated 12 January 2001 (BGH NJW-RR 2001, 733 et seq.), that these regulations contain **generally recognised principles** for determining the market value of properties and that they are not limited in their applicability to the valuation reports which are prepared by the committees of valuation experts formed in accordance with Section 192 BauGB in performance of the tasks assigned to them in Section 193 BauGB.

The Federal Valuation Ordinance contains regulations on the following methods of property valuation which are explained in more detail below:

- Comparative method of valuation (*Vergleichswertverfahren*)
- Income capitalisation valuation method (*Ertragswertverfahren*)
- Depreciated replacement cost method (*Sachwertverfahren*)

According to the principles of the Federal Valuation Ordinance, these valuation methods are to be regarded as **having equal priority** and, in accordance with Section 7 (1) WertV**, one or several** of these valuation methods can be used for the valuation of real estate (*Wertermittlung*). Accordingly, the Federal Court of Justice (*Bundesgerichtshof*) in its ruling dated 2 July 2004 (BGHZ 160, 8 et seq.) once again found that the courts in Germany are not bound by one specific valuation method but have to decide, after due assessment of the circumstances, which valuation method is appropriate for the case in question. A **combination** of the different valuation methods may also be considered in certain cases.

The above-mentioned valuation methods are standardised procedures which are laid down in the Federal Valuation Ordinance. Other valuation methods are also used in Germany in addition to these standardised procedures. They are

refinements of these valuation methods or are based on international valuation methods. The **residual method of valuation** (*Residualwertverfahren*), which is mainly used as part of the project development, and the **discounted cash flow method** (*Barwertverfahren*) deserve particular mention. In a ruling dated 16 January 1996 (BVerwG ZfBR 1996, 227 et seq.), the Federal Administrative Court (*Bundesverwaltungsgericht*) expressly found that the Federal Valuation Ordinance is not conclusive to this extent and that in those cases where one of the valuation methods laid down in the Federal Valuation Ordinance cannot be applied – e.g. due to insufficient data – other suitable valuation methods may also be developed and applied.

bb) Comparative Method of Valuation

The comparative method of valuation (*Vergleichswertverfahren*) is regulated in Sections 13 and 14 WertV. When this valuation method is applied, purchase prices of **comparable properties** (*Vergleichsgrundstücke*) have to be used in accordance with Section 13 (1) WertV. Comparable properties are those properties which adequately correspond to the property to be valued as regards the characteristics influencing their value as defined in Sections 4 and 5 WertV.

- Characteristics influencing the value as defined in Section 4 of the Federal Valuation Ordinance are the condition and the state of development of the land. Here a difference is made between agricultural and forest areas, potential development land (*Bauerwartungsland*), land zoned for development in a local plan (*Rohbauland*) and land ready for development (*baureifes Land*).
- Characteristics influencing the value as defined in Section 5 WertV are other condition characteristics of the property to be valued. These include in particular the type and extent of development permissibility in accordance with Sections 30, 33 and 34 BauGB, any encumbrances on the land, the state of development of the land, certain features of the land, the condition of the ground, the location of the land and, in the case of developed land, the condition of the building structures.
- In the case of undeveloped land suitable standard land values, which are derived from the standard land value map, can also be used in accordance with Section 13 (2) WertV to determine the land value in addition to or instead of prices of comparable properties.
- In the case of developed land, comparable factors (*Vergleichsfaktoren*), also determined in accordance with Section 12 WertV, can also be used in accordance with Section 13 WertV in addition to or instead of prices of comparable properties. In accordance with Section 12 (1) WertV, the purchase prices of similar properties must be initially used to determine the comparable factors. In accordance with Section 12 (2) WertV, these purchase prices must then be related to the sustainable annual income (so-called income factor, *Ertragsfaktor*) or to any other appropriate unit of reference – in particular to a unit of volume or area of the building (so-called building factor, *Gebäudefaktor*).
- If the condition of the property to be valued is different to the condition of the comparable properties or the condition of those properties for which standard

land values or comparable factors have been derived, this must be allowed for by additions or deductions or in another suitable way in accordance with Section 14 WertV. The index series (*Indexreihen*) regulated in Section 9 WertV and the conversion coefficients (*Umrechnungskoeffizienten*) regulated in Section 10 WertV are then applied.

The comparative method of valuation is the national valuation method most frequently used in practice. The main reason for this is that this method of valuation in accordance with Sections 15 (2) and 21 (2) WertV is generally also used as part of the income capitalisation valuation method and the depreciated replacement cost method for determining the land value (*Bodenwert*). Furthermore, the use of purchase prices actually paid is also a realistic basis for obtaining an optimum approximation to the purchase price which can be attained on the real estate market.

cc) Income Capitalisation Valuation Method

The income capitalisation valuation method (*Ertragswertverfahren*) is regulated in Sections 15 – 20 WertV. If this valuation method is used, the **land value** (*Bodenwert*) and the **building value** (*Gebäudewert*) are determined separately in accordance with Section 15 (1) WertV. The land value is determined using the comparative method of valuation (Sections 13 and 14 WertV) whereas the building value is calculated on the basis of the **income** (*Ertrag*) in accordance with the provisions of Sections 16-19 WertV. The land value and the building value give the capitalised income value (*Ertragswert*) of the property.

- In accordance with Section 16 (1) WertV, the sustainable annual net income (*Reinertrag*) of the property is to be used as a basis when determining the capitalised income value of buildings. The net income is the gross income (*Rohertrag*) less management and maintenance costs (*Bewirtschaftungskosten*).
  - The gross income to be determined in accordance with Section 17 WertV comprises all sustainable income from the property, i.e. rents, lease payments and other payments. Charges levied to cover operating costs (*Betriebskosten*) are not included.
  - The management and maintenance costs to be determined in accordance with Section 18 WertV comprise depreciation, administration costs, operating costs, maintenance costs and the loss of rental income risk. Operating costs which are covered by charges are not included.
- In accordance with Section 16 (2) WertV, the net income is to be reduced by an amount corresponding to a reasonable rate of interest on the land value. As a rule, the interest is to be based on the property interest rate (*Liegenschaftszins*) for the building in accordance with Section 11 WertV.
- The net income reduced by the rate of interest on the land value is to be capitalised in accordance with Section 13 (3) WertV with an annuity factor (*Vervielfältiger*) taken from an Appendix to Section 16 (3) WertV. The property interest rate (*Liegenschaftszins*) and the remaining life expectancy (*Restnutzungsdauer*) are the crucial factors for selecting the annuity factor.

- Other circumstances which influence the market value and have not been included in the real estate valuation in accordance with Sections 16 – 18 WertV are to be taken into account by additions or deductions or in another appropriate way in accordance with Section 19 WertV.

The use of the income capitalisation valuation method is practical and appropriate if the property to be valued is an investment property. These include in particular apartment buildings, office buildings and other commercial properties.

dd) Depreciated Replacement Cost Method

The depreciated replacement cost method (*Sachwertverfahren*) is regulated in Sections 21 – 25 WertV. If this valuation method is applied, the **land value** (*Bodenwert*) and the **building value** (*Gebäudewert*) are also determined separately in accordance with Section 21 (1) WertV. Whereas the land value is again determined according to the comparative method of valuation (Sections 13 and 14 WertV), the building value is calculated on the basis of the **building costs** (*Herstellungswert*). The land value and the building value give the depreciated replacement cost (*Sachwert*) of the property.

- To determine the building costs, the standard building costs per unit of volume or unit of space (*Normalherstellungskosten*) are multiplied by the corresponding units of volume or units of space in accordance with Section 22 (1) WertV.
  - The standard building costs also comprise the incidental building costs (*Baunebenkosten*), which include in particular the costs of planning, construction, official inspections and permits as well as the financing costs associated with construction.
  - The standard building costs which are based on empirical rates must, where necessary, be related to the date of the valuation on the basis of the building price index series (*Baupreisindexreihen*).
- When the building costs are being calculated, a value reduction for age must be made in accordance with Section 21 (3) WertV; this is calculated according to the provisions in Section 23 WertV.
- Moreover, when the building costs are being calculated, a value reduction for construction deficiencies and building damage must be made in accordance with Section 21 (3) WertV; this is calculated according to the provisions in Section 24 WertV.
- Other circumstances which influence the market value and have not yet been included in the valuation in accordance with Sections 22 – 24 WertV are to be taken in account by additions or deductions or in any other appropriate way in accordance with Section 25 WertV.

The use of the depreciated replacement cost method is practical and appropriate when the property to be valued is not an investment property. Such properties are in particular owner-occupied properties.

b) International Valuation Methods

There are no international valuation methods, there are only standardised (e.g. in accordance with the Federal Valuation Ordinance) and non-standardised valuation methods (e.g. the **discounted cash flow method**).

The most common international methods for determining the market value, which are also used in Germany in accordance with the Federal Valuation Ordinance (*Wertermittlungsverordnung - WertV*), are:

- **Comparative method of valuation** or **sales comparison method** (corresponds to the German standardised *Vergleichswertverfahren*)
- **Income capitalisation, income approach** or **direct capitalisation method** (corresponds to the German standardised *Ertragswertverfahren*)
- **Depreciated replacement cost** or **cost approach method** (corresponds to the German standardised *Sachwertverfahren*)

There are a number of other valuation methods (Monte Carlo method, residual method of valuation, Mosaic method etc.), but all other methods can be basically traced back to the three fundamental methods mentioned above.

The unstoppable globalisation of real estate investment markets and, as a result, the increasing competition between these markets and with other forms of investment will lead to the standardisation or harmonisation of national (standardised) valuation methods.

The highly standardised Federal Valuation Ordinance is unique to Germany. Theoretically, only the boards of expert valuers and publicly appointed and sworn experts are obliged to apply the Federal Valuation Ordinance to determine market values. In practice, however, this Ordinance has become the basis for all German market value appraisals and expert valuers.

In the following, the German **income capitalisation valuation method** (standardised method), which is regulated in the Federal Valuation Ordinance, is compared with the **DCF method** (non-standardised method) frequently used internationally.

For a better understanding, the German income capitalisation method is compared, in a first step, with the income approach method which is also common in other countries (also termed direct capitalisation). Both methods are static methods, i.e. the cash surpluses in the future are not estimated per period and discounted individually but the net annual income in one period is multiplied by a factor.

One initial difference is the method of determining the **net annual income** (*Reinertrag*). For simplicity's sake, we assume that the net annual income corresponds to the market rent or the sustainable rent. In both methods, the property management costs which cannot be passed on to the tenants are deducted from the rental income. In contrast to the income approach, the income capitalisation method also covers the loss of rental income risk. This means that when the German income capitalisation method is used, all other things being equal, the net annual income is lower than the net annual income determined using the international income capitalisation or direct capitalisation methods.

The net annual income is multiplied by an annuity factor corresponding to the all-risk yield in the international procedure. With the income capitalisation method, the net annual income is first reduced by the land value plus interest at the property interest rate. Only then is the amount multiplied by an annuity factor. This annuity factor is not the same as the reciprocal of the all-risk yield. The differences are, firstly, that the all-risk yield also includes the general vacancy risk (loss of rental income risk). Secondly, the annuity factor in the income capitalisation method allows for the remaining life expectancy of the building. In this method, the land value is added to the sub-total thus attained.

Formula for the income capitalisation method:

$$EW = (RE - BW * p) * V_{pn} + BW$$

EW	=	capitalised income value (*Ertragswert*)
RE	=	net annual income (*Reinertrag*)
BW	=	land value (*Bodenwert*)
p	=	property interest rate (*Liegenschaftszins*)
V_{pn}	=	annuity factor (*Vervielfältiger; n - remaining life expectancy of building*)

For the sake of completeness, it should be mentioned here that the value determined in this way is adjusted to obtain a market value which allows for other factors influencing the value (e.g. in over-rented or under-rented situations). Correctly applied, both the income approach and the income capitalisation methods of valuation produce the same result.

The main feature of these static methods is that the expectation of the future rent development is not estimated explicitly but is expressed implicitly by the annuity factor, the property interest rate or the all-risk yield. The dynamic procedure of the DCF method contrasts sharply with this. In the DCF method, the cash flows for future periods (normally per year) are individually estimated and discounted. In practice, this discounting is generally performed explicitly for a period of ten years. The cash flows even further in the future are taken into account in that the value of the cash flows is determined for the eleventh year in accordance with the income approach and then discounted by ten years and added on.

Formula for the DCF method:

$$DCF = RE_1 + \frac{RE_2}{1+q} + \frac{RE_3}{(1+q)^2} + \ldots + \frac{RE_{10}}{(1+q)^9} + \frac{\frac{RE_{11}}{q}}{(1+q)^{10}}$$

DCF	=	discounted cash flow
RE	=	net annual income (*Reinertrag*)
q	=	discount rate (*Kalkulationszins*)

The discount rate assumed for this calculation is not equivalent to the all-risk yield or the property interest rate. The all-risk yield and the property interest rate allow for the expected future rents and, in the case of the all-risk yield, also the loss of rental income risks, whereas, with the DCF method, these factors have to be explicitly estimated in the cash flows for every year. Consequently, the discount rate corresponds to the yield expected by the investor or, if the DCF method is used to determine a market value, the interest rate corresponds to the average rate expected by possible investors or groups of investors.

This rough comparison shows the strengths and weaknesses of the individual methods. The DCF method is analytically more accurate but the challenge here is that the future development of rents and all other relevant cash flows , e.g. vacancy risk, investment costs etc., have to be estimated individually by the person using the method. As a result, particular risks or opportunities can be reproduced more accurately than with the income capitalisation method but this method is more error-prone if the user does not have all the information or if his expectations of the future are not the same as those of most other market players. For the sake of completeness, it should be mentioned that the Federal Valuation Ordinance also permits the use of the DCF method to determine the market value if its application complies with normal business practice (Section 7 [2] WertV).

By contrast, with the income capitalisation method the individual characteristics of the real estate are not taken into account so analytically but are allowed for in the calculation of the property interest rate. Correctly determined, this property interest rate implicitly takes into account the expectations which the market places on the future development of rental income and also of the opportunities and risks of comparable properties.

The detailed procedures in the common income capitalisation methods and the discounted cash flow method and their applicability must comply with the national valuation standards in Germany (Federal Valuation Ordinance / Section 194 Federal Building Code, *Baugesetzbuch - BauGB*) or in the United States of America (Appraisal of Real Estate) or in Great Britain (Red Book of the Royal Institute of Chartered Surveyors). As the differences in standardised and non-

standardised methods already indicate, there are no clearly defined rules or guidelines for a DCF method. By contrast, for the income capitalisation method according to Section 194 BauGB, the Federal Valuation Ordinance and the German Administrative Regulations for Valuation (*Wertermittlungsrichtlinien 2006 – WertR 2006*) are detailed procedural regulations.

All in all, the income capitalisation method is different in that it has a high degree of standardisation which is difficult for foreign investors to follow. In particular the calculation and informative value of **property interest rates** is completely **unknown on the international markets.**

Conversely, this is also the key advantage of the DCF method: Its structure is very similar to the considerations which investors make anyway when deciding on a purchase and is therefore intuitively easy to understand for a large group of Anglo-Saxon investors and financial institutes.

Chapter 4 Financing and Securities

I. General Aspects of Financing

1. Development of Real Estate Financing in Germany

In recent years, real estate financing has changed remarkably in Germany as capital markets have become more and more international and global investors have appeared on the real estate market. The high write-downs on real estate financing and the equity regulations introduced in Basel II have also induced the banks in Germany to rethink their strategies.

Nowadays, small-scale construction finance is largely standardised. The banks offer financing packages which require less individual customer advice with very favourable conditions. Consumers can now even arrange their house financing on the Internet. This high level of loan standardisation also means the banks have greater and more attractive refinancing possibilities including securitisation. Therefore, the financing conditions for owner-occupied real estate are expected to stay favourable in the medium term. The German real estate market is becoming increasingly attractive for foreign investors as the opportunities to sell property are also improving.

On the other hand, financing for investors who develop or acquire large-scale real estate projects is becoming more and more individualised and requires more customer advice. German banks have now brought themselves into line with international standards and offer structured financing – in combination with a range of services. Such structured financing is provided for each specific case while syndication and securitisation on the international finance markets also remain an option. Therefore, the refinancing opportunities for the banks are growing which is, at the same time, having a positive impact on their willingness to also finance complex investments. Once a certain volume is reached (i.e. approx. € 200 million), the real estate investor may raise the funds required directly on the capital market using an arranger.

2. Traditional Financing

Traditionally, real estate financing has been provided by the German banking system through universal and mortgage banks (today: mortgage bond banks (*Pfandbriefbank*). The banks basically offer unstructured financing in the form of

“universal loans". This loan is based on the current market value which is determined by an expert. The market value forms the basis for the lending value. A first mortgage is granted for 60 % of the property's lending value and entered in the land register as a first-ranking mortgage. The remaining amount up to 80 % of the lending value is granted in the form of a personal loan, any amount exceeding this as an open credit. In some cases, the property is even financed entirely with borrowed capital.

The loans are long-term. The debt is serviced through current payments of interest and principal, which gradually reduces the financing bank's risk. The location and quality of the property, the reliability and solvency of the borrower, the amount of capital the borrower is putting up himself and any right to use granted to third parties are the main criteria for the granting of loans.

Furthermore, there are refinancing possibilities for banks, especially for mortgage bond (*Pfandbrief*) banks, which may - in accordance with the German Mortgage Bond Act (*Pfandbriefgesetz*) - issue mortgage bonds and sell them on the capital market in order to refinance the loans granted. Mortgage bonds are securities backed by mortgages. Therefore, only mortgages which provide security for loans up to an amount of 60 % of the lending value may be considered. The assessment is made on the basis of the Regulation on the Assessment of Lending Values (*Beleihungswertermittlungsverordnung*) which came into effect at the beginning of August 2006. This is the first regulation to lay down standard, transparent requirements on valuation methods and the qualifications of experts for all bond issuers.

The classic real estate financing, which offers banks the opportunity to refinance by issuing mortgage bonds, is still important for financing owner-occupied residential estates and commercial real estate on a smaller scale. The average loan granted by mortgage bond (*Pfandbrief*) banks in this sector is € 3.9 million. Since refinancing is relatively easy for the banks, i.e. they can issue bonds, the classic way of financing real estate will be continue to be important where long-term investment strategies are relevant (e.g. for owner-occupied residential and industrial estates).

3. Cash Flow-Oriented Financing

a) Fundamental Rules

Given its long-term nature, classic real estate financing is not adequately geared to the needs of international property investors with their buy-and-sell strategy. According to international financing standards with which German banks now also comply, the focus is on the cash flow which can be generated with the property. As part of finance structuring, the banks look at the total cash inflow and outflow of the property over the entire financing period, taking into account the terms of the tenancy agreements and the tenants' financial standing. Sensitivity analyses are conducted with different scenarios (best, normal and worst case) to determine the potential cash flow as accurately as possible with due allowance for

the uncertainties which any prediction involves. The financing plan is structured on the basis of these data.

The equity capital regulations of Basel II have also helped to induce German banks to adopt this procedure. The main purpose of Basel II is to stabilise financial systems. It requires adequate capital backing and pricing of the loans granted by the banks to cover risks. In the past, capital backing of 8% was demanded across the board, regardless of the risks involved in the different loans.

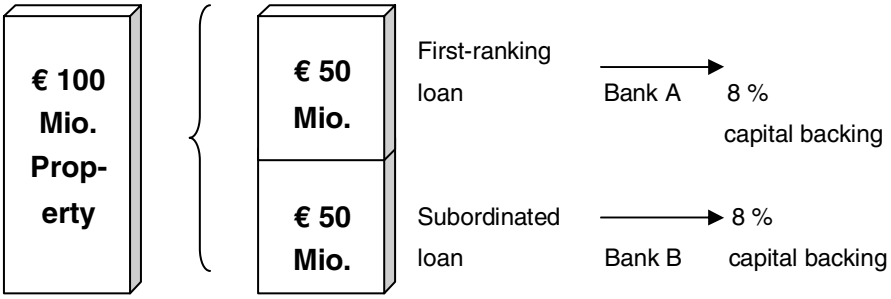


Figure 1. Capital backing in the part

This kind of risk covering makes no economic sense. Risks of non-payment arise almost exclusively with the subordinated loan. Therefore, Basel II ended this procedure because it gives bank A the possibility of granting a loan without capital backing whereas bank B has to provide adequate capital backing to cover the risk item. This procedure opens up the way for structuring financing:

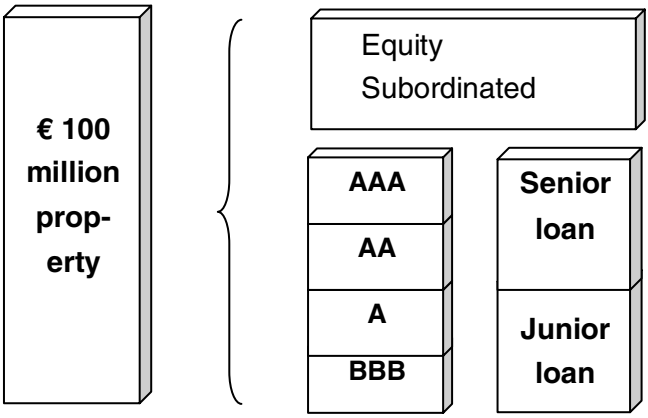


Figure 2. Structuring financing

b) Covenants

The banks apply the structured financing approach over the entire term of the loan. One important aspect here is the agreement of certain financial covenants which are either set by the lenders as positive ancillary obligations or as a precondition for pay-out of the loan. The failure to fulfil one of the financial covenants is frequently a reason for termination of the loan.

It should be noted that there is no standard set of financial covenants stipulated by the lenders. Different requirements are imposed depending on the type of property (office and business properties, properties held for sale, blocks of rented flats, special-purpose properties). The following financial covenants are of particular importance:

- Debt-Service Coverage Ratio (DSCR)

  The DSCR compares the cash flow expected from the property with the amount required to service the debt (i.e. payments of interest and principal).

- Loan-to-Value Ratio (LTV)

  This ratio is the amount of the loan in relation to the market value of the property.

- Loan Life Cover Ratio (LLCR)

  This ratio compares the cash value of the future cash flow to be expected during the loan life with the remaining loan debt.

- Interest Cover Ratio (ICR)

  This ratio is the net cash flow of one period to the interest cost in the same period.

The financial covenants are generally determined at certain periodic intervals. The cash flow model is an appendix to the loan agreement and an integral part of the contract.

c) Own Funds and Rate of Debt Servicing

With classic property financing, the percentage of funds put up by the borrower himself and rate of principal repayment play a major role in assessing whether a property investment will be financed by a bank or not. These two aspects are also of fundamental importance in the case of structured financing. It must be noted that 100% financing, which used to be not uncommon, is nowadays no longer offered by banks. It is therefore essential for the investor to provide some equity capital or similar funds himself.

However, there are also financing options for this case. German banks now offer various forms of mezzanine capital and equity financing. Mezzanine capital falls between senior debt and risk-bearing equity in terms of seniority and thus on the risk spectrum as well. In view of its nature, the price is not only determined through the interest charged, Returns are also enhanced through equity kickers such as shares in profit or other participation models. Mezzanine capital can be

provided through subordinated loans, partial loans or atypical silent participations, which mean that depending on the chance-risk ratio, the investor receives the right to participate in taking important decisions.

Moreover, equity financing is also conceivable. The requirements are naturally very high with this type of financing. It is performed using the same instruments as the mezzanine financing model.

II. Forms of Financing

Questions relating to financing arise with virtually every real estate purchase. Even if sufficient equity is available, it is sensible to use other financing instruments to exploit the difference between the borrowing costs and the income from the real estate so as to improve the return of equity (leverage effect). A large number of financing alternatives are available for this purpose. Innovative and flexible financing alternatives have now established themselves alongside the traditional bank loan. In the final analysis, the choice of the right financing concept is the basis for a successful real estate investment.

The different forms of financing can be broken down as follows.

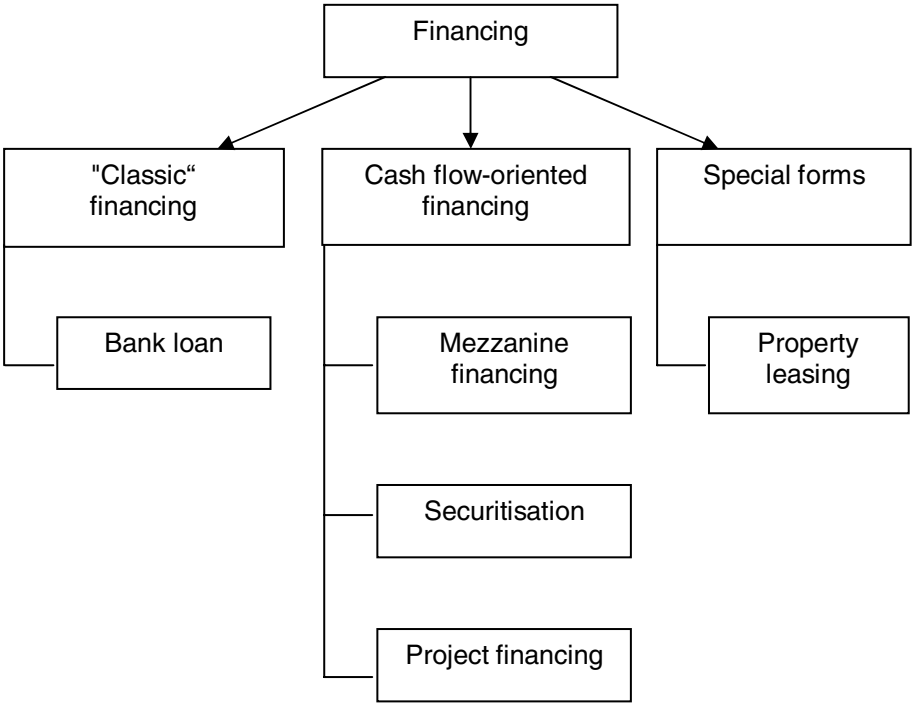


Figure 3. Different forms of financing

1. Loans

In German law, Sections 488 et seq. BGB regulate loan agreements. The lender is obliged to procure and provide the borrower with a certain amount of money in any form. The borrower must repay the sum of money at the agreed time and pay interest provided an appropriate agreement has been concluded (Section 488, para. 1 BGB). Loan agreements can be concluded without any particular form, which, however, does not happen in practice. Bank loans are frequently based on more or less extensive written agreements.

The special provisions for consumer loan agreements contained in Section 491 BGB and the provisions on real estate loan agreements (Section 492, para. 1a, sentence 2 BGB) only apply to agreements where the borrower is a consumer. According to Section 13 BGB, this presupposes that a natural person concludes a loan agreement which cannot be assigned to their business activities. Therefore, these provisions do not play any role in the field of commercial real estate investments.

a) Types of Loan

Loans can, first and foremost, be differentiated according to the different terms of payment for the borrower. With an annuity loan, the borrower pays the same instalments throughout the repayment period. A portion of each instalment is used to repay the capital borrowed, the rest as interest payments. As the loan is repaid, the interest portion decreases and the loan repayment portion increases. This contrasts with the instalment loan where a certain fixed portion of the capital is repaid in each instalment and interest is charged on the outstanding borrowed capital. This means that the instalment payments decrease over the term of the loan as the interest to be paid decreases. Finally, there is the interest-only loan where only interest is paid over the term and the entire original loan amount is paid on maturity. Interest-only loans are often taken out in conjunction with a life insurance policy. In this case, the principal is repaid at the end of the loan term with the money paid out when the insurance policy matures. With this form of financing, the borrower has to pay both the interest on the loan and the insurance premiums.

b) Structure and Content of Loan Agreements

aa) Financial Terms

In contrast to English law where the actual text of the agreement is usually preceded by a list of definitions, German law attempts to make the individual provisions of the agreement understandable in themselves without the need to refer to separate definitions of terms. The loan agreement is a reciprocal agreement against payment. In this reciprocal relationship, the lender procures and provides the borrower with the capital and the borrower pays interest, provides securities and assumes other obligations.

The borrower has a right to the pay-out of the borrowed funds from the loan agreement. The loan agreement generally lays down a so-called commitment

period, i.e. a period during which the borrower can draw down the borrowed funds. If the loan is taken out in connection with the erection of a building, loan pay-outs are made on the fulfilment of certain preconditions for pay-out. One pay-out precondition is usually that a certain stage of building progress has been reached, the funds paid out having to be used for a purpose defined in the loan agreement.

The borrower has three main obligations: Payment of the interest, payment of the agreed fees and repayment of the loan. The interest is the borrower's counter-performance for the lending bank's temporary provision of the loan principal. It is calculated on the basis of the term of the loan and does not depend on profit and turnover. The "commitment interest" often referred to in German loan agreements which frequently has to be paid is therefore not interest at all but a commitment fee which a lender charges a borrower for guaranteeing a loan at a certain future date even though the credit is not being used at that particular time.

As far as the payment of interest is concerned, a difference must be made between a fixed and a variable interest rate. It must be noted that with a fixed interest rate the borrower is, according to Section 489, para. 1, No. 3 BGB, always entitled to terminate the loan agreement after the expiry of ten years from receipt of the full loan amount. In practice, interest is therefore fixed for a maximum of ten years. With a variable interest rate, a variable reference interest rate (generally LIBOR or EURIBOR) is agreed plus a margin for the banks.

By agreeing to a variable interest rate, the borrower exposes himself to the risk of changes in interest rates. Therefore, interest rate derivatives are often used in order to exclude or at least reduce this risk (see section 2.6 below).

The fees which the borrower frequently has to pay include commitment fees. These are amounts which the bank charges for keeping a line of credit open to be drawn down at any time. Moreover, a number of special fees for activities are paid to the bank in connection with project financing (see section 2.5 below).

In addition to the payment of interest and certain fees, the repayment of the loan principal is the borrower's third main obligation. The repayment conditions depend on the type of loan (see section 2.1.1 above). The parties frequently agree early repayment or special voluntary repayment options in addition to the contractually agreed repayments. The possibility of such early repayments is generally limited. Unless otherwise stipulated in the loan agreement, an early repayment charge (*Vorfälligkeitsentschädigung*) normally has to be paid.

bb) Conditions Precedent

Loan agreements often lay down certain preconditions for pay-out which have to be fulfilled prior to the first or each pay-out. The purpose of these preconditions for pay-out is to ensure that the spreading of financing risk is achieved before pay-out of the loan amount by the conclusion of appropriate contracts and the creation of real rights. Preconditions for pay-out are typical for project funding, i.e. for the acquisition of land with the subsequent construction of a building. However, they also play an important role in the purchase of buildings which are already standing. In such cases, the entry of a priority notice of conveyance (*Auflassungs-*

vormerkung) in the land register is often demanded before the loan is paid out to the buyer of real estate.

In legal terms, the preconditions for pay-out are conditions precedent (Section 158, para. 1 BGB). However, it is not the effectiveness of the entire loan agreement that is subject to the fulfilment of the preconditions for pay-out. The condition precedent merely relates to the borrower's entitlement to pay-out of part or all of the loan amount.

A basic difference must be made between the preconditions for pay-out which have to be fulfilled before pay-out of the first part of the loan amount and those which have to be fulfilled before every subsequent pay-out. Preconditions for pay-out which have already to be fulfilled before the first pay-out are also frequently found in loan agreements for financing the acquisition of real estate. The following arrangements are typical in this case:

- Legally effective establishment of the borrower as a company,
- Conclusion of important contracts, e.g. insurance policies,
- Proof or payment of the agreed own capital by the borrower.

Project financing arrangements often include the following preconditions to further pay-outs:

- Drawdown notice (*Auszahlungsanzeige*) by the borrower. The drawdown notice form is generally enclosed as an annex to the loan agreement.
- The loan funds to be paid out are required for the purposes defined in the loan agreement, i.e. the project has reached a certain stage (construction progress).
- The necessary official permits have been obtained.

cc) Affirmative and Negative Covenants

Loan agreements governed by English law contain numerous other affirmative and negative covenants of the borrower which serve to ensure that the loan can be paid back. The four main purposes of such ancillary obligations are to:

- continuously monitor the financial circumstances of the borrower.
- ensure the borrower complies with conditions under company law.
- maintain the borrower's financial situation.
- provide information on the borrower's financial situation.

Nowadays, a number of covenants are also agreed in the loan agreements made by German banks.

The information of the lending banks on the borrower's financial situation is particularly important under German law and deserves special mention here. According to Section 18 KWG (German Banking Act), banks are obliged to make borrowers who are granted loans for more than € 750,000.00 disclose their financial situation, in particular by submitting annual financial statements. The bank can only waive this requirement if there would obviously be no reason to demand disclosure given the securities provided by the borrower or the other obligors. For real estate financing loans, there are also other relaxations of these strict requirements. If the loan does not exceed four-fifths of the lending value as

defined by Section 16 of the German Mortgage Bond Act (*Pfandbriefgesetz)*, the bank may also waive continuous disclosure. Moreover, the bank has suitable latitude if the borrower meets his interest payments and principal repayments without any problems. In practice, however, the presentation of annual financial statements certified by an auditor is frequently demanded, irrespective of Section 18 KWG.

Two kinds of problems may arise from the legal point of view if covenants are agreed. Firstly, the loan agreement may be null and void as it may be regarded as unconscionable by restricting and exploiting the borrower too much within the meaning of Section 138, para. 1 BGB. According to court rulings, such extreme restriction exists particularly in the case of a de facto management of the company. A lender is a de facto managing director, without being formally a shareholder, if, on the basis of contractual provisions, he combines business interests with sufficient possibilities of asserting control over the company (Federal Court of Justice NJW 1988, 1789, 1790). However, a bank will rarely impose requirements that secure it such comprehensive rights of control and approval that it can prevent every business transaction and, as a result, control the attainment of corporate objectives by imposing obligations. A case has to be very extreme for covenants to lead to a loan agreement being declared contrary to public policy (*sittenwidrig*) on the grounds of it being unconscionable.

Furthermore, the agreement of covenants in loan agreements leads to questions in connection with the German Equity Substitution Law (*Eigenkapitalersatzrecht*). A shareholder who puts borrowed capital and not his own capital into his company in a crisis risks this borrowed capital being reclassified as equity. His claims to the repayment of the borrowed capital are then subordinate to all other claims for payment of the company's creditors. According to the statutory provision, certain lenders are placed on the same footing as the shareholders. A lien holder is therefore put on a par with a shareholder if he can also determine the fate of the company in a similar way to a shareholder (BGHZ 119, 191). Whether such a position similar to that of a shareholder is created by the agreement of covenants has so far not been decided in court rulings. Following the rulings made on lien holders, the lending bank must, through the agreement of covenants, be able to influence the company's success like a shareholder. In practice, this borderline is frequently not crossed by the agreement of covenants.

dd) Default

German law differentiates between termination with notice (within certain agreed periods) and termination without notice (for which a reason must be given). It is not usual to agree on a contractual period of notice to terminate. However, the statutory provisions in Section 489 BGB must be observed. According to these provisions, loans with a fixed interest rate may be terminated at the latest after ten years from receipt of the total loan amount and loans with a variable interest rate may be terminated at any time by the borrower serving three months' notice. Both provisions are mandatory in favour of the borrower and cannot be changed in the loan agreement.

If the General Terms and Conditions of Banks (*AGB*) are included in the loan agreement, section 18 of the AGB must also be observed. This provision grants the customer the right to terminate without notice if there is good cause which makes it unreasonable for the customer to continue the business relationship, even after giving consideration to the legitimate concerns of the bank. If the interest rate is changed on loans with a variable interest rate, the customer is entitled, according to section 12 of the General Terms and Conditions of Banks, to terminate the business relationship with the bank without serving notice within six weeks from notification of the change.

For its part, the bank may terminate the loan agreement without notice if the borrower violates the agreement. As a rule, the reasons for terminating the agreement without notice and the deadlines to be observed are stipulated in a loan agreement for complex financing projects. Section 19 of the General Terms and Conditions of Banks lists reasons for termination without notice by the bank. The following in particular are reasons which permit the bank to terminate without notice:

- The customer has given incorrect information on his financial standing which was of considerable importance in the bank's decision to grant a loan,
- A major deterioration in the financial circumstances of the customer or in the valuation of a security occurs or threatens to occur and, as a result, the repayment of the loan or the discharge of any other obligation to the bank is at risk,
- The customer has not fulfilled his obligation to create or increase securities within the reasonable period set by the bank.

If the General Terms and Conditions of Banks are included in the agreement, the main reasons for termination without notice are already mentioned. In practice, however, there are frequently provisions which go far beyond the three points mentioned above and which are agreed in the individual case in question.

If the loan agreement is terminated, the contractual relationship of the contracting parties reverses completely. This means that the borrower is obliged to immediately repay the loan amounts already paid out. If the borrower defaults on repayment of the outstanding loan amount, the bank is entitled to realise the personal and real securities.

c) Syndicated Loans

In view of the frequently high loan amounts required for commercial real estate financing, these loans are syndicated by banks to reduce their risk. Two approaches can be adopted to syndicate loans. Either one or more banks participate in the loan of another bank or banks can join together to form a syndicate and offer a syndicated loan. In the case of participation, there is no direct contract between the borrower and the other banks but only between the lending bank and the participating banks.

The situation is different with the syndicated loan. The members of the syndicate regulate their rights among each other and towards the borrower in an

intercreditor agreement (*Konsortialvertrag*), a syndicated loan agreement (*Konsortialkreditvertrag)* and, as regards the securities, in a security sharing agreement (*Sicherheitenpoolvertrag*).

The intercreditor agreement regulates the internal relationships of the bank syndicate members. It is a partnership agreement as the bank syndicate forms a BGB company, a company constituted under civil law. In German law, the intercreditor agreement is separate from the actual loan agreement with the borrower. The intercreditor agreement regulates the following issues in particular:

- The proportional shares of the individual syndicate banks. This determines not only the proportional shares of the individual banks in the loan amount but also conversely the proportional distribution of all payments by the borrower to the syndicate banks.
- The organisation of the management and representation. In German law, the lead bank is frequently authorised to manage and represent the syndicate on its own. This means that one bank handles the business dealings with the borrower on behalf of all the member banks of the syndicate.
- Internal obligations of the lead bank. Even though the lead bank may represent all the other banks without restriction in the relationship with the borrower, it is nonetheless subject to certain internal restrictions. Individual decisions, such as the serving of notices of termination, generally require the consent of a certain majority of all the banks.

The syndicated loan agreement regulates the loan relationship between the borrower and the member banks of a syndicate. In practice, this agreement is frequently concluded in a so-called decentralised form. With this form of syndicated loan agreement, each member bank undertakes to make its portion of the syndicated loan available to the borrower directly. The borrower therefore does not have a claim to payment of the entire loan amount from one bank (e.g. the lead bank) but merely has a claim against each individual bank for the respective portion thereof.

With syndicated loans, the banks also want to have their portion of the loan amount secured by the real and personal securities which are provided in connection with the real estate financing. For the purposes of simplification, the securities are, in German law, created for the lead bank and held in trust and managed by this lead bank for the other banks. The trust relationship between the banks is established and regulated by the security sharing agreement. This agreement is concluded between all the banks and the borrower.

The security sharing agreement generally has the following contents:

- A list of securities which the borrower is obliged to create in favour of the lead bank and which are included in the security pool.
- A security purpose agreement which specifies the secured claim.
- A trust agreement according to which the lead bank manages the securities in trust for the other banks and, if required, also realises them.
- Provisions on the distribution of the proceeds from the realisation of the claims.

2. Property Leasing

a) Fundamentals

Leasing financing is of great importance for financial engineering. Since the first leasing companies were established in Germany in 1962, the importance of leasing has grown considerably. Leasing financing is continuing to grow rapidly from year to year.

In principle, leasing is also an attractive alternative for financing real estate. The lessee conserves his own funds, frees up the balance sheet and thus also improves his own equity ratio. On the other hand, the leasing payments are deducted from the current earnings of the lessee.

The basic philosophy of leasing is, from an economic point of view, not to own the commodity leased, i.e. the real estate, but rather to use it. The lessee can obtain use of the leased property without investing any capital or at least considerably reducing his capital investment. There are no statutory regulations on leasing contracts. The contents of leasing contracts are largely determined by the extensive court rulings and provisions under tax law. Leasing contracts can therefore be regarded as long-term rental agreements with special characteristics. The basis of leasing is a long-term contract between a lessee and a leasing company (lessor) which cannot be terminated during the primary leasing period. The lessor acquires the commodity (frequently also from the lessee – sale and lease back) and makes it available to the lessee for use for a contractually fixed period (primary leasing period). The contract term is between 40% and 90% of the usual operational service life for tax reasons (leasing ordinance of the tax authorities). In the case of real estate leasing, contracts are therefore concluded for terms of between 10 and max. 30 years. At the end of the term, the lessee must return the leased property or can exercise certain options.

Just as with a rent, the leasing company is both under civil law and normally also the economic owner of the leased property and therefore also includes it in the balance sheet. The lessee is the user who pays a certain fee to the leasing company for permission to use the property. The basis for calculating the leasing payment is the refinancing loan of the leasing company. The lessor generally finances the acquisition or construction of the leased property by means of loans and must service this debt which comprises payments of interest and the principal during the term. For the lessee, the leasing payment is therefore made up of a so-called depreciation charge (capital repayment) and a finance charge (interest on tied-up capital of the lessor) as well as a margin for administration, risk and profit of the leasing company.

At least three parties are always involved in real estate leasing: A leasing company (the lessor), a lessee and one or several financing banks. If the leased property has still to be built, a provider of construction services is the fourth party. The leasing company is generally a holding company under which various special-purpose vehicle companies operate as wholly owned subsidiaries. A leasing company therefore establishes its own SPV (property holding company) to handle a leasing contract. This company is then the lessor as the following diagram illustrates.

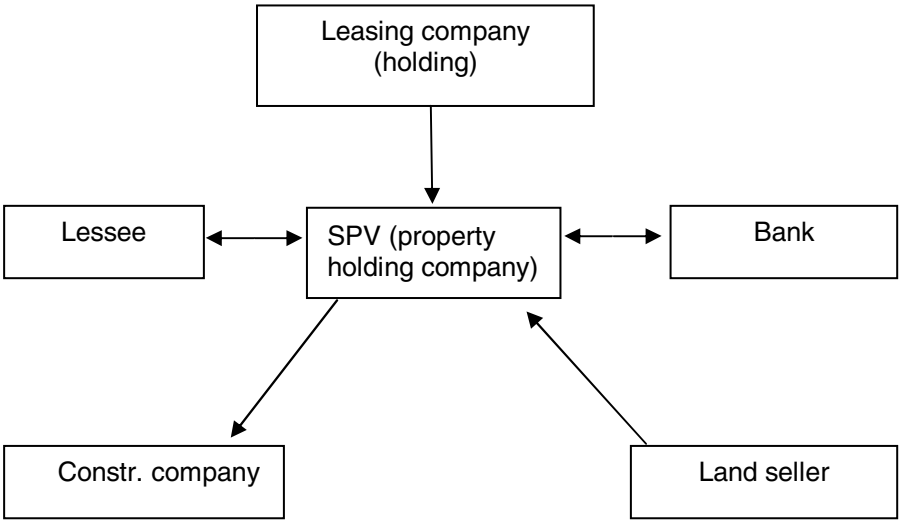


Figure 4. Leasing financing

b) Contract Forms

The basic elements of finance leasing are the use of the leased property by the lessee and the financing by the lessor. With the full pay-out model, the lessee pays back all expenses the lessor incurs in full with his payments during the non-cancellable primary lease period. The payments comprise the acquisition or production costs of the leased property as well as all ancillary costs including the financing costs. Accordingly, all expenses are fully paid back by the leasing payments and any special payments.

The full pay-out lease has only minor significance in practice. As all the lessor's costs are covered by full pay-out during the contract term, the lessee would have to be granted the right, at the end of the contract, to acquire the leased property at a symbolic price of € 1.00. Alternatively, there would also be the possibility of prolonging the lease with a symbolic leasing payment. Both the agreed "purchase price" and the agreed "leasing payment" would naturally be substantially below normal market levels. Therefore, in the Leasing Ordinance dated 21 March 1972, the tax authorities refused to assign the beneficial ownership of the leased property to the lessor with a full pay-out contract and with the option for the lessee described above. This means that the leased property would not have to be shown on the lessor's but on the lessee's balance sheet. If the lessor is to be recognised as having beneficial ownership of the property with a full pay-out contract, the lessee must pay the residual book value after straight-line depreciation in addition to the investment costs already paid back. This generally results in a total financial burden which makes such a financing model unattractive.

Therefore, in practice, the non-full pay-out model has established itself on the market. With this contract form, the leasing payments do not cover the entire investment costs. During the primary lease period, the repayments on the principal of the refinancing loan must not exceed the accumulated depreciation. On expiry of the primary lease period, an outstanding amount is left payable on the loan which is at least equivalent to the remaining tax book value. The longer the primary lease period is, the lower the residual value is. With regard to this unsecured residual value at the end of the contract term, there are various arrangements used in leasing agreements in practice which lead to the lessee ultimately bearing the full financing burden. The following models are conceivable:

- The lessor is entitled to offer the lessee the leased property at a previously agreed price which covers the remaining costs.
- At the end of the contract, the leased property is sold and the lessee has to pay any difference between the proceeds and the residual value stated in the leasing contract.
- At the end of the contract, the lessee has to make a final payment amounting to the lessor's total costs not covered by the leasing payments, 90% of the proceeds from the disposal of the leased property being allowed for.

Special legal issues arise with leasing in connection with warranty claims. As the lessee is the actual user and has no direct contractual relationships with the real estate seller or the construction company, the lessee also has no warranty claims against the construction company or the seller. It is the leasing company which has the right to make these claims.

In practice, the lessor therefore normally excludes his liability for defects on the leased property and assigns the warranty claims he has against the seller of the property or the construction company to the lessee. In the Federal Court of Justice's opinion, the exclusion of liability, even if it is agreed in the general terms and conditions, is legally effective as these conditions give leasing contracts their typical characteristics which are, in this respect, different from the nature of a rental agreement (BGHZ 81, 298 et seq.).

However, the exclusion of liability is only legally effective if the assertion of the warranty claims by the lessee against the seller or the construction company also has effects on the leasing contract relationship. If, for example, the purchase contract between the lessee and the property seller is reversed owing to rescission by the lessee, there is no longer any basis for the leasing contract. This means that from the very outset the lessor has no claims to lease payments even if the leased property has been intermittently used (BGHZ 114, 57 et seq.). If the lessee makes a claim against the seller on the grounds of impairment of the property, the leasing payments are also reduced.

3. Mezzanine Financing

Mezzanine capital is "equity interim financing" with profit participation which closes the financing gap between the equity the real estate investor has available and the lending value or loan promised by the financing bank. It is therefore the part of the real estate financing which is neither provided by equity nor by secured borrowed capital.

Mezzanine financing is primarily found in German law in two different forms. The mezzanine investor either grants a subordinated loan or acquires a dormant equity holding. In the case of the subordinated loan, the lender concludes a loan contract with the borrower. The loan contract also contains a so-called subordination agreement according to which, in the event of insolvency, the claims under the mezzanine loan are subordinate to the claims of all other creditors of the company with the exception of the shareholders. The investor does not therefore participate in the loss (but can participate in the profits) and receives fixed interest on the capital he has provided during the contract term. Subordinated loans are generally agreed for terms of five to ten years. Mezzanine loans are normally unsecured.

The mezzanine investor becomes a partner in the borrower on conclusion of a dormant partnership agreement. One typical aspect of the dormant partnership is that the lender participates in the commercial enterprise of someone else by making a capital contribution. A dormant participation must by law involve profit-sharing; loss-sharing may be agreed in the contract. Furthermore, the contract can also include continuous minimum interest which has to be paid to the investor, regardless of the company's results. A dormant participation gives the dormant partner certain supervisory rights. For example, the dormant partner is entitled to demand a copy of the annual financial statements and check them for correctness by examining the books and records. A dormant participation is shown as borrowed capital in the balance sheet. However, other contractual forms are conceivable so that a separate item is formed between equity and borrowed capital in the company's balance sheet.

The costs of mezzanine financing are higher than those of a conventional bank loan owing to the risk involved. In addition to a share in the profits, dormant partners or subordinated lenders are often granted a right of conversion. This means that the lender is given the right to convert his capital, in whole or in part, into direct equity and as a result become a shareholder. Such a right is often linked to a negative development of the company. The advantage for the borrower is that, when claims to repayment are converted into equity, the repayment claims are reduced or are even eliminated completely. The disadvantage is that a usually unwanted third party becomes a shareholder.

4. Securitisation

With securitisation, receivables are packaged as securities and issued as bonds on the capital market. Securitisation therefore replaces traditional financing

instruments such as bank loans and gives a broader range of financing sources. Securitisation permits real estate investors to gain direct access to the capital market.

The basic structure of securitisation is that the respective assets are transferred to a bankruptcy-remote financing vehicle in the form of a corporation which issues bonds to investors to refinance the assets. Assets are removed from the company's balance sheet in the form of asset-backed securities (ABS) and refinanced on the international capital markets through a company established solely for the purpose of financing.

In connection with the financing of real estate, it is above all future flows of receivables arising from rental contracts, future rental contracts, remaining real estate values or proceeds from the sale of real estate which are securitised.

The heart of an ABS transaction is a special-purpose entity, or special-purpose vehicle SPV. This is a body corporate, e.g. a limited company or a limited partnership, established solely for the purposes of financing, which is legally independent and bankruptcy-remote. It issues bonds or certificates to investors for its refinancing. The special-purpose vehicle acquires the financial assets (e.g. the receivables from rental contracts) from the selling company (originator) and finances the purchase price by issuing suitable securities on the capital market on the basis of the assets. The SPV is obliged to make the interest and redemption payments to the investors. It discharges this obligation by passing on the receivables regularly collected from the seller of the receivables (originator) to the investors. The receivables are purchased without recourse, i.e. the default risk passes to the SPV. It is restricted in its business activities to these functions.

A company which securitises receivables is called the originator. It sells its receivables to the SPV and, in return, receives the cash value of its receivables from the SPV. The originator is normally only liable for the existence of receivables but not for the enforcement of receivables. Therefore, they no longer have to be included in the originator's balance sheet. The originator therefore has indirect access to the capital market through the ABS transaction.

If the transaction volume is high enough (ABS transactions are frequently concluded for approx. € 200 million upwards), such a financing structure can also be used to finance the acquisition of real estate. The acquiring company (originator) transfers the receivables from the rental contracts to the special-purpose vehicle which pays a consideration (= cash value of the future receivables = purchase price) to the originator. The special-purpose vehicle, in turn, refinances itself by issuing securities on the international capital market and pays interest and makes redemption payments on the securities it has issued by collecting the receivables from the transferred rental contracts. The assignment of rent receivables means the assignment of future receivables, which poses no problems under German law.

Property securitisation can present many advantages, e.g.:

- It provides cash,
- It releases the equity tied up in the real estate in the balance sheet,
- There are trade tax benefits due to the reduction of long-term liabilities,

- It gives a flexible framework for arranging financing,
- The company can optimise the real estate portfolio,
- It improves the return on equity.

With property securitisation, there are no restrictions as regards the suitability of various types of real estate. As long as the transaction volume justifies the increased expense for securitisation compared with a classic loan, all types of real estate can be securitised. The preconditions for the securitisation of a real estate portfolio are as follows:

- The real estate generates the necessary cash flows to make interest and redemption payments (stable cash flow).
- The real estate must be homogeneous.
- There must be a relatively high number of individual receivables (i.e. several rental contracts).

III. Loan Collateral

1. Mortgages and Land Charges

Loan collateral in the form of liens is standard as part of long-term financing with borrowed funds. Liens are rights in rem to real estate which can exist regardless of its respective owner. A lien can be created on real estate in the form of a mortgage, land charge or annuity charge.

Liens offer the creditor of the secured claims the possibility of seeking satisfaction from the real estate if the borrower does not pay a certain sum of money plus interest in full and on time. To create a lien, it must be entered in the land register (Section III (*Abteilung III*)).

Liens can be created in the form of certificated (*Briefrecht*) or non-certificated (*Buchrecht*) mortgages or land charges. In the case of certificated mortgages or land charges, regarded as the basic case in the statutory provisions, the mortgage or land charge is entered in the land register and a certificate issued (mortgage or land charge certificate). In this certificate, the relevant right is evidenced together with further details (amount, real estate encumbered). However, it is possible for the issuing of a certificate to be excluded. The lien then exists as a non-certificated mortgage or land charge. With this form, the right is also entered in the land register but with a note that the issuing of a certificate has been excluded.

Liens contain the requirement that a certain sum of money has to be paid from the real estate to the beneficiary. This establishment of the contents in Sections 1113, para. 1 and 1191 BGB means that the real estate owner is obliged by the lien to tolerate immediate enforcement (*Zwangsvollstreckung*) on the real estate. Liens are therefore real realisation rights, which means that the owner is liable with the real estate – i.e. not with any other assets – to satisfy a claim but, owing to the lien as such, does not personally owe the payment of a sum. The creditor can only have recourse to the encumbered real estate right including the jointly liable rights

to satisfy the secured claim "arising from the real estate". This requires the realisation of the real estate by means of immediate enforcement which the real estate owner has to tolerate. The lien holder is satisfied from the proceeds according to his priority and any proceeds left over must then go to the other creditors in satisfaction of their claims. The special security which liens afford consists in the fact that lien beneficiaries rank before the creditors not secured in rem with regard to the proceeds from the disposal of the real estate.

Liens also act as rights in rem against third parties, in particular subsequent purchasers. Liens which have been created with legal effect pass with the encumbered real estate. This means that, if the owner changes, any new owner of the encumbered real estate must also tolerate immediate enforcement.

For historical reasons, the German Civil Code has provided, in the mortgage and the land charge, two liens which are identical in the major respects and has selected the mortgage as the basic case in terms of regulation. The provisions on the land charge are based on those for the mortgage and are only special features of it.

a) Mortgage

According to Section 1113 BGB, the mortgage is an encumbrance on real estate, the contents of which determine that a certain amount of money has to be paid out of the real estate to the person in whose favour the encumbrance is created to satisfy a claim to which he is entitled. The mortgage is therefore only due to the creditor in direct conjunction with a claim arising from the law of obligations. The creation of a mortgage presupposes that the secured claim is also due to the lien holder. If the secured claim is met by the owner, the mortgage passes to the owner. If the mortgage is foreclosed, it must be noted that the lien holder only has the right to the outstanding amount for which he has a secured claim under the law of obligations and not to the original mortgage amount entered in the land register which may be much higher.

b) Land charge

The main difference between the land charge, on the one hand, and the mortgage, on the other, is that the land charge can be created independent of a claim actually existing. With the land charge, the real estate is also encumbered in such a way that a certain amount of money has to be paid from the real estate to the person in whose favour the encumbrance is created.

The land charge, as a non-accessory security, is an abstract security right. It is created regardless of whether the lien holder has a claim under the law of obligations against the real estate owner. It does not extinguish because the lien holder is no longer the creditor of a secured claim.

In contrast to a land charge, the mortgage therefore offers the debtor quite considerable protection. The mortgage is only created if a claim exists and can only be transferred to a new creditor together with the claim. If the secured claim extinguishes, the mortgage is due to the owner. The land charge is also created in

practice to secure a claim (land charge as security) but, for legal reasons, it does not depend on the existence of the claim.

In the case of a land charge as security, the link is created between the land charge and the claim by means of a security purpose agreement. This is a contract under the law of obligations which makes the land charge accessory to a certain degree – comparable with the mortgage – at law of obligations level.

In practice, it is the land charge which is now mainly used for securing loans in Germany. One major reason for this is that the ineffectiveness of the secured claim does not affect the existence of the land charge. Since it is independent from the existence and amount of a secured claim, the land charge is also much more flexible to manage. It is particularly suitable to secure several claims which may exist at the same time or consecutively without it being necessary to change the entry in the land register when individual claims are replaced. The land charge also offers the creditor an easy way of attaching the real estate. The creditor can enforce the claim from the land charge certificate and enforce the claim against the real estate without having to prove the existence of a secured claim. The debtor is responsible in full for showing and proving that the secured claim has extinguished.

c) Creation

As it is only the land charge as a security which is of practical importance, it is dealt with in detail below. Three elements which have to be regarded separately from a legal aspect are important for the creation of a land charge to secure a loan:

- The establishment of the loan relationship by the conclusion of the loan agreement;
- The security purpose agreement under the law of obligations between the lending bank and the borrower, the main contents of which is the determination of the purpose of the security (see 3.1.4 below);
- The establishment in rem of the land charge itself.

The prerequisites for the establishment of a land charge are the agreement in rem between the real estate owner and the lien holder and the entry in the land register. If a certificated land charge has been agreed, the certificate must also be handed over. If, on the other hand, a non-certificated land charge is to be created, an agreement on exclusion of the issuing of the certificate and the entry of the exclusion of a certificate in the land register are also required.

The agreement on the creation of a lien does not require any specific form to be effective under civil law. However, the agreement must be submitted in an authenticated and notarised form for entry in the land register. In practice, the declaration of the creator of the land charge is therefore notarised in the land charge creation certificate. The bank participates in the agreement in rem in that it follows the application for entry by a corresponding order to the notary public to also apply for an entry for the bank.

In addition to the agreement between the real estate owner and the lien holder, the major factor in the creation of the land charge is its entry in the land register.

To this end, the real estate owner's consent to the entry is required in a notarised form in addition to the entry application.

The lien is entered in Section III of the land register. The following are entered in accordance with the statutory provisions:

- the creditor,
- a certain amount of money to be paid from the real estate,
- whether interest is to be paid and the interest rate,
- if appropriate, other ancillary payments,
- if appropriate, condition or time limit of the land charge or the interest or the other ancillary payments,
- if appropriate, exclusion of the issuing of the certificate in the event of the establishment of a non-certificated land charge,
- if appropriate, reference to agreement to immediate enforcement.

d) Agreement on the Provision of Collateral

The connecting of the land charge to the secured claim is made in the security purpose agreement. This security purpose agreement under the law of obligations is the legal basis for the creation of the land charge in rem. The security purpose agreement is always effective without a specific form and can therefore also be concluded orally. In banking practice, security purpose agreements are made in writing.

The security purpose agreement contains the following provisions in particular:

- the agreement on the purpose of the security;
- an agreement on the setting-off of payments;
- agreements on maintenance and insurance of the property;
- provisions on the assignment of the retransfer claims;
- agreement on the assignment of retransfer claims regarding land charges with priority or equal priority.

e) Transfer

Instead of creating a land charge for itself, the lender can have a land charge which has already been entered assigned to it. In practice, this procedure is frequently adopted for the interim financing of construction projects where a land charge is initially transferred to the interim financer and later to the end lender. Equally, a land charge entered in the land register can be used when the financing bank changes, e.g. after the expiry of a financing period.

As far as the transfer is concerned, a difference must be made between non-certificated and certificated land charges. Non-certificated land charges are transferred by an agreement between the lien holder as the assignor and the assignee as well as by an entry of the assignment in the land register. The assignment is not legally effective until an entry has been made in the land register. The previous lien holder must approve the entry of the change in creditors in an authenticated and notarised form.

In addition to the agreement in rem and the declaration of assignment, the handover of the land charge certificate is sufficient for the assignment of the certificated land charge. The entry in the land register is not mandatory. For reasons of practicality and to ensure the correctness of the land register, the entry is, however, made in the land register. The declaration of assignment must be made in writing and contain all the necessary information, in particular the exact land register designation of the land charge and the encumbered real estate as well as the parties involved. In practice, the declaration of assignment is notarised because otherwise the owner of the encumbered real estate can contest the assertion of the lien by the new creditor even if the creditor presents the certificate. If the position of the creditor is not evident from the land register, the creditor must prove, at the debtor's request, his entitlement to be a creditor by means of a success ional series of notarised declarations of assignment leading back to a creditor who is entered in the land register. This chain of notarised declarations of assignment has the same legitimisation effect as an entry in the land register of the lien holder.

f) Retransfer Claims

The security purpose agreement is the legal basis for the bank to keep the land charge and, if necessary, to be able to enforce it. As soon as the purpose of the security which the contracting parties have agreed in the security purpose agreement has been finally fulfilled, the security purpose agreement also ends.

However, the land charge does not extinguish automatically at the end of the security purpose agreement under the law of obligations. On the contrary, it has to be retransferred to the encumbrancer. This retransfer obligation exists regardless of whether the retransfer has been expressly agreed or not (Federal Court of Justice WM 1990, 305).

Whether the agreed purpose of the security has been fulfilled depends on the individual case. In principle, it can be stated that the purpose of the security is always fulfilled when all secured claims have been satisfied. An obligation of the bank may exist to retransfer the land charge even before the end of the security purpose agreement when it is clear that it is finally no longer needed (BGHZ 137, 212 et seq.).

The retransfer claim can be asserted in three forms:

- claim to retransfer of the land charge;
- claim to a waiver with the result of the acquisition of the land charge by the real estate owner;
- claim to cancellation with the result of the extinguishment of the land charge.

In principle, the party providing security, i.e. the real estate owner, can choose which of these three claims he asserts. However, in practice the claim to retransfer is frequently excluded in the agreement. Such an exclusion is always effective if it is not to apply in the case of a change of ownership of the encumbered real estate. (Federal Court of Justice WM 1989, 490).

g) Foreclosure

If the holder of a land charge is not satisfied with respect to the secured claims, he can foreclose. He can decide in favour of enforcement by means of compulsory sale or compulsory administration of the real estate. In addition, private sale of the land charge is also possible.

A precondition for the initiation of enforcement is a court order conferring title to enforcement. The entry of a lien alone does not permit the creditor to foreclose directly. In practice, in order to avoid possibly protracted and costly legal proceedings to obtain the title to enforcement, the creator of the land charge agrees to immediate enforcement in the notary deed on the creation of the land charge. The consequence is that the land charge creation document itself represents the required title to enforcement and the bank can have an enforceable copy issued by the authenticating notary public at any time.

The security purpose agreement frequently contains provisions which regulate in more detail the conditions which must be met before the bank can apply for enforcement. In principle, such provisions state that the borrower has not observed the agreed repayment date or due payments on the secured claim were not made despite several periods of grace having been set.

aa) Compulsory Sale Procedure

The purpose of a compulsory sale is to make use of the intrinsic value of the real estate. It is initiated on application by the holder of a land charge. The proceeds from the compulsory sale are to be used to satisfy the creditor and, where applicable, any other lower-ranking creditors. The real estate is sold to the highest bidder.

In as far as other land charge rights take priority over the right of the creditor initiating the compulsory sale procedure, these rights must not be prejudiced by the compulsory sale. They continue to exist and are taken over by the purchaser of the real estate. The purchaser allows for the fact that he must take over these land charges by suitably reducing the price he pays for the real estate.

The lien of the creditor extinguishes when the land is sold in the compulsory sale. The proceeds from the auction replace them as a substitute. The rights of lower-ranking creditors, i.e. those creditors who rank behind the creditor who initiated the compulsory sale, also extinguish. They only participate in the distribution of the proceeds of the auction according to their ranking until the proceeds are exhausted.

bb) Compulsory Administration

Compulsory administration is geared to exploiting the income from the real estate. When compulsory administration is ordered, the rent and lease receivables covered by the land charge are seized. The administrator can collect these receivables.

In practice, it is often agreed for this type of enforcement that the filing of the application does not depend on the lender having called in the secured loan in order to prevent the other resultant disadvantages in favour of the borrower.

Instead it is normally agreed that the lender can already apply for compulsory administration when the borrower is already in arrears with his payments by a certain sum.

Compulsory administration offers the creditor the advantage that he can be satisfied from the income when the debtor is suffering temporary financial difficulties without having to terminate the entire loan and security relationship with the debtor.

cc) Private Sale

Instead of immediate enforcement on the encumbered real estate, the holder of a land charge can also make use of the land charge by selling it to a third party. In contrast to immediate enforcement from the land charge, the claim secured by the land charge does not have to be overdue in this case. The authority for private sale does not have to be agreed in the security purpose agreement. The authority can also arise through the interpretation of the security purpose agreement.

In principle, there are two possibilities for the private sale of the land charge. As part of the so-called isolated assignment of the land charge, the bank transfers the land charge to a third party without the secured claim and offsets the proceeds from the sale of the land charge against the secured claim, which results in the extinguishment of the loan claim in the amount of the money attained from the sale. As, according to rulings by the Federal Court of Justice, an isolated assignment of the land charge without the secured claim contradicts the purpose of the security, this isolated assignment is only effective with the express consent of the debtor.

Therefore, in practice, the land charge is normally transferred together with the secured claim. The transferring bank is obliged to make sure that the purchaser cannot enforce a higher amount from the land charge than the value of the secured claim (Federal Court of Justice WM 1986, 1386). If the bank, as the creditor, transfers a land charge for a higher amount than the claim is actually valued at and if the purchaser claims against the debtor for a higher land charge, the transferring bank makes itself liable for claims for damages from the real estate owner.

2. Other Securities

Other securities are mainly to be considered in the form of the personal securing of claims of the banks against third parties. In banking practice, the guarantee (*Bürgschaft*) is the most common form. With it the fulfilment of an obligation of the main debtor is secured in such a way that the creditor has an additional claim under the law of obligations against a certain person.

In contrast to liens, the guarantee does not create a right for the financing bank to satisfy its claims from certain assets of the guarantor. The holder of the guarantee is merely offered the opportunity, like other creditors of the guarantor, to attach his assets in accordance with the provisions in enforcement law. The value of the guarantee as a security depends decisively on the financial

circumstances of the guarantor. In practice, therefore, a guarantee is only accepted from people or companies that have a good credit rating.

The guarantee is only one case of a person or company standing surety for another's debt. Collateral promise (*Schuldbeitritt*) is another worth mentioning. This is where the person or company giving a collateral promise also enters into the debt obligation towards the bank in addition to the previous debtor. This means that both debtors are now joint and several debtors. The creditor can choose which of the two debtors he claims against. By contrast, the guarantee indebtedness is subsidiary to the principal debt. The guarantor is only liable after the main debtor.

The debts of third parties are frequently assumed in practice by taking over a warranty (*Garantie*). A warranty is characterised by the fact that the guarantor assumes an obligation of indemnification if the guaranteed success does not occur. The claim of the bank, as the holder of the warranty, is therefore aimed at claiming damages for the loss it incurred due to the non-fulfilment or late fulfilment of the claim against the debtor. In contrast to the guarantee, the warranty does not depend on the existence and scope of the secured principal debt.

The guarantee on first demand is between the abstract warranty and the guarantee which depends on the existence of the principal debt. With this type of guarantee, an unconditional, provisional and independent payment obligation is constituted for the guarantor. The question of whether the creditor may finally keep the payment again depends on the existence of the principal debt but this is only decided in a legal action taken by the guarantor against the creditor for the recovery of the amount initially paid. Thus the guarantor, who has undertaken to pay on first demand, runs the risk of being unjustifiably claimed on and being unable to assert a recovery claim owing to the creditor’s insolvency.

Chapter 5 Purchase Contract

I. Notarisation

1. Notarised Purchase Agreement

In Germany, real estate purchase contracts require notarisation (*notarielle Beurkundung*) to be effective. According to Section 313 (1) BGB, the entire purchase contract has to be notarised. In principle, a later modification or addition must be notarised as must conditional purchase contracts and provisional purchase contracts.

Furthermore, it must be remembered that, according to Section 139 BGB, a deed executed by a German notary is also necessary for all other contracts which are closely connected with the real estate purchase contract (e.g. construction contract, BGH, 16.12.1993, NJW 1994, 721).

> **Practical advice:** In the specific case, it can be very difficult to decide whether a notary deed is necessary or not. To ensure that the real estate purchase contract and the connected contracts are effective, it is strongly advisable to execute the contracts in a notary deed. It should also be noted that the certificate of authority (*Vollmacht*) of the chief negotiators of both sides does not have to be notarised if the certificates of authority (*Vollmacht*) are revocable. According to Section 311 b (1) BGB, any fault in the notarisation can be rectified by the notarised conveyance of ownership (*Auflassung*) and entry of the transfer of property (*Eigentumsumschreibung*) in the land register (*Grundbuch*).

If notarisation is not performed, the real estate purchase contract and the previous entry of a priority notice regarding the property (*Vormerkung*) in the land register (*Grundbuch*) are not effective.

2. The Notary According to German Law

According to German law, a notary is a neutral and independent person who looks after the interests of both contracting parties. He has an obligation to examine the contractual provisions and advise the contracting parties. The notary is obliged to maintain secrecy and must not become involved if there is a conflict of interests.

II. Real Estate

1. Property

In Germany, according to Section 903 BGB the ownership of property means absolute ownership.

2. Land

a) Land Register, Cadastral Map, Register of Contaminated Sites

In Germany, real estate is registered in the land register (*Grundbuch*), which is kept at the district court (*Amtsgericht*) responsible. To make sure that all the specifications of the land register (*Grundbuch*) are up to date, it is advisable to also examine the cadastral map (*Liegenschaftskataster*). Only the cadastral map contains the exact location, size and use of the real estate.

The land register is subdivided into three sections.

- **Section I** lists the owners and the kind of property transfer (e.g. purchase).
- **Section II** contains all relevant conditions, covenants and restrictions (*Belastungen und Beschränkungen*) except mortgage liens (*Grundpfandrecht*). For example:
  - land and building lease (*Erbbaurecht*) according to Section 1 ErbbRVO
  - easements (*Grunddienstbarkeit*) according to Section 1018 BGB which are rights to make limited use of another person's real estate.
  - the right in rem to the usufruct (*Nießbrauchsrecht*) according to Section 1030 BGB.
  - restricted personal easements (*beschränkt persönliche Dienstbarkeit*) according to Section 1090 BGB.
  - pre-emptive rights (*Vorkaufsrecht*) according to Section 1094 BGB
  - ground rent (*Reallast*) according to Section 1105 BGB which gives another person the right to receive payments or services secured by the real estate.
- **Section III** contains the mortgage liens.

The priority of the entries in the land register is very important. Rights with a higher priority go before low-priority rights. According to section II or section III of the Land Register Code (*GBO*), the order of priority of the entries depends on the date of registration.

The land register (*Grundbuch*) is the most important register for the purchase of real estate. According to Section 892 BGB, the buyer can assume that the details provided in sections I to III are correct. This **public reliance** (*öffentlicher Glaube*) provides the buyer with comprehensive protection. The buyer acquires the land as it is shown in the land register to the detriment of the land owner. This applies regardless of whether the land register was viewed by the buyer beforehand or not.

Practical advice: The protection of Section 892 BGB only applies to the entries in sections I to III. It is necessary to check the cadastral map to ensure that the location and the size of the real estate are correct.

In Germany, all information on known contamination is compiled in the register of contaminated sites (*Altlastenkataster*). The authorities are obliged to provide information to the real estate owners, users and third parties who have a justified interest in this.

b) Partial Area

According to German law, partial areas of cadastral units (*Teilflächen noch nicht vermessener Flurstücke*) may also be the subject of a purchase contract. Here, it is recommended to draw the partial areas in question in a site plan which is to be enclosed with the purchase contract.

Practical advice: The buyer should obtain a guarantee from the seller that the splitting of the land is also legally effective under public law. Moreover, the buyer should have the size or at least a minimum size of the partial area involved guaranteed by the seller.

3. Fixtures and Fittings

German law differentiates between fixtures (*wesentliche Bestandteile*) in accordance with Section 94 BGB and fittings (*Zubehör*) in accordance with Section 97 BGB.

- Fixtures belong to the property and are therefore part of the property being purchased. They include the items permanently connected to the land, including but not limited to buildings and the items introduced to erect the building.
- By contrast, fittings are movable items which serve the economic purpose of the land or the building. According to Section 926 BGB, there is a statutory presumption that the fittings are also included in the sale.

Practical advice: The fittings can, for example, include production plants on factory premises, building material and facilities for a commercial enterprise. A separate contractual provision on such objects should always be made in the purchase contract in order to avert otherwise inevitable legal disputes.

III. Hand-over/Possession

1. Fixed Date

It is advisable to determine a calendar date on which hand-over of the property (*Grundstücksübergabe*) is to take place. If the seller does not hand over the property on the fixed calendar date, he is in default without any reminder being issued. From this time on, the seller is liable for damages if he is responsible for the delay.

> **Practical advice:** In cases where the purchase price is to be initially deposited with the notary, it is also recommended to agree on the hand-over date.

2. Hand-over before Payment

In some cases, hand-over (*Grundstücksübergabe*) before payment is agreed. Under German law, this frequently creates the problem that the transfer of ownership represents an advance performance by the seller for which he still has no security. In this case, provisional payment of part of the purchase price is a solution. This money can be deposited with the notary or paid into a special account (*Sperrkonto*) to which the buyer only has access in the event of the complete reversal of the transaction.

3. Benefits and Charges

On hand-over of the property, the benefits and charges (*Nutzen und Lasten*) pass, in accordance with Section 446 BGB, to the buyer although he is in fact not yet the owner. The contracting parties may agree something else, which, however, is not recommended due to the buyer's proximity to the land from the time of the hand-over.

4. Insurance

It should be noted that, in accordance with Section 69 VVG, the buyer has no claims arising from a building insurance policy until the property is transferred (*Eigentumsumschreibung*).

IV. Notarised Conveyance of Ownership and Transfer of Property

According to German law, the buyer does not acquire ownership of real estate until a notarised conveyance of ownership (*Auflassung*) and entry of the transfer of property (*Eigentumsumschreibung*) in the land register (*Grundbuch*) have been completed in accordance with Sections 873 and 925 BGB. The notarised conveyance of ownership is normally performed in the real estate purchase contract. On this basis the buyer could, in principle, according to German law apply for entry of the transfer of property in the land register in order to acquire ownership. As already described, the buyer does not become the owner until entry of the transfer of property in the land register by the land registry office (*Grundbuchamt*). As the land registry office makes the entry of the transfer of property some time after the application has been made, the simultaneous exchange of performance (transfer of property) and the counter-performance (payment) is not possible under German law. This is the main problem which has to be overcome in a real estate purchase contract.

1. Conflicting Strategies

It must therefore be ensured in purchase contracts that both the performance of the buyer and the performance of the seller are guaranteed. This leads to different conflicting strategies for the buyer and seller.

a) Buyer's Strategies

The buyer's main objective is the transfer of property. He must ensure that ownership is passed to him and is neither transferred to a third party nor remains with the seller after the conclusion of the purchase contract.

- The buyer's most important means of security is the priority notice regarding the property (*Eigentumsvormerkung*) which has to be entered in the land register (*Grundbuch*). As the owner of the property, the seller has to give his consent before this entry can be made. According to Section 883 BGB, the priority notice gives the buyer comprehensive protection against dispositions made by the owner after its entry (refer also to section VI., 1.). The buyer can also secure other property rights with a priority notice (*Vormerkung*), including for example, rights of access to and rights of way on the property (*Zugangs- oder Wegerechte*).
- Furthermore, to protect the buyer, it is frequently recommended that he should not pay the purchase price direct to the seller but deposit it with the notary. Notary custody (*notarielle Verwahrung*) gives the credit institutes and banks the necessary security. Another possibility is to initially pay the purchase price into a special account to which the seller only has access under conditions previously defined in detail (*Sperrkonto*).

b) Seller's Strategies

The seller is frequently faced with the problem that he has already given his consent to the buyer having a priority notice regarding the property (*Eigentumsvormerkung*) entered in the land register without having already received the purchase price. The seller must therefore ensure in the purchase contract that he does not lose his property without the buyer paying the purchase price. Therefore, he must secure payment of the purchase price.

- One possibility of achieving this is agree that the purchase contract and the notarised conveyance of ownership (*Auflassung*) are in two separate contracts. However, this increases costs.

> **Practical advice:** In the case of the sale of a partial area of a cadastral unit (*Teilfläche eines noch nicht vermessenen Flurstückes*), it is advisable not to set forth the real estate purchase contract and the notarised conveyance of ownership until the exact location and size of the partial area have been determined.

- In Germany, another approach to securing the seller's rights is frequently chosen: the conditional transfer of property (*Eigentumsumschreibung unter Vorbehalt*). The conveyance of ownership is already agreed in the purchase contract. However, the notary is instructed by both contracting parties jointly not to file the application for the transfer of property with the land registry office (*Grundbuchamt*) until payment of the purchase price has been verified to the notary. In such cases, a firm promise of payment or confirmation of financing by the bank involved often are considered to be sufficient.

> **Practical advice:** The conditional transfer of property has advantages in many cases as a notarised conveyance of ownership already exists. This permits amendments to the contract to be made after the notarisation of the conveyance of ownership in a simple way without renewed notarisation being required (BGH, Urteil vom 6. Mai 1988, BGHZ 104, 277).

2. Public Land Charges

In Germany, public land charges (*Baulast*) are listed in a separate register, the land charges register (*Baulastenverzeichnis*). Here, all restrictions on the property under public law are recorded, such as rights of access, rights to pass water and sewage pipes through the property and parking rights. A public land charge is a voluntary obligation by the land owner to the building control authority to perform an action which is not already prescribed by regulations under public law. For example, in cases where a building is to be erected but there are not enough parking spaces on the land in question, the authority responsible demands the entry of a public land charge on a neighbouring plot of land. The public land charge then serves to secure the provision of parking spaces on the neighbouring

land. Naturally, the neighbour must give his consent to this and receives remuneration for this from the beneficiary land owner in one way or another.

Practical advice: Any existing public land charges may limit the value of the property quite considerably. The problem is that the notary is not obliged to examine the land charges register prior to the conclusion of the purchase contract. If the land charges register is not examined by the contracting parties, this should be expressly recorded in the contract. In this case it is advisable for the buyer to have the seller guarantee that the property being purchased is free from any public land charges.

3. Mortgage Liens and Easements

Under German law, mortgage liens (*Grundpfandrechte*) are understood to mean rights to the land which serve as security for a claim. They comprise the land charge (*Grundschuld*) in accordance with Section 1191 et seq. BGB, the mortgage (*Hypothek*) in accordance with Section 1113 et seq. BGB and the rent charge (*Rentenschuld*), which represents a special form of the land charge in accordance with Section 1199 BGB.

Easements (*Grunddienstbarkeiten*) in accordance with Section 1018 BGB occur in Germany in the form of the encumbrance of real estate in favour of another property in the following way:

- The right to use the other property in a certain way (e.g. rights of way and passage, laying of lines and pipes)
- Ban on performing certain actions on the encumbered property (e.g. ban on a certain development or the pursuance of a certain business)
- Restriction of certain property rights (e.g. toleration of air pollution and other nuisances).

However, according to Section 1090 BGB the easement may not only be entered in favour of another piece of land but also in favour of a person. This is then a limited personal easement (*beschränkte persönliche Dienstbarkeit*). The limited personal easement cannot be sold unless it was entered in favour of a legal person or an incorporated partnership. For example, the use of an apartment can be secured with a limited personal easement in accordance with Section 1093 BGB.

4. Special Focus: Purchase of Portfolio Property

a) Transfer of Tenancy Agreements

When a buyer purchases real estate, he acquires ownership in accordance with Section 566 BGB and more importantly he also enters into the existing tenancy agreements of the existing housing units. According to Section 566 BGB, an

explicit change or transfer of the tenancy agreements is not necessary. This arrangement therefore simplifies the purchase of large real estate portfolios.

> **Practical advice:** However, the fact that Section 566 BGB does not cover all cases is often overlooked.

- The living space must already have been handed over to the tenant prior to the transfer of property. Therefore, Section 566 BGB does not apply to future tenancy agreements where the rented property has not be handed over.
- In addition, difficulties frequently arise when the property is bought and sold several times by different companies within a short space of time, i.e. is, de facto, only passed on. For Section 566 BGB is only applicable if the seller is, at the same time, the owner of the residential real estate. According to German law, however, ownership is not acquired immediately on conclusion of the purchase contract but only on entry of the transfer of property in the land register. In cases where several companies in succession acquire and immediately resell the residential real estate after conclusion of the respective real estate purchase contract, often no entry of the transfer of property in the land register is made for these companies. The result is that the individual companies no longer acquire ownership and consequently the tenancy agreements do not pass to the company which last acquires the property.

b) Planned Constructions

The case may arise, not only with the sale-and-lease-back procedure but also with other contract forms, where the buyer of the property also enters into a construction obligation. Here, the following must be noted in particular:

- A purchase contract containing an obligation to construct a building is treated under German law as a unitary contract if the purchase of the real estate and the construction contract are dependent on each other. This means that both the real estate purchase contract and any related construction contract require notarisation in accordance with Section 311 b BGB.
- The seller's obligation to construct a building means that he assumes a very extensive liability on conclusion of the purchase contract. As the building has not yet been erected, subsequent changes to the property purchased and to the building which is still in the planning stage are often difficult from a legal point of view. As a rule, the property and the building to be constructed have already been described with contractually binding effect and conclusively in the purchase contract. Therefore, any later changes in the planning of the building to be erected require new negotiations which also lead to renewed notarisation. A purchase contract connected with a construction contract therefore necessitates, in the legal respect, a host of provisions which take the problems which usually arise during construction into account from the very outset.

c) Architects Contract

In the past, purchase contracts were frequently concluded in Germany containing an obligation according to which a certain architect had to be contracted to design and execute the building. Such obligations are ineffective (tie-in ban) in accordance with Article 10, section 3 MRVerbG (German Act to Improve the Rent Law and Limit Rent Increases and to Regulate Engineers' and Architects' Work). However, something else may apply if a development company (*Bauträger*) or a general contractor (*Generalübernehmer or Generalunternehmer*) constructs the building on land previously transferred to the buyer.

V. Purchase Price

1. Fixed Purchase Price

A fixed purchase price is frequently agreed when the land has already been accurately surveyed.

2. Adjustment of Purchase Price

However, in many cases, the purchase price cannot be finally assessed on conclusion of the real estate purchase contract. This is the case, for example, when:

- The possibilities of use have not yet been determined from the public building law aspect. In particular, it may still be uncertain whether a building permit (*Baugenehmigung*) or a preliminary building permit (*Bauvorbescheid*) will be granted and, if so, what its contents and requirements will be.
- In the case of residential real estate (*Wohnimmobilien*), the value of the real estate plus buildings may depend on the tenancy agreements yet to be concluded and the rents obtained in such agreements.
- The purchase price will also always be difficult to determine in those cases where a partial area of a cadastral unit (*Teilfläche eines noch nicht vermessenen Flurstücks*) is sold as its exact size and location are still not certain on conclusion of the contract.

There is no straightforward solution to the subsequent determination of the purchase price. If a partial area is sold, the purchase price should be determined according to the actual size on the basis of a square metre price. However, to prevent disputes later, clear-cut criteria on how the purchase price is subsequently to be determined should always be laid down in the purchase contract. It is also possible to fix a minimum and a maximum price.

Practical advice: For very complicated purchase price calculations, it is recommended that the contracting parties should agree from the outset on an arbitrator who will make a final decision if the contracting parties cannot reach mutual agreement on the purchase price. This avoids a costly legal dispute which may go on for many years.

3. Allocation of Purchase Price

It is often advisable for tax reasons to split the purchase price into an amount for the land and an amount for the building(s). It may equally be sensible to show the land and the respective fittings (*Zubehör*) separately in the purchase price.

VI. Payment of the Purchase Price

1. Usual Conditions of Payment in Germany

Under German property law, it is accepted and customary for the buyer not to pay the purchase price until he has a secure legal position as regards the forthcoming acquisition of property. The following conditions of payment are therefore frequently agreed in the purchase contract:

- Entry of a priority notice/caution in the land register (*Grundbuch*)

Practical advice: The priority notice, however, only protects the buyer against any rights which are entered in the order of priorities after the priority notice in the land register in accordance with Sections 883 and 888 BGB. Therefore, the buyer must make sure that no rights precede the priority notice in the order of priorities in the land register. Otherwise it must be ensured that all rights preceding the priority notice in the order of priorities are deleted. In order to protect the buyer, the purchase price must only become due after that.

- Submission of all necessary permits to the notary
- Subsequent approval of a deputy on conclusion of the contract
- Abandoning of pre-emptive rights (*Vorkaufsrechte*) by the municipality or third parties (Sections 1094 and 577 BGB)
- Submission of all necessary authorities for cancellation (*Löschungsbewilligung*) with regard to land charges, mortgages, easements etc.

2. Conflicting Strategies

During the contract negotiations, each sides tries to conclude the best possible contract for himself. Therefore, farther-reaching agreements on the conditions of payment are often made in the purchase contract.

a) Buyer's Strategies

- The buyer tries to get further conditions of payment so he has pay the purchase price at as late a date as possible.
  - If the buyer plans to erect a building, he will frequently attempt to make payment of the purchase price contingent on receipt of the corresponding building permits (*Baugenehmigung*) or preliminary building permits (*Bauvorbescheid*).
  - In the case of buildings which are no longer used or being converted, partial or total eviction (*Räumung*) is often made a condition of payment.
- It is also recommended for the buyer to consider a possible failure of the contract from the outset. The following safeguards can be used to ensure that he gets the purchase price back even in such a case:
  - The purchase price is deposited (*Hinterlegung*) in a notary's client account (*Notaranderkonto*)
  - Payment is secured by mortgage (*Hypothek)* or land charge (*Grundschuld*)
  - The seller provides a guarantee (*Bürgschaft*).

b) Seller's Strategies

By contrast, the whole aim of the seller's negotiation strategy is not to give up his property until he has received the purchase price.

- The seller can secure his property by only agreeing in a separate contract to the conveyance of ownership (*Auflassung*) or the conditional transfer of property (refer also to section IV., 1., b)).
- Moreover, the seller has a great interest in securing payment of the purchase price. This is frequently achieved as follows:
  - The buyer declares his agreement in the purchase contract to the levy of execution on the purchased property *(Unterwerfung unter die sofortige Zwangsvollstreckung aus der Urkunde des Grundstückskaufvertrages*) in the event of a delay in payment of the purchase price. The buyer is then liable with all his assets.
  - The purchase price is deposited *(Hinterlegung)* in a notary's client account (*Notaranderkonto*)
  - Payment is secured by mortgage (*Hypothek*) or land charge (*Grundschuld*)
  - The buyer provides a guarantee (*Bürgschaft*)

VII. Cancellation of Former Land Charge in the Land Register

One particular problem is the cancellation (*Löschung*) of former land charges (*Grundschulden*) in the land register. The due payment of the purchase price or the pay-out of the purchase price deposited with the notary is frequently made dependent on the presentation of the authority for cancellation (*Löschungsbewilligung*). Otherwise the buyer would acquire a property with the land charge on it, which would quite substantially reduce the value of the property.

Practical advice: Under German law it is a difficult problem to ensure that existing land charges are actually deleted. The following requirements must always be observed:

- The authority for cancellation (*Löschungsbewilligung*) should be submitted to the land registry office (*Grundbuchamt*) in accordance with Section 875 BGB so that any future revocation is impossible.
- Moreover, the authority for cancellation in accordance with Section 878 BGB should be submitted with an application for execution to the land registry office (*Grundbuchamt*) so the buyer has protection against any future insolvency of the seller. Furthermore, there is then no longer the risk of the land charge being assigned to another creditor.
- To ensure that the land charge is not partly subject to attachment, the relevant rights to the land charge can already be assigned to the buyer in the purchase contract.

VIII. Warranties and Guarantees

1. General Aspects

In accordance with Section 433 (1) BGB, the seller is obliged to hand over the purchased property and to give the buyer ownership of the purchased property. Moreover, the seller has to make the purchased property free from defects in quality and defects in title.

2. Defects in title

According to Section 435 BGB, defects in title (*Rechtsmängel*) exist when third parties have rights to the purchased property which they can assert against the buyer.

a) Mortgage Liens, Easements and other Rights

Rights of third parties which constitute a defect in title include all rights entered in the land register (*Grundbuch*). A fact which is often overlooked is that this also includes in particular all the rights entered in section II of the land register, for example easements (*Dienstbarkeiten*) and pre-emptive rights (*Vorkaufsrechte*). A district heating line of an energy utility, for example, for which a limited personal easement (*beschränkte persönliche Dienstbarkeit*) exists represents a defect in title, if there is no respective provision set forth in the contract to make sure that the seller assumes no liability for this. According to Section 435 BGB, a right erroneously entered in the land register is also regarded as a defect in title (BGH, 17.05.1991, NJW 1991, 2700).

b) Tenancy Agreements

In the case of the purchase of residential real estate (Wohnimmobilien), a special agreement must be reached on the relevant tenancy agreements. In principle, the seller has to provide the buyer with unlimited possession (*Besitz*). Existing tenancy agreements, however, represent a third party's right to possess, which may constitute a defect in title, if there are no other provisions set forth in the contract ensuring that the seller assumes no liability for this.

> **Practical advice:** Cases where it is unclear whether individual tenancy agreements have already been terminated with legal effect are difficult to evaluate. To protect the seller, an exclusion of liability (*Haftungsausschluss*) should be agreed in these cases, listing the exact tenancy agreements to which the exclusion of liability applies.

c) German Act on Controlled Rents

It must also be considered that dwellings covered by the German Act on Controlled Rents (*Wohnungsbindungsgesetz*) are also to be regarded as constituting a defect in title. Therefore, to protect the seller, the purchase contract should make it clear that the seller assumes no liability for this.

3. Defects in Quality

According to Section 434 (1) BGB, defects in quality (*Sachmängel*) exist if the condition of the property (*Beschaffenheit des Grundstücks*) does not correspond to the contractually agreed condition at the time of the passing of risk (*Gefahrübergang*). If no particular condition of the property (*Beschaffenheit des Grundstücks*) has been agreed, according to Section 434 (1) No. 1 BGB, the property must fit the contractually presumed use or, if such a use cannot be established, the customary use according to Section 434 (1) No. 2 BGB. Risk generally passes with the granting of possession, i.e. the hand-over of the property.

In addition to the general warranty obligation, the seller is liable in many cases for guarantees he has assumed. This is regulated under German law by Section 443 BGB.

a) Contamination

Contamination of the soil and the groundwater are of particular importance when it comes to warranty obligations, especially with properties which were previously used for commercial or even industrial purposes. It is then recommended to include in the contract an agreement on possible contamination of the soil and groundwater which satisfies the interests of both contracting parties.

> **Practical advice:** The seller often does not know whether the property is polluted with contaminants, which also include plant protection agents etc. In these cases the seller will refuse to accept any liability for the property. If an exact examination of the soil on the land is not a possibility, the only solution is for the buyer and seller to agree on a time-restricted right to rescind the contract.

b) Defects of Buildings

A defect in quality also exists if buildings on the property are not in the contractually agreed condition (*Beschaffenheit*) or have structural defects.

A defect in quality also exists if illegal alterations to buildings (*ungenehmigte Umbauten*) have been made.

4. Limitation and Exclusion of Liability

a) Limitation of Liability

Section 442 BGB is the key provision governing the question of how the seller can minimise his liability as far as possible. According to this provision, the seller is not liable for those defects in title and defects in quality of which the buyer is aware on conclusion of the contract. If the buyer remains unaware of a defect owing to gross negligence, the seller is only liable if he has fraudulently, i.e. wilfully concealed this defect or the seller has assumed a guarantee for the condition of the property.

b) Exclusion of Liability

In many cases, real estate purchase contracts contain a clause completely excluding the seller's liability. The property is sold as seen, i.e. in the existing condition which the buyer could inspect beforehand.

> **Practical advice:** Such a comprehensive exclusion of liability under German law must be treated with caution. It may be ineffective for several reasons.

- The provisions of Sections 305 et seq. BGB must be observed in the case of general terms and conditions of business (*Allgemeine Geschäftsbedingungen*). These provisions contain a large number of requirements for general terms and conditions of business to be effective. Moreover, under Sections 308 and 309 BGB, a large number of certain general terms and conditions of business are declared to be ineffective. Section 307 BGB contains a general clause according to which all general terms and conditions of business are ineffective if they are an unreasonable disadvantage for the contracting party contrary to the principles of good faith. Section 305 c (1) BGB also stipulates that unexpected general terms and conditions of business are also ineffective.
- According to Section 309 No. 8 b BGB, limitations on liability are ineffective in connection with a new building. This may also apply to "virtual new buildings" where merely the original old facade is retained and a completely new building is constructed behind it.

c) Duty to Disclose

According to Section 444 BGB, the seller may not rely on an agreed exclusion of liability if he has concealed circumstances material to the conclusion of the contract. In this case the seller is liable without any limitation. Moreover, the buyer has the right under Section 123 BGB to contest the contract, which results in the invalidity of the contract. The contract is then deemed to have not been concluded from the outset and the buyer has the right to assert farther-reaching claims for damages. The duty to disclose circumstances material to the contract may, however, only be decided in the specific case in question and in practice it is frequently difficult to assess.

- The seller must disclose all facts which conflict with the purpose of the contract and are therefore of substantial importance for the buyer's decision to conclude the contract. The disclosure must, however, be expected according to generally accepted standards.
- The duty to disclose covers in particular cases where the planned contractual use is not possible as a result of a certain previous use or the existence of contamination or restrictions under public law.

Negotiators called in by the seller must also be correctly informed by the seller. Otherwise the seller must expect to be imputed with incorrectly informing his representative or failing to inform at all.

In many cases, real estate purchase contracts also contain declarations of the seller that, to the best of his knowledge, he is unaware of certain contractually relevant circumstances. If the seller is a company, it must ensure, according to German law, that all information known within the company is also disclosed.

5. Conflicting Strategies

a) Buyer's Strategies

The buyer naturally has a great interest in the seller giving extensive warranties and guarantees. This applies in particular to all circumstances which could not be clarified in full to the buyer's satisfaction during the examination of the property being purchased.

On the other hand, the buyer must also remember that the mere disclosure by the seller of any defect in title or quality by the seller does not constitute any liability of the seller for such defects. On the contrary, in accordance with Section 442 BGB the seller no longer assumes any liability for these disclosed defects. Therefore, separate contractual agreements (warranties and guarantees) have to be concluded to cover these aspects.

b) Seller's Strategies

It is crucial for the seller to give as few warranties and guarantees as possible.

Therefore, the seller's strategy is frequently to disclose defects in the property being sold as part of a due diligence without assuming any particular liability for the defects (warranties and guarantees) and without the purchase price being reduced. Under his duty to disclose (see section VIII., 4., c)), the seller is obliged anyway to disclose all circumstances to the buyer which are relevant to the conclusion of the contract. Otherwise, he is obliged to pay substantial damages and the buyer may even have the right to contest the contract on the grounds of deceit in accordance with Section 123 BGB.

Practical advice: Special care must be taken with rights entered in the land register. According to Section 442 (2) BGB, the seller must always remove those rights even if the buyer is aware of them. Therefore, to protect the seller, a separate contractual arrangement must be made regarding the rights entered in the land register.

IX. Infrastructure Provisions to Allow Land to be Developed

In accordance with Section 436 BGB, the seller of a property is bound to bear the costs which arise as a result of the infrastructure provisions to allow land to be developed (*Erschließung des Grundstücks*). The seller must pay for all construction engineering work which has been commenced prior to the conclusion of the contract.

X. Purchase Price Financing

1. Taking out New Loans

If the purchase price is being financed by the buyer taking out a loan, it is possible, with the seller's consent, to create a land charge (*Grundschuld*) on the property being purchased as security for the loan.

> **Practical advice:** The seller must make sure that entry of the land charge (*Grundschuld*) does not result in any liability for him. By allowing the land charge to be registered, he is encumbering the property which is still in his possession. The real estate purchase contract and the contract on the entry of the land charge must contain provisions according to which the lender may only make use of the land charge when the loan on the purchase price has been paid out. It appears to be even better to only allow utilisation of the land charge when the lender has settled the purchase price in full.

2. Transfer of Existing Loans

As far as costs are concerned, it may well be advantageous for the buyer to take over existing loans. However, he should then have all the seller's rights and claims arising in this connection assigned to him in the purchase contract. This is the only way of preventing land charges from being subject to attachment by a third party or used further by the seller. It is also recommended to demand a guarantee from the seller that no other rights of third parties exist in connection with the land charges in question.

XI. Strategies before Signing

The phase prior to the signing of the purchase contract normally commences with a provisional examination of the property by the buyer and agreement of both contracting parties on a letter of intent (LOI), which may also contain a provisional indication of the purchase price. This is then followed by a full-scope due diligence. The seller's liability is then finally negotiated on the basis of the due diligence and a final purchase price determined.

1. Buyer's Strategies

a) Letter of Intent (LOI)

The buyer will try to get the seller to agree in the LOI that he is granted the sole right to examine the property being sold and negotiate for its purchase for a certain

period (exclusivity). Moreover, it is frequently important to the buyer that the ongoing negotiations are conducted in strict confidence. A confidentiality agreement is therefore often concluded.

b) Buyer – Due Diligence

The examination of the real estate in a due diligence is of particular importance to the buyer. Here it is normal to conduct a market, technical, environmental und legal due diligence. The tax aspect is also examined. The buyer's aim is to discover unknown risks involved with the real estate in good time before conclusion of the contract so he can make separate agreements on liability with the seller and/or to reduce the purchase price accordingly. After the due diligence, the buyer may wish to refrain completely from the planned purchase if the profit expectations no longer appear realistic.

2. Seller's Strategies

a) Letter of Intent (LOI)

Confidentiality is of particular importance for the seller. His concern is that his intention to sell might become known on the market. This not only applies to listed companies with large property portfolios but basically to all sellers of real estate. The confidentiality clause is therefore an important element of the LOI. Moreover, it is advantageous for the seller if the LOI already lays down some key points of the future contract as having been negotiated. It is then up to the buyer to renegotiate these basic points, which is frequently not easy. Therefore, the well-known strategies of the seller also include establishing in the LOI a timeframe for the examination and negotiation phase which is both fixed and as short as possible in order to limit the buyer's scope for examination and negotiation.

> **Practical advice:** If the seller is in a good negotiating position, he may well demand a **reservation fee** for the exclusivity granted to the buyer. The reservation fee is due on conclusion of the LOI and may only be demanded back in the event of a breach of contract by the seller or deceit by the seller. If the buyer has paid such a reservation fee, he will frequently have more interest in concluding the subsequent purchase contract.

b) Seller – Due Diligence

As already outlined, (see section VIII., 4., a)), the due diligence offers the seller the possibility of limiting his liability in accordance with Section 442 BGB by disclosing defects. It is particularly advantageous for the seller if lists of defects or a certain condition of the property are included in an appendix to the purchase contract without the corresponding liability provisions being included in the contract. In order to limit his own liability, the seller must anyway disclose to the

buyer all circumstances relevant to the conclusion of the contract as part of the due diligence (see section VIII., 4., c)).

All in all, the seller will have prepared documentation on the property which is as comprehensive as possible so as to present the anticipated ROI and the further development potential of the real estate to potential buyers and optimally market the property.

c) Sale by Tender

Sale by tender (*Bieterverfahren*) is being increasingly used, especially to sell large portfolios. This method can be advantageous in many respects for the sale of companies: The competition between various potential buyers often increases the purchase price. Moreover, the sale of the portfolio by tender is subject to objective criteria which can also be substantiated to any supervisory bodies (Supervisory Board, Advisory Board, etc.).

After confidentiality has been agreed, the tender procedure normally commences with the first or indicative offer which the bidders already have to submit at the start of the procedure. In a second phase, potential buyers have to make further bids after they have been able to thoroughly examine the portfolio (due diligence). In the third and final phase, the seller decides in favour of one or more potential buyers with whom negotiations on the sale of the portfolio are conducted on the basis of the bidders' binding offers.

XII. Option of Purchase

In some cases, the selling negotiations have already been completed but the buyer does not want to finally commit himself. This may be the case, for example, if the buyer wants to wait for a building permit to be granted. In such cases, it is recommended to agree on an option of purchase (*Kaufoption*), which is readily possible under German law. The seller in turn may possibly receive a reservation fee for the fact that he is still bound for a some time by his offer to sell (see section XI., 2., a)).

XIII. Ground lease

In Germany, it is not absolutely necessary to acquire ownership of the land in order to implement a project or acquire portfolio properties. It may well be enough to conclude a ground lease agreement (*Erbbaurechtsvertrag*) or to acquire such a ground lease (*Erbbaurecht*) from a third party. The agreement may be concluded for an indefinite period. In Germany, such an agreement is often concluded for a period of 30 – 99 years. The ground lease can be sold or bequeathed. A ground rent (*Erbbauzins*) has to be paid for the ground lease. A ground lease is entered in the land register. The agreement on the granting of a ground lease requires

authentication by a notary. In principle, it is possible – as with land ownership – to encumber the ground lease with mortgage liens (*Grundpfandrechte*). The encumbrance then only relates to the ground lease and not the land. If a building is erected on the leasehold land (*Erbbaugrundstück*), it belongs to the leaseholder (*Erbbauberechtigter*). When the ground lease expires, ownership of the building, however, passes to the land owner.

XIV. Former German Democratic Republic

In the eastern German states, isolated ownership of erected buildings could be acquired, detached from the land ownership, when the German Democratic Republic still existed. This is not possible according to the provisions of the German Civil Code. The owner of the land is always the owner of the building located on the land as well. The only exception is a ground lease (see section XIII.). In 1994, the *Sachenrechtsbereinigungsgesetz* was passed in order to provide regulations for settling the conflicts of interest between the land owners and the building owners in the east German states which were part of the former German Democratic Republic.

Priority was given to the building owners in the necessary settlement of diverging interests. They now have a choice: The owner of a building may either buy the land at half the market value or have the ground lease (*Erbbaurecht*) transferred at half the ground rent (*Erbbauzins*). The land owner only has opposing rights if the building was acquired dishonestly.

XV. Special Focus: Share Deal

In some cases, not least for tax reasons, it is not the real estate which is purchased but the company that owns the real estate. The land transfer tax (*Grunderwerbssteuer*) in particular can be avoided if less than 95 % of the business shares of a company are bought. Notary costs are, however, frequently incurred as the purchase of shares in a private limited company (*GmbH*) or a limited partnership (*GmbH & Co. KG*) also requires notarisation.

The purchase of a shareholding in a company for the purpose of acquiring the real estate does, however, entail some risks.

- The assumption of any liability for old liabilities of the company should always be avoided. The buyer's liability for any shareholder contributions not made, incorrectly assessed non-cash capital contributions or the unlawful return of shareholder contributions must not be overlooked, either.
- In contrast to the real estate purchase contract, the buyer of a share in a business cannot have a priority notice entered in the land register as security for the acquisition of real estate. This is because the buyer only becomes an indirect owner of the company's real estate through the purchase of the shares

in the company. The company remains the owner of the real estate. This makes it necessary for the buyer to clarify the following aspects in a due diligence:

- The seller must be entitled to sell the business shares. The previous owners of the company should all be identified.
- The buyer must receive a security which protects him in case the seller sells the real estate to a third party prior to the transfer of the shares in the business to the buyer.
- Moreover, the buyer must take care that no third party can seize the real estate through the enforcement of a court judgement.
- Finally, an arrangement must be made in favour of the buyer for the event of any possible insolvency of the seller.

Practical advice: As part of a thorough due diligence, the buyer must check carefully that the seller is entitled to sell the real estate. The seller must be able to provide conclusive proof that he is the owner of the share in the business in question. Furthermore, extensive guarantees should be included in the contract to protect the buyer. It is also possible that the buyer may require the seller to provide securities for individual risks (guarantees, etc.).

In practice, it is frequently agreed that the business shares to be sold do not pass to the buyer until he has paid the purchase price in full (condition precedent). This not only safeguards the seller but also protects the buyer against third parties claiming the business shares in question. However, it is not absolutely clear whether a transfer of shares subject to a condition precedent also provides protection against the seller's insolvency.

- It is also particularly important to realise that, in contrast to the case of the real estate purchase contract, the real estate cannot be used as security for financing the purchase price. This is because the buyer, who is the borrower, is not identical to the company to be acquired, which, in the final analysis, remains the owner of the real estate. Here, various contractual provisions can be considered as a solution, e.g. the pledging of the share in question.
- The warranty provisions for a real estate purchase contract are in principle the same as those for the purchase of a share in a business.
- Without going into further details in this chapter on real estate purchase contracts, it should be noted that anti-trust law issues must also be borne in mind.

Chapter 6 Design and Project Management

I. Design

1. Architects and Engineers in Germany

When a major construction project is being implemented nowadays, all those involved must not only satisfy demanding and complex technical requirements but must also comply with architect and building law. This is a widely diversified field of law. There is no uniform codification in one law and so a variety of regulations which can be found in different places interlock. Moreover, there are countless court rulings and extensive legal literature. Architect and engineer law is described and explained in detail in this chapter.

As with building law, a difference must first be made in architect law between private and public architect law. Public law always applies when the state unilaterally lays down the relationships with its citizens on the basis of its sovereign power by means of laws, ordinances, by-laws or administrative acts. Public law includes, for example, the regulations which lay down the professional rights of architects and engineers.

By contrast**,** private law always applies when a sector of life is regulated where only citizens/companies are acting between each other or when the state lowers itself to the same level as its citizens (e.g. as a contracting party for the conclusion of a contract). Private architect law is used to regulate the contractual relationships between an architect or engineer and his client. According to court rulings, the architect's contract is a contract for work or services. The engineer's contract must also be regarded as a contract for work or services. Therefore, the provisions of the sections on contracts for work and services in the German Civil Code (Sections 631 et seq. BGB) are first to be applied to the contractual relationships between architects/engineers and their clients. In addition, numerous other regulations from different laws are applicable. Examples worth mentioning are the German Commercial Code (HGB), the law on standard business terms (Sections 305 et seq. BGB) or the Real Estate Agents' and Property Developers' Ordinance (MaBV), and in particular the German Fee Structure for Architects and Engineers (HOAI)**.**

In order to be able to use the professional title of architect, it is necessary to be entered in the architects' list of the chamber responsible. If someone uses the professional title of architect without being entered in the architects' list of the chamber responsible, this chamber is entitled and obliged to prohibit the use of the

professional title and, if necessary, issue a fine. In order to be entered in the relevant architects' list of the chamber of architects, an application must first be made and this sets a registration procedure in motion. As part of this procedure, the chamber examines whether the applicant fulfils the conditions for entry in the architects' list. One requirement for entry is in particular that the architect must have an appropriate educational background. The entry requirement concerning the right educational background is designed to protect the general public and is in the interest of the general building culture so that people who do not have suitability qualifications can be excluded from being entered in the list and therefore from using the professional title of architect.

If someone has inadmissibly called himself an architect in legal relationships, he has an unlimited duty to disclose this information to his clients. This behaviour may result in the client contesting the architect's contract on the grounds of wilful deceit. Moreover, a client may, under certain circumstances, have the right to claim damages, aimed at restoring the condition prior to the conclusion of the contract; this claim may conflict with the architect's claim to the full fee. Any claim to the rescission of the contract which is based on an infringement of the architect's duty to disclose information is, however, null and void if the client would have also concluded the contract with the contractor if he had known that the latter was not an architect.

a) Scope of Application - HOAI

The German Fee Structure for Architects and Engineers (HOAI) came into force on 1 January 1977 and now applies in the version of 1996, which came into force on 1 January 1996 with the 5th HOAI amendment. The objective of the HOAI is to make a contribution towards reducing building costs by setting a statutory limit on architects' and engineers' fees and therefore to limit the rise in rents. At the same time, however, the aim was to ensure that planners were given adequate and cost-covering remuneration in order to prevent ruinous price competition.

The HOAI represents so-called price law. This means two things:

- Firstly, it does not contain any provision on the rights and obligations arising from an architect's contract. Nor does it contain any provisions regarding the question of what is owed as work under an architect's or engineer's contract. The architect or engineer must lay down in the contract with his client what work exactly he has to produce. Only after this exact definition of work to be performed does the HOAI provide information on what fee the architect or engineer is due for his work.
- Secondly, price law means that the fees arising from the HOAI are mandatory for both parties to an architect's or engineer's contract. The architect's fee may therefore only be freely negotiated within the narrow limits prescribed by the HOAI.

In a free market economy such as that in the Federal Republic of Germany, it would seem natural to anyone working in the business world that the price for the work he has to produce is only governed by the laws of the market and can be

freely negotiated. In fact, this is not possible within the scope of application of the HOAI – apart from some exceptions – because the HOAI prices are mandatory in their character. The minimum and maximum fees contained in the HOAI are mandatory for both parties and, as a rule, also apply in cases where the parties have agreed on a different fee. Therefore, for work covered by the scope of application of the HOAI, price competition is, apart from some exceptions, basically only admissible within the margin between the minimum and maximum fees.

One example of an exception is the project management contract (see section 2 below). Provisions on prices for a project management contract can be found in Section 31 HOAI. According to Section 31, para. 2, HOAI fees for project management work can be freely negotiated. This is due to the fact that, according to rulings by the Federal Court of Justice, price regulations for project management contracts do not fall under the authority of the HOAI and are therefore null and void.

The HOAI covers work on buildings, outdoor facilities and extensions or conversions to create rooms, urban development work, landscape planning work, structural planning work, work on engineering structures and traffic systems, work on technical equipment, work for thermal building physics, work on noise control and room acoustics, work on soil mechanics, earthworks and foundation engineering as well as surveying services.

As far as the specific applicability of the HOAI is concerned, a check must be made in each case to determine whether the HOAI can be applied in the geographical, personal and technical respects.

aa) Geographical Scope of Application (HOAI)

The geographical scope of application is not regulated in the HOAI. In the final analysis, a distinction has to be made between three different case groups:

- The HOAI applies when a German architect or engineer wants to provide planning or construction supervision services for a structure/building to be erected in Germany.
- There is still controversy about whether the HOAI also applies to foreign planners who want to work in Germany. A high-court ruling on this issue has yet to be made. Some people are of the opinion that the HOAI should apply to the services of foreign contractors in Germany if they have a branch office here in Germany. However, there are good arguments for making all foreign architects who want to work in Germany subject to the regulations of the HOAI as, on the basis of the general provisions of international private law, it has in principle to be assumed that the parties to an architect's or engineer's contract do not have a choice of law with regard to tenant and consumer protection regulations. This results from Section 34 EGBGB. Due to the regulations on maximum and minimum prices which it contains, the HOAI is mandatory public law. Mandatory provisions in German law must, according to Section 34 EGBGB, also still be applied when the contract in question would mean that foreign law and not the law of the Federal Republic of Germany would have to

be applied. Accordingly, the HOAI can also be applied to foreign architects and engineers who provide their services in Germany.
- The HOAI can be applied to the services of German architects and engineers in Germany when German law can be applied. This may be the case when the contractor and the client have agreed on the applicability of German law or when the parties have agreed a German venue for disputes.

bb) Personal Scope of Application (HOAI)

The personal scope of application stipulates what group of people the HOAI is binding on. There is no clear answer to this in the HOAI. It does not define either the term 'architect' or the term 'engineer'.

The Federal Court of Justice has now made a final ruling on the previously disputed question of the personal scope of application. It has made a functional determination of the personal scope of application: According to this, the HOAI is only to apply to those providers who, on the basis of the service they offer, perform the typical role of an architect or engineer. The Federal Court of Justice therefore dictates the scope of application in relation to the work and not to the person involved.

This means that the HOAI cannot be applied to providers who provide architect or engineering services in addition or in conjunction with construction services as they also provide services above and beyond the typical work of an architect. This applies in particular to property developers, suppliers of prefabricated houses and project developers.

By contrast, the engineering office of a construction company would have to be assessed differently if it only provides planning services in certain cases. The HOAI can then be applied to the charging of such services.

cc) Technical Scope of Application (HOAI)

The provisions in Section 1 HOAI apply to the calculation of the remuneration for the services of architects and engineers as contractors provided that such services are covered by so-called Scopes of Work *(Leistungsbild)*. Scopes of Work within the meaning of this definition are, for example:

- Planning of a Building Project (Section 15 HOAI)
- Planning of Engineering Structures and Traffic Systems (Section 55 HOAI)
- Planning of Structural Engineering (Section 64 HOAI)
- Planning of Technical Equipment (Section 73 HOAI)
- Planning of Heat Insulation (Section 78 HOAI).

By contrast, the following types of services are not covered by the scope of application of the HOAI pricing regulations:

- Services which are not typically provided by architects and engineers (e.g. real estate agent services, designer services)
- Separate, special services, i.e. services which do not belong to the basic services defined in the Scopes of Work and for which therefore a separate order has been placed. This does not apply if basic services of the same Scope of

Work have also been commissioned with the order. Examples of separate special services are an application for a preliminary building permit or the economic viability calculation.

dd) Exceptions

As already explained, the provisions of the HOAI are, within their scope of application, binding on everybody and must therefore be observed by the contracting parties. However, the HOAI does permit exceptions where the contracting parties are free to agree the fee to be paid. In such cases, the HOAI gives the contracting parties a free hand as regards the fee to be paid and therefore reinstates the parties' freedom of choice with regard to the price. However, this is only possible in the cases specifically mentioned in the HOAI and only for these very cases. Examples which deserve mention here are:

- Section 16 para. 3 HOAI – for basic services for buildings and room-creating interior conversion or extension work where the chargeable costs exceed € 25,564,594.00
- Section 17 para. 2 HOAI – for basic services for outdoor facilities in accordance with Section 16 para. 3 HOAI
- Section 26 HOAI – for services for furnishings and integrated advertising installations, it is permitted to freely agree a flat-rate fee provided that this is agreed in writing when the order is placed.
- Section 28 para. 3 HOAI – for the planning and supervision of prefabricated components, a flat-rate fee may be freely agreed when the order is placed. Otherwise a time-based fee must be charged in accordance with Section 6 HOAI.

b) Architect's/Engineer's Contract

The HOAI itself does not contain any information standardised by law on the content or scope of an architect's contract. Whether the architect or engineer received an order at all, what work he has to perform and whether he can claim any remuneration for this at all is regulated exclusively by the contract. The architect must explain and prove the circumstances according to which the architect's work can only be expected in return for remuneration. The HOAI merely answers the question of how much remuneration the architect or engineer is to receive. It therefore merely has the character of a "fee schedule".

As no special statutory regulation exists, the German Civil Code must be applied. Of the types of contract regulated by the BGB, the contract for work in accordance with Section 631 et seq. and the contract for services in accordance with Section 611 et seq. BGB are most appropriate. The correct choice of contract type is of crucial importance as the scope and character of the contractual duties and the consequences of default in performance are regulated in different ways for each type of contract.

aa) Contract for Work

High-court rulings have classified the architect's contract as a mixed contract with elements of a contract for services and a contract for work but the predominant feature is its character as a contract for work. In general, the trend in court rulings is therefore towards qualifying an independent order placed with an architect/engineer as a success-oriented contract for work and not merely as an obligation to provide services. The same ruling has already been applied to the following categories of engineer: structure planners, surveyors, heating engineers, engineers for sanitation and electrical work (technical equipment), and soil experts.

The qualification of an architect's or engineer's contract as a contract for work has the following consequences:

- The architect or engineers is obliged to produce work which is free of defects and which meets the purpose of the contractual agreement.

  Once the architect's or engineer's contract has been generally classified as a contract for work, the next question to be answered is what the success owed by the architect is and in particular whether this success is the erection of the building as such. This is not the case. In contrast to the success which the construction company has to achieve, the work of the architect or engineer consists of a wide range of intellectual work. He has to produce plans which are both technically and economically without fault and the work he performs must be geared to the construction of a building which is free of defects on the basis of his plans. If the architect owed the building itself, he would also be liable for defects which he could not prevent even with diligent supervision of the construction work. The same applies to the engineer: He, too, generally does not have to provide any supplies or perform any construction work.

- What work is necessary to achieve the above-mentioned success is basically irrelevant. It also does not make any difference whether the work falls under the heading "basic services" or "special services" as defined by the HOAI. If no stricter criteria are agreed in the contract, generally accepted engineering practice sets the minimum standard for the contractual compliance of this work success.

  The Federal Court of Justice (BGH) has consistently ruled that the crucial factor is the published state of the art at the time of the acceptance inspection and not at the time the contract was concluded. This has to be separated from the question of whether a planning shortcoming is the architect’s fault and whether he can therefore be sued for damages. In this case, it all depends on the time when the architect's work was planned and performed. An examination must be conducted to determine whether the architect could, given his subjective level of knowledge, have detected the shortcoming in the planning in time.

- The agreements made in the contract primarily dictate whether the architect's work is free of defects.

The principle of equitable interpretation dictates that the interests of the client in the work stages necessary for the work success owed by the architect are substantiated by the specific contract and must be taken into account.

bb) Contract for Services

In the case of a contract for services, the person providing the service is obliged to perform the activities he has undertaken with due care. A contract for services does not contain any liability for success comparable with that laid down in work contract law. The focus in a contract for services is on the service. It will only be possible to classify an architect's or engineer's contract as a contract for services in a few exceptional cases. Such cases are in particular when an architect working under an employment contract performs planning work on the basis of that employment contract or when an architect, as a free-lancer, only provides supplementary planning and co-ordinating services under a comprehensive architect's/engineer's contract signed by his employer. In these cases, there is "only" an obligation to carefully perform the contractual work but there is no liability for success under a contract for work described above.

The remuneration is paid in the form of a salary or the agreed fee for the services.

Example: An architect commissions a colleague to determine the quantities used for billing purposes and agrees to pay his colleague an hourly fee. In order to perform this work, the colleague works an average of 10 hours a day for seven months. He does not run his own office and is not able to not perform any orders other than the one in question during that time. When the work has been completed, the architect suddenly says that the colleague will be paid for the work of determining the quantities in accordance with the HOAI because he would have to pay less. Here the adjudicating court decided that since the colleague was economically dependent on the commissioning architect and devoted his entire working capacity to the performance of this task, there was in this case a work relationship similar to that of an employee and therefore the agreed hourly fee had to be paid (Oldenburg Higher Regional Court, IBR 1996, 252).

cc) Client Acquisition Work

The prerequisite for an architect's or engineer's claim to any remuneration at all is that he must be able to prove that a contract has been concluded, regardless of whether this contract is a contract for work or a contract for services. A difference must be made between work without a contract and therefore not subject to the payment of a fee and contractual work which is thus subject to remuneration.

If an architect's contract is not concluded in writing and so it is difficult for the architect to prove that a contract subject to remuneration has been concluded, the client frequently regards the architect's work as client acquisition work without any obligation on the client’s part and refuses to pay any remuneration. In order to

avoid this problem, architects and engineers are therefore strongly advised to always conclude their contracts in writing.

Even in cases where client acquisition work has been agreed, i.e. the architect's work was agreed to be without obligation, this does not mean, according to court rulings, that there is no architect's contract. "Without obligation" is not equivalent to "free of charge". According to court rulings, the mere fact that “no obligation” was agreed does not mean that the conclusion can be drawn that there was no intention to conclude an architect's contract. In any event, an architect's contract with only a limited scope of engagement exists. This means an obligation to pay remuneration can in principle be assumed.

The mere act of performing client acquisition work involves an offer for the conclusion of an architect's contract which the prospective client tacitly accepts if he accepts and uses the architect's work. If the client maintains that there was an agreement that the architect's work was to be produced free of charge, he bears the full burden of proof in this case.

If the architect cannot prove that an architect's contract has been concluded, court rulings on the dividing line between client acquisition work and work subject to a fee assume the following: If the architect takes action on his own, it can be assumed that this is client acquisition work. If an architect is expressly engaged to produce a plan without any obligation on the client’s part, the absence of obligation can be equated with the work being free of charge. However, the more extensive the architect's work is, the more usual it is to assume remuneration must be paid.

The amount of work involved and the fee expected for the performance of the architect's contract also play a role in assessing each individual case. The court rulings assume that the higher the expected order volume is, the greater the architect’s interest in acquiring the potential client will be. This means that extensive preparatory work by an architect may be viewed as client acquisition work if the scope of such work can be regarded as reasonable given the expected fee.

Example: In one case involving an order volume of € 93,055.12, 131 working hours were regarded as client acquisition work (Cologne Higher Regional Court, NJW-RR 1998, 309).

Another aspect is the economic climate. It is assumed that during a recession in the building industry an architect will be more prepared to perform extensive client acquisition work than in times of a boom.

In principle, an architect is not obliged to inform the client what his fee will be. However, if an architect has stated that he is, for example, prepared to find out what the development and financing possibilities are for a project, initially without charge, it is considered his duty to inform the client in good time as to when he will start charging a fee for his work. If the architect fails to provide such information, he has no claim to a fee. The same applies in certain cases when the architect realises that the client obviously only expects work free of charge and would not have the work done if he had to pay for it.

The Federal Court of Justice confirms the obligation to pay remuneration if the architect produces as-built drawings, a quantity survey of the building, pre-planning work, a calculation of the construction costs and a economic viability calculation as such services do not require so little work that they are usually provided free of charge. Moreover, obtaining a public authority grant for modernisation work is not regarded in court rulings as involving minimum work, so the architect has to be paid for these services. Work on draft plans is also not considered to be minor work which is not usually subject to remuneration.

c) Liability

The term liability is widely used. The architect/engineer may be liable both to the client and third parties. Mistakes of the architect which result in liability can arise at numerous junctures during the planning and implementation of a building project. For example, the work of the planning architect may contain errors or omissions or the architect hands over the plans late or the specified construction budget is exceeded. The architect supervising construction work may also be made liable in numerous cases, e.g. if he fails to see that a contractor performing the work is not building in accordance with the approved plans or implementation plans. All these – and other – mistakes may lead to the client claiming against the architect in respect of defects.

aa) Liability of the Architect/Engineer

The architect's contract is a contract for work or services (see above). It is the architect's job to ensure that the building is erected without defects by performing the tasks for which he is responsible. The architect's liability for breaches of contract is primarily based on Sections 633 et seq. BGB. It presupposes a fault in performance which frequently occurs in the form of a defect in the work. According to Section 633 BGB, this exists

- when the work is not of the agreed nature,
- or, if the nature of the work has not been agreed, the work is not suitable for the use presumed by the contract or customary use and is not of the nature customary for works of the same type and which the client can expect according to the type of work.

This is always the case when the actual nature of the work deviates from the specified nature. The term nature of the work covers the properties inherent in the work including the external circumstances to which the work is automatically subject as well as all factors which can have an effect on the use of the work including its value.

Typical defects in the architect's work are, for example, plans which do not comply with generally accepted engineering and construction practice, plans which cannot be used as they do not comply with regulations under public law and plans which do not meet the economic conditions which were the basis for the contract.

The following describes typical cases of liability and architects' mistakes.

(1) Planning mistakes

The architect does not owe his client the best possible quality of work. He in fact also discharges his duties in accordance with the contract if he produces average, i.e. usable, work. To this extent, the architect has planning discretion. If the architect exceeds his latitude for planning discretion, this may also constitute a planning mistake. However, concrete contractual specifications defining the target performance must always be observed.

A difference must be made when it comes to a defect in the building itself. If the building exhibits a defect, an examination must be conducted to see whether this defect results from incorrect planning or faulty workmanship. The architect may only be considered liable if the defect in the building is objectively attributable to deficient fulfilment of the architect's contractual obligations as only then is there also a defect in the architect's work, i.e. a defect in the planning or building supervision.

In certain cases it may be difficult to assess whether the architect's work is deficient. The architect's plans are always unusable and therefore deficient if no building suitable for the intended function can be erected on the basis of these plans. The architect's work must comply with generally accepted engineering and construction practice. This also includes the technical regulations for the design and construction of buildings which are recognised in science as being theoretically correct and have proved successful in practice.

(2) Special proposals by the architect

As part of his planning activities, the architect may submit separate proposals to the client for the building. If these proposals become part of the contract, the architect is himself responsible for his own proposals. The architect is therefore liable for defects which are attributable to his separate proposals just as if the separate proposal had already been part of the original plan which was based on the client’s expectations and specifications. The architect is liable if it subsequently turns out that the separate proposal itself is deficient or that the incorrectness of the architect's work is due to the fact that the rest of the plans are not compatible with the separate proposal.

(3) Delayed performance

The architect must produce his work by the contractually agreed deadline. If specific contractual deadlines have not been agreed, an assessment must be made on a case-by-case basis as to when the client could reasonably expect completion of the architect's work. The architect’s work is then due at this time.

As far as the performance of the architect commissioned to do the planning is concerned, contractually stipulated delivery deadlines are normally agreed for the plans. If this is not the case, it must be determined on the basis of other circumstances, for example the contractual schedules for the work to be performed, when the architect's plans have to be submitted at the latest in order not to risk hindering the contractors and therefore causing a delay in the overall project.

(4) Inadequate supervision of the work of third parties

The architect supervising construction must have the building site "under control". He must ensure that the contractors and tradesmen working on it perform the work in line with generally accepted engineering practice and that performance of the work complies with the building permit and the implementation plans and specifications.

If the faulty workmanship of third parties leads to defects in the building to be erected, the architect supervising construction is also accountable for the defects if the accusation can be made that the defect which has occurred would have been discovered and corrected if construction work had been properly supervised.

This also applies to faulty planning of third parties. The architect is obliged to regularly examine the plans provided by third parties and the shop plans and drawings, and, if necessary, point out any defects.

(5) Liability as an agent

Another reason for the liability of the architect may stem from the special position of trust which the architect holds vis-à-vis the client. In view of the architect's wide-ranging tasks in which the client must place particular trust, the architect is generally termed the client's agent.

The architect performs his work as an agent by developing a plan which is feasible according to any reasonable opinion and meets the client's economic expectations. This does not mean that the architect has to provide a solution which, objectively speaking, is the best possible one for the building project. The architect is neither an investment advisor nor tax consultant. Given his position as an agent, the architect has to discharge the following obligations:

- provide project and client-specific information and advice,
- duly discharge obligations which he, as an architect, has expressly undertaken in order to perform the contract,
- discharge duties to provide information and support prior to, during and subsequent to the contract.

The architect is liable for the infringement of any one of these obligations.

One of the typical obligations of the architect as an agent is the selection of the specialists and building tradesmen to be deployed. He should provide his client with all the relevant decision-making assistance, such as the particulars and information on the skills of the specialists and building tradesmen, the probable scope of the work they have to perform and the likely fees and remuneration based on empirical values. The architect is duty-bound to thoroughly examine and evaluate the quotations of the specialists and building tradesmen in order to provide the client with a basis for the conclusion of the subsequent contracts.

As part of his planning activities, the architect must ensure that his designs and the intended materials comply with the latest engineering practice. Moreover, he must explain what plan he is striving to achieve to his client and outline what alternatives there may be to avoid any risks.

In general terms, the architect, as an agent, has a duty to inform, which means that he has to report all circumstances to the client which, objectively speaking,

are crucial for the client when the latter is forming an opinion. This duty to inform also includes the architect's obligation to clarify the cost framework. This means he must find out what amount of money the client intends to invest in the building project. The architect must point out any imminent cost overruns which the client's special wishes may cause. If the architect is aware that the client wants to take advantage of tax benefits during the implementation of the building project, he is obliged to also take these tax aspects into consideration in his plans.

The architect must also consider how the client intends to use the planned building. First of all, that means he must create the technical conditions to permit the planned use, e.g. for using the planned structure as a garage. Secondly, the architect must know and comply with the relevant legal requirements. He must therefore examine the legal aspects with regard to the interests of neighbours and point out any consequences under public law, e.g. building lines and setbacks.

During the building work, the architect is obliged to inspect the work performed and the building materials supplied for any defects. However, this obligation does not go so far that he has to be present for every delivery of material. In principle, random sampling is enough. On completion of the building, the architect is obliged to conduct a technical acceptance inspection, i.e. to examine the finished work to ensure it complies with the contract, the specifications and planning documents and that it does not exhibit any technical defects. The legal acceptance inspection with its legal consequences is, on the other hand, solely a matter for the client. As far as the legal acceptance inspection is concerned, the architect merely has a duty to inform the client about the legal consequences of the acceptance inspection.

The architect is also obliged to help the client assert claims for the rectification of defects. This includes the objective clarification of the causes of defects even if the architect's own planning and supervision mistakes are discovered. The architect is obliged to instruct the relevant contractor who caused the defect to have it remedied. Moreover, the architect must inform the client of the legal situation resulting from the progress of defect rectification and advise him of the technical circumstances and possibilities. It must be noted here that the architect is not entitled to give legal advice. Moreover, he may not place orders with other tradesmen or contractors. This decision is always the client’s alone.

Finally, the duties of the architect as an agent also include checking contractors’ invoices. He must, in particular, make sure that the prices indicated are the same as those agreed on, that the quantities quoted are the same as those used or indicated in the bill of quantities/quantity survey and that any additionally charged work is not already covered by the main contract. The architect must also check invoices for payments on account to see whether they are in line with what has been agreed in the contract, whether they are mathematically correct and whether the work on which the invoices are based was actually performed. The same applies to subsequent claims on the part of the contractors. Here, too, the architect must check the supplements for technical and mathematical correctness. This includes examining whether the work listed in the supplement is not already covered by the main contract. As the architect is not the client's legal advisor, he is not obliged to clarify difficult questions of interpretation or complicated legal

evaluations relating to the scope of the order, such as occur, for example, when a lump sum contract is agreed. It also applies in those cases where the architect is obliged to inform the client that he has reached the limits of his knowledge and possibly recommend the client to obtain legal advice.

bb) Liability consequences

The provisions on contracts for work and services in the German Civil Code include several liability consequences, i.e. claims for the rectification of defects, rescission of the contract or a reduction in price as consequences of the architect's breach of an obligation regardless of fault as well as a claim for damages if the architect has culpably breached his contractual obligations. Rescission of the contract or damages may be considered in the event of a delay in planning.

(1) Rectification of defects, Section 634 No. 1, Section 635 BGB

If the work of the architect is deficient, he must, at the client's request, remedy the defect or produce new work. A peculiarity of an architect's contract is that the rectification of defects or production of new work is not always advisable, for example because the building planned by the architect has already been built and the planning mistake has already been implemented. In this case it is only advisable and possible to remedy the defect on the building itself but not in the planning work of the architect. The rectification of defects can therefore only be considered if the deficient planning of the architect has not yet been implemented.

> **Example:** An architect is commissioned to prepare the approval plan for a residential building. In his planning, he disregards the mandatory specifications of the relevant development plan. The authority which grants planning permission therefore rejects the client's application for a building permit. In this case the architect is obliged, at the client's request, to re-plan the building in compliance with the specifications of the development plan.

As a rule, while the architect has, on the one hand, an obligation to remedy defects he also, on the other hand, has a right to remedy defects.

This is undisputed at least as long as the deficient planning of the architect has not been implemented in the building. If the client does not give the architect the chance to rectify the mistake(s) in his planning, the client loses his right to claim for defects. In this case the architect can demand his full fee despite the deficiency of the work performed.

The question of the existence of a right to remedy defects is not quite so clear if the architect's planning mistake has already been incorporated into the building. In this case, rectification of the defect, as described above, is only possible on the building itself but not in the architect's plans. Here, court rulings grant the architect a right to remedy the defect under the following conditions:

- The architect must declare explicitly that he is in a position to completely remedy the defects on the building.
- The action he proposes must be explained.

- The action must also have a good chance of success.

If the client refuses to allow the architect to remedy a defect although the above-mentioned conditions are satisfied, the objection of contributory negligence can be held against his claim for damages or such a claim for damages may be completely excluded.

(2) Rectification of the defect by the client, Section 634 No. 2, Section 637 BGB

If the architect's work is deficient, the client may set him a reasonable period in which to remedy the defect. If the deadline elapses to no avail, the client may remedy the defect himself and demand compensation for expenses. This only does not apply if the architect rightly refuses to remedy the defect, in particular in view of the disproportionate cost of such work.

No deadline needs to be set in the following cases:

- The architect refuses to perform the work seriously and conclusively.
- The architect should have already performed the work on a contractually agreed fixed date and continued interest in the work was already linked in the contract to the observance of the fixed deadline.
- The architect refuses to subsequently perform the work in view of the disproportionate cost of such work.
- Subsequent rectification of the defect has already failed or the client cannot reasonably be expected to accept it.
- There are special circumstances which, with due consideration of the interests of both parties, justify the immediate rescission of the contract.

The client may demand an advance payment from the architect for the costs required to remedy the defect.

(3) Rescission of the contract, Section 634 No. 3, Section 636 BGB

If the architect does not perform due work at all or inadequately and if the client then sets a reasonable deadline to remedy the defect, the client may rescind the contract if the architect allows the period set to elapse to no avail. However, it should be noted that rescission is not an option if it is a minor defect. It does not have to be the architect's fault for the claim to arise.

After the contract has been rescinded, the contractual relationship must be wound up and the work already performed returned. If return is not possible, possibly because the building has already been partially erected according to the architect's plans, the client must pay compensation for the part of the work which he keeps.

(4) Reduction in remuneration, Sections 634 No. 3, 638 BGB

Reduction in remuneration means a cut in the fee. This is also possible if there are only minor defects in the architect's work. The reduction must be explained to the architect. Any reduction in remuneration also requires the client to set a deadline.

(5) Damages, Section 634 No. 4, Section 636 BGB

The architect is obliged to pay damages if the client incurs a loss as a consequence of defects in the architect's work and if it is the architect's fault.

It is necessary to set a reasonable deadline for the rectification of the defect. If the deadline passes to no avail or if it was not necessary to set a deadline, the client can demand damages instead of the work. The client is to be put in the same position as he would have been in if he had received work without any defects. The client can always demand that the damage caused by the defect itself be rectified including the damage arising as a result of the delay involved in the rectification of the damage (so-called minor damages). The client may only demand so-called major damages, i.e. damages instead of all the work, in the event of a substantial defect. However, he can then no longer demand that the architect perform the work itself.

Instead of damages to replace the work, the client may also demand reimbursement of the expenses which he incurred because he was relying on receiving the work. If the client has rented road areas, for example, because the start of construction is imminent and if the planning submitted by the architect is so deficient, even after a deadline has been set and has expired, that the start of construction has to be postponed, the client may demand that the architect reimburse the rent which has been paid to no avail.

It is mainly those cases where mistakes in the planning or construction supervision only become apparent after completion of the building that are relevant in practice. The damage has then already occurred when the planning mistake is discovered. It is then not necessary to set a deadline as rectification of the planning defect makes no sense in these cases. The deficient supervision of construction cannot be remedied as such, either. As part of his claim for damages, the client is to be put in the same position as he would have been in if the architect's work had been free of defects from the very outset. The client's claim is aimed at the payment of money. Accordingly, the client can demand the amount of money which has to be spent to create the condition which would have existed if the architect had not made the mistake. This includes all costs of rectifying the damage, i.e. costs for conversion, restoration to the original condition and re-construction, costs for experts and consequential costs arising from any delay in the completion of the building, typically loss of rental income.

However, the client must always discharge his obligation to reduce the damage. This means that he may only incur expenses which any other client would also reasonably incur in his situation. Complete demolition and reconstruction therefore generally breach the obligation to reduce the damage if rectification of the defect is possible by the performance of subsequent work. If the client breaches the obligation to reduce the damage, he may only demand damages from the architect in the amount which would have arisen if reasonable measures had been performed to rectify the damage.

Moreover, costs which arise anyway, the so-called unavoidable costs, have to be taken into account when determining the amount of damages. Thus the client can only demand damages from the architect in the amount incurred additionally as a result of the subsequent action required. If the architect, for example, forgets

to plan drainage and if this is then subsequently installed, the client may only demand, as damages, reimbursement of the costs which are incurred additionally – for example for the dismantling or removal of building structures already erected. The costs of drainage itself, on the other hand, would also have been incurred if the architect's plan had been free of defects. The client cannot therefore demand that they be reimbursed.

cc) Period of limitation of claims of and against the architect

(1) Period of limitation of the architect's claims to his fee

According to Section 195 BGB, the period of limitation of the architect's claim to his fee is 3 years.

The period of limitation commences at the end of the year in which the claim arises. A claim arises, in particular, when it can be asserted and is therefore due. The submission of the verifiable invoice for the final fee to the client after performance of the work under the contract is key to the start of the period of limitation.

The architect is therefore in a position to dictate the start of the period of limitation by issuing the final invoice and, if necessary, to delay the start as much as he wants. If the client is interested in the final invoice being issued and in the period of limitation being set in motion – for example, to use financing funds – the Federal Court of Justice (BGH) has provided the following possibility for the client:

The client can set an architect who is late with the final invoice a reasonable period to present the invoice. If the architect allows the period to elapse to no avail, the period of limitation commences on expiry of the period set.

(2) Period of limitation of claims against the architect

The 5-year period of limitation according to Section 634a, para. 1 No. 2 BGB always applies to the client's claims for defects in an architect's contract concluded since 1 January 2002 if the architect's work has been performed for a building.

According to Section 634a No. 2 BGB, the period of 5 years applies to a building and work whose successful completion consists in the provision of planning and supervisory services. If the architect has provided different planning or supervisory services which are not intended for the construction of a building, the 2-year period in Section 634a No. 2 BGB applies.

The Federal Court of Justice (BGH) has developed so-called secondary liability for the architect/engineer which, above and beyond statute law, prevents claims due to defects being statute-barred as long as the architect has not clarified the causes of the defect and has not reported them to the client. Accordingly, the architect has a duty to disclose defects in his own work to the client, which means that the client is enabled to assert his rights also against the architect in good time before they become statute-barred.

The duty to disclose one's own mistakes stems from the support and supervisory functions assumed by the architect. In the case of an architect commissioned with extensive work such support and supervisory duties are derived from the fact that he has undertaken project support and supervision. He is

obliged to ensure the structure is free of defects and to also support the client, also after completion of the building, in examining and remedying building defects.

A violation of the architect's duty to inform substantiates a further claim for damages in that the period of limitation of the claims for defects against the architect is deemed not to have commenced.

The period of limitation of the claims arising from secondary liability has not yet been conclusively clarified. Here, a 30-year but also a 5-year period of limitation is assumed. A clarifying ruling by the Federal Court of Justice has yet to be made.

d) Copyright Protection for Architectural Plans

Contrary to what architects generally believe, not every plan has copyright protection. A plan only enjoys such protection if it stands out from the normal work of an architect, i.e. there must be a high degree of design work involved. The copyright itself is a highly personal right and cannot be transferred. However, the originator may grant rights of use to his work. In an architect's contract which at least covers the approval planning, the courts have consistently ruled that the right to realisation is also transferred. By contrast, with a preliminary planning contract no rights of use are transferred to the client without a separate agreement.

There is little statutory protection for work not covered by copyright. Here, contractual provisions may prevent undesirable exploitation and provide the grounds for claims for damages in the event of non-compliance.

2. Various Fields of Planning

The fields of work of architects and engineers are classified in the HOAI into so-called Scopes of Work, which are again divided into individual work phases. They describe the work which is generally necessary for the proper performance of an order (basic services; Section 2, para. 2 HOAI) or which comes on top of this work when certain demands are placed on the performance of the order which exceed or change the general services (special services, Section 2, para. 3 HOAI).

The most important Scopes of Work under HOAI are:

- Planning of a Building Project (Section 15 HOAI)
- Planning of Engineering Structures and Traffic Systems (Section 55 HOAI)
- Planning of Structural Engineering (Section 64 HOAI)
- Planning of Technical Equipment (Section 73 HOAI)
- Planning of Heat Insulation (Section 78 HOAI).

The descriptions of the individual planning and supervision work of the different Scopes of Work are only decisive for the claim to a fee; they do not, however, describe the professional duties which are owed by architects and engineers as contractors. The duties incumbent on them are solely governed by the architect's contract and not by the HOAI (Federal Court of Justice, BauR 1999, 187; see also above). The scope and content of the services owed therefore do not depend on the

Scopes of Work and work phases of the HOAI but on the architect's contract. The work described in the Scopes of Work is a catalogue of services whose fulfilment is a prerequisite for the remuneration.

In the following, the most important Scopes of Work of the HOAI are first described and then their work phases are explained by way of example (see section 1.3).

a) Planning of a Building Project

The scope of services laid down in the Scope of Work under Section 15 HOAI relates to the planning of a building project. Work on new buildings, reconstruction and extension work, the addition of one or more storeys, conversion and modernisation work, extensions or conversions to create rooms, maintenance and repair work as well as work on outdoor facilities (see the term definitions in Section 3 HOAI) are all covered by this Scope of Work.

The architect's services under this Scope of Work are broken down into 9 work phases. The specific tasks which arise in the performance of all planning, contract-awarding and supervision work are listed in a detailed catalogue of services. Each work phase contains basic services and special services which are generally necessary for complete fulfilment of the tasks. Basic services cover the services which are generally necessary for the proper performance of a contract. Basic services which objectively belong together are put together in work phases which are each separate in themselves (Section 2, para. 2 HOAI). Special services can be added to the basic services or replace them when special demands are placed on the performance of the contract which are above and beyond or change the basic services (Section 2, para. 3 HOAI). The work phases are structured so that they mesh with each other and build upon each other. If only part of the work of one work phase has been completed, the next work phase cannot be performed without the entire workflow of the planning, contract-awarding and supervision work being disturbed.

b) Planning of Engineering Structures and Traffic Systems

Section 55 HOAI concerns the Scope of Work Planning of Engineering Structures and Traffic Systems. It covers the contractors' work on new buildings and new plants, as well as reconstruction, extension, conversion, modernisation, maintenance and repair work. The term definitions in Section 3 HOAI also apply here.

This Scope of Work also applies to engineering structures and traffic systems; specific features are expressly listed in the Scopes of Work. The Scope of Work is sub-divided into 9 work phases. The designations are the same as those of the Scope of Work for buildings in accordance with Section 15 HOAI.

c) Planning of Structural Engineering

Section 64 HOAI covers the planning of structural engineering. This Scope of Work relates to services in connection with proof of stability and design work. This Scope of Work is also divided into 9 work phases.

d) Planning of Technical Equipment

Section 73 HOAI contains the services to be performed in connection with the Planning of Technical Equipment. This regulation covers facilities in buildings and engineering structures. These are technical supply and disposal plants for covering the demand for heat, cold, air, electricity, water or other media. This technical equipment includes in particular gas, water and sewage plants as well as systems for providing water for fire extinguishing, hot water production systems for space heating, domestic hot water production systems, air-conditioning systems, electrical systems, elevator, conveyor and storage systems, kitchen, laundry and dry-cleaning systems as well as medical and laboratory systems.

e) Planning of Heat Insulation

Section 78 HOAI regulates the services for the planning of heat insulation. Such work has increased in importance in recent years. Special regulations, such as in particular the Heat Insulation Regulations *(Wärmeschutzverordnung)* place special demands on limiting thermal conductivity and heat losses. These services may be required for both buildings and engineering structures.

3. Different Phases of Planning

As already mentioned above, the Scopes of Work are subdivided into different work phases. Thus the following applies:

Scope of Work (e.g. Planning of a Building Project, Section 15 HOAI) → Work Phases 1 - 9

↓

↓

These 9 work phases for the Planning of a Building Project (Section 15 HOAI) are:

↓

Basic Planning Concept
Preliminary Planning
Final Design Planning
Building Approval Planning
Implementation Planning
Preparation for Contract Awarding
Involvement in Contract Awarding
Supervision of the Building Project
Supervision of Final Work and Documentation

These different work phases of the Scope of Work for the planning of a building project (Section 15 HOAI) are described in more detail in the following. It explains the basic services which the architect generally performs (cf. Section 2, para. 2 HOAI) and the typical special services which can be agreed in addition as required (cf. Section 2, para. 3 HOAI).

a) Basic Planning Concept

Basic services: Before planning work, the focus is on duties to advise and explain. They are to create the preconditions which are necessary to perform a certain contract. These include clarifying the client's ideas concerning the concrete construction work he envisages, defining the financial resources he wishes to invest (Federal Court of Justice, BauR 1991, 366), giving him advice on how to achieve his objective and giving him help to decide, for example, what specialists to involve in the planning (such as specialist engineers). These are services which every project involves and, if they are taken out of the package of services which the architect's contract covers, can only be performed by a specialist - in the case of a public authority as the contract awarder, for example by its building authority. If an architect receives an order to plan a building with a cellar, he must also obtain information about the groundwater levels without having to be given any further instructions (Zweibrücken Higher Regional Court, IBR 2001, 130). As far as liability is concerned, in this phase it is relevant whether the architect fails to point out that a specialist should be consulted or even advises against calling in an engineer. A plan which is free of defects and fit for use must also take the soil conditions into consideration as part of the determination of the basic prerequisites for the project (Bamberg Higher Regional Court, IBR 2003, 555). This is, as a rule, part of the job of the architect and not of the structural engineer as a basis for the right structural calculations (Jena Higher Regional Court, IBR 2002, 320).

Even at this early stage, the architect must point out possible risks involved in the use of new building materials which are not proven. The limits to this duty to advise are where the architect cannot be expected to have such knowledge himself. If the architect culpably violates his duties to give the client advice, the client may claim for damages (see above).

Special services: One important special service is a stock-take of the present situation, above all when construction work is to be performed on an existing building. This stock-take is necessary to assess the building or parts of the building. The result is important for assessing the planning requirements and considering what options for the execution of the work are available. If the client does not stipulate what rooms he requires and their function, the architect must point out that this information is indispensable for planning the building. Such information is typical work to be provided by the client. If this information is missing because the client is not able to do such work himself, it is the architect's job to prepare such a room and function plan.

b) Preliminary Planning

Basic services: These involve the development of a planning concept including an examination of alternative options meeting the same requirements which takes the client's and the users' wishes into consideration**.** Drawings of the various options have to be made, e.g. line drawings. The drawings do not have to be to scale. However, the drawings must be made in such a way that the client can easily see the design elements as well as the layout and size of the rooms. Therefore, ground plans, the design of the building and the facades and the location on the land have

to be shown. The services of other specialists involved in the planning are to be integrated and the main connections are to be clarified and explained. Furthermore, preliminary negotiations are to be conducted with the authorities and other bodies on the possibility of getting building approval for the project. As an initial determination of the costs, a cost estimate has to be made at this stage so initial information of the likely cost of the project can be given to the client. The cost estimate in particular is of considerable importance for checking the client's chances of financing the project; this rough estimate of the costs is to give the client a rough guide so he can already change or reduce what he wants.

Special services: One special service which deserves mention is the application for a preliminary building permit, which is aimed at obtaining a preliminary building permit to ensure that the project can be built in compliance with the regulations under public law. If the plan is risky, the architect must normally apply for a preliminary building permit to clarify whether the project can be built.

c) Final Design Planning

In this phase, the planning concept is now turned step by step into drawings. The contributions of the other specialists involved in the planning are used and integrated. The result is a full design draft prepared using a scale of 1:100, with larger projects 1:200 or even 1:500. With rooms, a scale of 1:50 or even 1:20 may be used. However, these drafts do not have the form of plans ready for submission. As a further way of determining the costs, a cost calculation is required in this phase. This is a more accurate calculation than the cost estimate but is still based on empirical values.

d) Building Approval Planning

Basic services: In accordance with public law regulations, the planning documents are to be prepared and completed so that they meet the public law requirements for the necessary permits or approvals. The contributions of other specialists involved in the planning such structural calculations, proof of provision of sound and thermal insulation, drainage plans, are to be used as well.

Special services: Services which deserve special mention are helping to obtain the consent of neighbours and the preparation of documents for special examination procedures. The provision of professional and organisational support for the client also refers to objection proceedings and legal action, in which the architect is to support the position of the client in his capacity as a professional consultant. He can demand an additional fee for this (Schleswig Higher Regional Court, BauR 1992, 188).

e) Implementation Planning

Basic services: They cover the preparation of layout plans with detailed plans and design drawings up to a scale of 1:1 with all the individual information necessary to execute the project and the necessary explanations. Simply the choice of the 1:50 scale for ground plans in the construction documents does not yet justify calling the drawings implementation plans. The architect is to take into

consideration and provide adequate solutions to meet building physics demands connected with the construction project such as protection against damp. This also includes, if necessary, the use of a vapour barrier. He must work out the basics for the other specialists involved and finally incorporate their contributions into the implementation plans. During implementation, the implementation plans are to be updated.

Special services: These include the preparation of functional specifications, in which the demands on the interior and finishing works, the design and the technical equipment are to be described in words instead of shown in drawings.

f) Preparation for Contract Awarding

The quantities required are to be determined and put together as a basis for the preparation of specifications and bills of quantities. The specifications for the different areas are to be co-ordinated; they must be unambiguous and clear.

The architect must plan sealing work, where necessary, and allow for it in the awarding of contracts. The calls for tenders for exterior finishes must indicate the coating/paint to be used and the thickness of the coating (Celle Higher Regional Court, BauR 1984, 647).

The architect must prepare the contracts and give advice on the various forms of calls for tenders (e.g. awarding to a number of specialist companies or awarding to a general contractor). He does not have to formulate the construction contracts as this would constitute giving legal advice, which he is not allowed to do (Brandenburg Higher Regional Court, BauR 2003, 1751).

g) Involvement in Contract Awarding

The documents prepared in the previous work phases (specifications with bills of quantities according to the different work areas) are now compiled to make up the tendering documents. On the basis of these documents, the architect must obtain tenders, examine and evaluate them, draw up a list of prices and make a quotation on the basis of the tenders he has received. The architect's tasks include being involved in the placing of orders or awarding of contracts. If the architect has the appropriate authority to act on the client's behalf, he may sign contracts with the companies in his name. The above-mentioned involvement relates to professional advice as to which of the tenders is the most acceptable from both the technical and economic points of view.

h) Supervision of the Building Project

In this phase, the project planner has to perform comprehensive supervisory work which relates to the execution of the building project in compliance with the building permit or approval and/or the implementation plans and the specifications in accordance with engineering and architecture practice as well as pertinent regulations. The purpose of the duty to supervise is to ensure that the project is built without defects and in accordance with the plans. How this work is to be performed depends on the individual case. There is no duty to supervise simple work routinely performed by tradesmen. For example, he is not obliged to

supervise the proper performance of painting work either personally or by suitable staff because such work is simple work routinely performed by tradesmen and the architect can rely on the work being performed properly (KG, BauR 2001, 1151). He does not have a duty to be continually present at the building site. However, the architect is to directly supervise the most important stages of the construction work on which the success of the entire project hinges. This also applies to difficult and critical stages. In such cases, it is not sufficient for the architect to make random inspections.

One important service is to keep a construction log book, in which all important information is to be entered, e.g. work performed by the tradesmen and companies, deliveries of building materials, deployment of manpower and weather conditions. However, it is not necessary for this construction log book to have a particular form. The scope of work is to be determined by performing a quantity survey together with the construction company: This is necessary for checking the invoices for the work actually performed by the company. The architect does not have to perform the acceptance inspection himself, but only make the preparations and check the technical side. It is the client's responsibility to perform acceptance, i.e. accepting that the work performed complies by and large with the contract, unless the client has authorised the architect to perform this work for him.

i) Supervision of Final Work and Documentation

In addition to the preparation of formal documentation, generally by completing the entire drawings including the final calculations for the building as a basis for building maintenance, the architect must inspect the building in order to detect any defects before any warranty periods of the construction companies expire. Within the periods of limitation for claims under warranties, the architect is obliged to supervise the rectification of defects. However, the architect is not obliged to continually keep an eye on the building; in this case, it is enough for him to inspect the building once before the period of limitation for claims against the general contractor expires.

II. Project Management

As the building volume increases, so do the demands on the client to put his ideas on the construction project into practice, and in so doing co-ordinate, control and supervise events from the technical, legal and commercial aspects. This work is the original task of the client and must be separated from the services of the architect and engineer. As a result of the increasing complexity of the work, in particular through the involvement of other people in the planning, clients are not always able to perform all project management functions themselves when the project exceeds a certain size. In practice, orders are placed for project management services in these cases. The orders cover in particular advice, co-ordination, information and controlling services.

The legislators felt that it was sensible to take this development into consideration and lay down fee regulations for project management services. Thus, Section 31 HOAI was introduced. As there are no representative studies on reasonable fees, Section 31 HOAI limits itself to describing the project management services and allowing the parties to freely agree the fee for such services. So the discussion on fees for project management services is kept open (BR-Drucks. 270/76, p. 39).

Thus the project manager's tasks are, in the end, originally tasks of the client. What tasks are the client's tasks can be measured by the HOAI Scopes of Work. In all cases where a decision on the part of the client is necessary, the project manager can take the decision on the client's behalf as an expert construction consultant. Therefore, the architect and planner do not have to advise the client for such a long time when solutions have to be found. Particularly with complex construction projects, problems escalate and make the deployment of project managers a sensible approach, also from the point of view of the architect.

Section 31, para. 1 HOAI lists some of the services of a project manager, the list is, however, not exhaustive. The services of the project manager include in particular: clarifying the task involved, preparing and co-ordinating the programme for the entire project, clarifying the conditions which need to be established before planners and other specialists involved in the planning can be deployed, drawing up and monitoring the observance of organisational plans, timetables and payment plans, co-ordinating and monitoring those involved in the project, preparing and looking after those involved in or affected by the planning, updating of planning targets and resolving conflicting goals, providing the client with a steady flow of information on the progress of the project, co-ordinating and monitoring the handling of funding applications, applications for grants and building approval procedures. This catalogue of services is not final and does not claim to be complete.

In its more recent rulings, the Federal Court of Justice tends to classify the project management contract as a service contract (cf. Federal Court of Justice, IBR 1999, 423; see also: Düsseldorf Higher Regional Court, BauR 1999, 508). Here, it is a question of whether the services are provided under a contract for services or under a contract for work. The classification of the legal nature of the project management contract is of crucial significance as regards the following legal consequences:

- With contracts for work, there is a warranty regardless of the question of fault, with contracts for services, however, liability depends on the question of fault (see above);
- Different periods of limitation (claims to fees under contracts for services and contracts for work: 3 years, Section 195 BGB; warranty claims under contracts for services: 3 years, Section 195 BGB; under contracts for work: five years for an architect's work on a building, Section 634 a, para. 1, No. 2 BGB);
- Different due dates for remuneration (Section 614 BGB: under a contract for services, after performance of the services, possibly after certain periods of

time, Section 641 BGB: under a contract for work, the remuneration is due on final acceptance);
- Different possibilities for terminating the contract and different consequences of notices of termination (Section 621 BGB: under a contract for services, at any time if remuneration after certain periods of time has been agreed, Section 649 BGB: under a contract for work, for the contract awarder at any time, for the contractor only for good cause, by analogy with Section 626 BGB).

Practical advice: In view of the above, it is urgently recommended to expressly and contractually regulate (i.e. in writing) the legal qualification of the project management contract as a contract for services or a contract for work. This should be achieved by the use of a clear heading as well as by a clear regulation of the contents of the contract. In the end, however, this question has to clarified by a lawyer.

In accordance with Section 31, para. 2 HOAI, the project management fee can be freely agreed. According to the wording of Section 31, para. 2 HOAI, a project management fee can only be demanded when this has been agreed in writing when the order was placed. This provision is null and void following a ruling of the Federal Court of Justice (BGH) in 1997; according to this ruling, a claim to a project management fee does not presuppose that a written agreement on the fee was made when the order was placed (Federal Court of Justice, BauR 1997, 497).

Practical advice: It is advisable to draw up a written contract on the fee to be paid which is to be signed by both parties to the contract (client and project manager).

Chapter 7 Construction Contract

I. General Aspects

This chapter firstly contains a brief description of the regulatory basis of German construction contract law. Moreover, it provides an overview of the most common types of construction contract and types of contractor as well as the main rights and obligations of the contracting parties usually laid down in a construction contract in German construction law practice. It is not intended to pre-formulate a standard construction contract. In view of the different interests and objectives of the parties in each particular case, no attempt has been made to make any proposals for the individual wording of contract clauses.

1. Contractor's Obligation for Successful Completion

Strictly speaking in legal terms, the construction contract is a contract for work and services (*Werkvertrag*) in accordance with Section 631 et seq. BGB (German Civil Code). The main feature of a contract for work and services is that the contractor not only owes the performance of certain actions individually described but also the provision, free of defects, of the work/service described in the contract in return for the agreed remuneration. The contractor owes the **achievement of success.** This principle is crucial in determining the relationship between performance and counter-performance in the contract for work and services and therefore the legal relationship between the contractor and principal.

2. Applicable Law/Regulations

Two regulations in particular have practical importance for regulating the material legal relationships between the parties to a construction contract. These are firstly the statutory provisions on contracts for work and services in Sections 631 to 651 BGB and secondly the 18 sections of the General Contractual Conditions for the Performance of Construction Work (*VOB/B*); the text is reproduced in Appendix II.

In contrast to the provisions of the BGB, the regulations contained in the **VOB/B** do not have the character of a law. They are **general terms and conditions** (*AGB*). As a result, the VOB/B must be expressly and effectively

agreed as an integral part of the contract between the parties if the provisions contained in them are to be applied to the construction contract. The provisions of the **BGB,** on the other hand, apply automatically. Their validity is at best influenced by differing provisions of international private law (*EGBGB*).

If the parties to a construction contract have agreed on the provisions of the VOB/B as an integral part of the contract, it is referred to in practice as a **VOB/B contract.** If there is no effective agreement, reference is made in practice to as a **BGB contract.**

a) Contracts Governed by the BGB

The construction contract in the form of a BGB contract is in practice used almost exclusively for **minor construction projects** or for individual types of work in minor construction projects. The reason for this is that, in contrast to the VOB/B, the general law on contracts for work and services in the BGB is not tailored exclusively to the needs of the parties to construction contracts but regulates in general the rights and obligations of the parties to contracts for work and services. It is obvious that any set of regulations which can be applied equally to the legal relationship between a taxi driver and his passenger and to the legal relationship between a shoemaker and his customers cannot govern the legal relationships between a principal and a contractor in the implementation of a complex construction project in such a way as to largely satisfy their interests. The updated law of obligations (*Schuldrechtmodernisierungsgesetz*), which came into force on 1 January 2002, has changed nothing essential in this limited suitability of the BGB provisions for governing a contract for work and services for the implementation of complex construction projects.

b) Contracts Governed by the VOB/B

In view of the only limited suitability of the general law on contracts for work and services to equally satisfy the interests of the contractor and principal in construction law, the VOB was developed by the German Award and Contract Committee for Construction Work (formerly German Award Committee for Public Works Contracts). It is divided into **three parts:**

Part A: "General provisions on the awarding of contracts for construction work"
Part B: "General contractual conditions for the performance of construction work"
Part C: "General technical contractual conditions for construction work"

- The VOB/A contains material provisions on procurement law. This is dealt with above under Chapter 10. Parts B and C of the VOB are crucial for the performance of a construction contract. If VOB/B is agreed, Part C of the VOB is also agreed through the reference in Section 1, No. 1, sentence 2 VOB/B.

Practical advice: As the provisions of the VOB/B are general terms and conditions, it is imperative to note that the text of the VOB/B must be made available at the time the contract is made to a contracting party who is inexperienced in construction work. This also applies to the sections of the VOB/C. Otherwise, the simple fact that the inexperienced contracting party is not given the possibility to obtain this information means that the VOB/B and/or VOB/C have not been agreed with legal effect (cf. Federal Court of Justice, ruling dated 14 June 2006, file No. I ZR 75/03, IMR 2006, 131). The contract is then a BGB contract.

- The provisions of the VOB/B contain numerous regulations which differ from those in the BGB. In some cases they put the principal, in others, however, the contractor, in a better or worse position than he would have been in according to the provisions of the BGB. According to the general opinion and rulings of the Federal Court of Justice, however, the alternating advantages and disadvantages of the contracting parties in the **VOB/B** as a **whole** represented a balanced set of rules to perform construction contracts to suit their respective interests. For this reason the individual provisions of the VOB/B were not subject to review by the Law on General Terms and Conditions (*AGBG*) – now integrated into the BGB (Section 305 et seq. BGB) – provided the parties did not substantially amend the key provisions of the VOB/B. To this extent, the VOB/B was therefore deemed to be privileged. This privileged position was increasingly called into question after the updated Law of Obligations came into force. Moreover, the Federal Court of Justice revised its rulings to the extent that each contractual amendment to the provisions of the VOB/B eliminated the privileged position of these general terms and conditions as a whole (cf. Federal Court of Justice, ruling dated 22 January 2004, file No. VII ZR 419/02, IBR 2004, 20). As almost every construction contract also contains amendments to individual provisions of the VOB/B, in the majority of cases the VOB/B is subject to review by the regulations on the Law of General Terms and Conditions. Provisions which do not stand up to such a review are ineffective. They are replaced by corresponding provisions of the BGB. However, only the provisions which give the **user** of the VOB/B a unilateral advantage are affected by such an examination. The provisions which place the user at a disadvantage are not affected. They remain effective. The user is the person who introduces the VOB/B into the contract vis-à-vis the other contracting party as an integral part of the contract.

Practical advice: The VOB/B remains a very sensible set of rules for ensuring a fair balance of interests of both parties in the performance of construction contracts. However, as they have almost completely lost their privileged position against Section 305 et seq. BGB, it is recommended to ensure not to be the user of these provisions if the VOB/B is agreed as an integral part of the contract.

- The VOB/B 2006 came into force on 1 November 2006. It contains amendments and supplements to the VOB/B 2002 which, however, mainly represent the integration of court rulings into the VOB/B 2006.

> **Practical advice:** In view of the amendment to the BGB by the updated law of obligations on 1 January 2002 and the amendments to the VOB/B (2000, 2002 and 2006), a thorough examination of existing construction contracts should be made to determine which provisions apply to the contract in question.

- If the VOB/B is agreed as an integral part of the contract, this means generally that its contents take priority over the provisions of the BGB. This does not mean that the provisions in the BGB no longer apply and are meaningless in a VOB/B contract. They only do not apply to the extend as they are replaced by effective provisions of the VOB/B. Apart from this, they apply in full.

c) Contracts Governed by the FIDIC

The provisions of the FIDIC (International Federation of Consulting Engineers) have almost no significance in the performance of construction contracts in Germany. The reason for this may be the existence of the VOB/B as a useful instrument for properly reconciling the interests of the principal and contractor during the performance of construction contracts. Moreover, public authorities are even obliged to agree on the VOB/B as an integral part of the construction contracts they conclude.

3. Types of contract

There are a large number of different types of contract. The individual contract types are often combined with each other. In Germany, the contract type "cost + fee" common in the Anglo-American countries is rare.

a) Unit Price Contract

The unit price contract (*Einheitspreisvertrag*) was **previously** very wide-spread and, at the time of the introduction of the VOB/B, its basic principle. With this type of contract, the principal prepares a bill of quantities in which he itemises and describes in detail the individual work and services to be provided by the contractor. The quantities to be provided for each item are specified in the bill of quantities in the call for tenders. The quantities are based on assumptions which in general originate from the architects plans or quantity surveys of the locality. The contractor submits a unit price which he has calculated for the work or services on the basis of the call for tender documents for each individual item in the bill of quantities. Multiplication of the assumed quantities by the unit price gives the total tender price for the work or service for each item. The sum of all the itemised prices gives the total tender sum. After completion of the work, the work and

services actually performed by the contractor are measured and multiplied by the unit price. This procedure, which is to be performed for each item, ultimately leads to the total remuneration which is due to the contractor as remuneration for the actual work performed. The parties can stipulate how the contractor must perform a quantity survey/measurement (*Aufmaß*) of the actual work performed. If they do not lay down the procedures in the contract, the type of survey to be conducted is always based on the relevant provisions of the VOB/C for the type of building work in question.

b) Lump Sum Contract

The lump sum contract (*Pauschalpreisvertrag*) has largely **superseded** the unit price contract as far as importance is concerned. It can be found in two variations:

aa) Detailed Lump Sum Contract

With a detailed lump sum contract (*Detailpauschalpreisvertrag*), the principal **details** the work and services to be provided by the contractor for each item in the same way as with the unit price contract. In the call for tender, the principal also indicates assumptions about the quantities to be provided for the major items. The contractor submits a total tender price for each individual item. There is no need to indicate unit prices. The contractor receives the total tender price for the individual items after the actual performance of the work or service tendered as remuneration for these items, basically regardless of the actual quantities provided for each item. No quantity survey is conducted. The sum of the individual total prices gives the total remuneration for the contractor.

> **Practical advice:** During the call for tender phase, the principal often initially asks for unit price contracts instead of detailed lump sum contracts. The contractor submits his tender for this unit price contract. During the subsequent contractual negotiations, the principal then tries to negotiate cheaper individual unit prices. At the end of these negotiations on each item, the principal then also asks the contractor to indicate a lump sum as the total remuneration to be agreed on for the complete performance of the work. In this way, the principal gets the lump sum he wanted from the very outset.

bb) Global lump sum contract

In a global lump sum contract (*Globalpauschalpreisvertrag*), the principal describes the work and services to be provided by the contractor in much **less detail** than with the detailed lump sum contract or unit price contract. The specification of quantities is more or less completely dispensed with in the specifications of the call for tenders. The principal can also issue a call for tender by merely describing the function which the structure to be erected has to fulfil. The contractor can then select the means and work with which he achieves the desired function of the structure. For the work and services described in this way, the contractor submits a lump sum as a total tender price which is due to him as

his total remuneration after the actual performance of the work and services tendered.

As mentioned at the start of this chapter, calls for tender frequently contain **combinations** of least a detailed lump sum contract and a global lump sum contract.

c) Partnering Contract

In 2006, the Association of the Building Industry in North Rhine-Westphalia (*Bauindustrieverband Nordrhein-Westfalen*) developed a type of contract called a partnering contract (*Partnering Vertrag*) in collaboration with leading members of the Association. With this type of contract, the principal and the contractor jointly plan the construction project at a very early stage, i.e. at the outset of project development, and implement the project on a partnership basis. The contractor is involved in all stages of the planning and submits planning and optimisation proposals tailored to the interests of the principal. The aim of this method is to develop a plan optimised to suit the principal's budget and objectives, to jointly award contracts for the work to subcontractors and to handle the construction project up to its completion on a partnership basis. It remains to be seen whether this sensible contract form will establish itself on the German building market.

d) Guaranteed Maximum Price Contract

The guaranteed maximum price contract (GMP contract), which is frequently found in Anglo-American countries, has not gained equally great significance in this form in Germany. Most GMP contracts are purely lump sum contracts as described above in section I.,3., b). There is generally no joint planning of the construction project by the contractor and the principal. Often it all boils down to that fact that the principal, together with the contractor, only awards the fully planned work to subcontractors and both contracting parties receive a certain percentage of the profits from the contract.

4. Types of contractor

Just as there are different types of contract, there are different types of contractor. The terms used for the contractor are governed by the **scope** of the **activities** he is contractually obliged to perform and depend on whether he performs these activities himself or has them performed by third parties.

a) General contractor

In Germany, a contractor is called a general contractor (*Generalunternehmer*) when he has to provide all the construction work and services to produce the entire building and perform the **major** part of the construction work **himself.**

b) Prime contractor

In Germany, a contractor is called a prime contractor (*Generalübernehmer*) when he also has to contractually provide all the construction work to produce the entire building. However, in contrast to the general contractor, he only performs **minor** work or no work at all **himself,** having most of the work performed by third parties (sub-contractors).

c) General planner and general contractor and general planner and prime contractor

These two terms are used in Germany when the general/prime contractor not only has to provide all the **construction** work but also all the **planning** for the construction project from the moment the contract is awarded.

Awarding contracts to one of these four types of contractor in contrast to placing orders for the individual items of work has, in particular, the following advantages for the principal:

- The principal receives the entire work from **one source.** This means that the principal has only one contract party during the performance of the construction contract. As a result, the principal does not need to co-ordinate the performance of the individual works. This is done by the contractor.
- The same applies to the assertion of any **warranty** claims after completion and acceptance of the construction project. Here, too, the contractor is the sole person obliged to provide the principal with a warranty for all defects. There is no discussion about interfaces and who is responsible for the various works.
- Moreover, the principal himself does not need to negotiate and place **different** orders for all the works to be performed. His negotiations and contract awards are restricted to the placement of the order with the contractor for the performance of the entire construction project.

In principle, the contractor gets in addition a percentage of the price he quotes for performing the individual works and services. This is the contractor's **compensation** for the co-ordination services he provides and his higher risk of liability.

d) Subcontractor

In many cases, the contractor subcontracts parts of the work he has to perform to third parties. These subcontractors may in turn contract other subcontractors to perform parts of their contractual work, so-called sub-subcontractors, etc. The principal has no direct contractual claims against the subcontractors. The contractual claims are always to be asserted down the **contract chain.** The principal has to assert his contractual claims solely against the contractor. The contractor may, however, assign his contractual claims against the subcontractors to the principal.

In the construction contract, the principal may forbid the contractor to commission subcontractors to perform contractual work of the contractor (the VOB/B contains this prohibition in Section 4, No. 8). Moreover, the principal

may specify in the construction construct that the contractor is only to commission companies he has previously accepted as subcontractors to perform parts of the work or he may impose certain minimum requirements on the subcontractors.

> **Practical advice:** As the principal is also liable for infringements of the provisions of the German Employee Secondment Act (*Arbeitnehmerentsendegesetz*) by the contractor's subcontractors, regardless of who is to blame, it is always recommended to contractually oblige the contractor to indemnify the principal against any claims made by the authorities responsible.

Regardless of the type of contractor the contractor can become a party to a construction contract as a **single contractor** or as a **consortium** together with other companies.

- Single contractor

  The more extensive and complex the volume of the construction work to be commissioned and performed becomes, the more seldom it is for the contractor to conclude the construction contract with the principal as a single contractor. Exceptions to this principle can be found with turnkey construction projects. Otherwise, the form of the single contractor is generally used for relatively small construction projects or for the performance of some sections of construction on more complex construction projects.

- Consortium

  The larger the construction project, the higher the probability is that the principal will conclude the contract with a consortium (*ARGE*) as the contractor. A consortium is an association of several companies who get together with the objective of performing the construction project put up for tender. The company is generally founded with a standardised contract, the consortium specimen contract (*ARGE-Vertrag*). In terms of company law, a consortium is generally a company constituted under civil law (*Gesellschaft bürgerlichen Rechts*), in rare cases also a general commercial partnership (*offene Handelsgesellschaft*) (controversial). The company itself frequently has no assets of its own. In addition to the company, the individual shareholders of the consortium are liable jointly and severably to the principal, i.e. each of them to the full extent. It is not the shareholders but exclusively the company (the consortium) that holds claims, e.g. claims for remuneration.

II. Individual Regulations (selected)

The following deals with important provisions of the **VOB/B 2002.** Moreover, it lists individual issues which should be contractually regulated between the parties in addition to the VOB/B. As most existing construction contracts currently fall

under the provisions of the VOB/B 2002, the following statements are tailored to the contents of these provisions. No comparison with a BGB contract has been made since a BGB contract is rarely used complex construction projects.

1. Remuneration

The provisions of Section 2 VOB/B govern what work is covered by the contractually agreed remuneration and in what cases the contractor may demand additional or revised remuneration for work or services provided.

a) Agreed Contract Price

The agreed prices cover all work and services which are part of the contractual work in accordance with the specifications, the special contractual conditions, the additional contractual conditions, the additional technical contractual conditions, the general technical contractual conditions for building work (VOB/C) and common practice in the industry ,Section 2, No. 1 VOB/B. The list in Section 2, No. 1 VOB/B therefore defines what, subject to any other contractual agreements, belongs to the **contractually owed work.** The reference to the VOB/C and common practice in the industry mean that the contractor must also perform work which is not expressly mentioned in the specification items. In Section 4.1, the VOB/C describes the work which the contractor also has to perform without it being expressly mentioned in the contract as contractual work and for which the contractor may not demand any additional remuneration (ancillary work). Such work includes, for example, the set-up and clearance of the building site (Section 4.4.1 VOB/C), the supply of process materials (Section 4.1.7 VOB/C), the provision of small pieces of equipment and tools (Section 4.1.8 VOB/C) etc. In addition to this ancillary work defined as such in the general regulations for construction work of any kind (DIN 18299), the DIN standards for each building trade/section of construction contain lists of other ancillary work (to be found in Section 4.1 of each DIN standard).

Practical advice: Evaluating what work is contractually owed is always a question of the individual case. The answer can only be found by looking at the contract as a whole and interpreting all parts of the contract (cf. Frankfurt/Main Higher Regional Court, ruling dated 22 March 2006, file No. 4 U 94/05, IBR 2007, 14). The fact that work is not expressly mentioned in the specification items in no way means that the contractor does not have to perform it. The result of an interpretation of the contract may even mean that the contractor has to provide the work without additional remuneration.

b) Modifications

However, the above principle mentioned in Section 2, No. 1 VOB/B only covers the contractually owed work as described at the **time** of the **awarding** of the

contract. Subsequent modifications to the scope of performance or the construction circumstances which have been described or can be determined may lead to a change in the contractor's right to remuneration. The VOB/B lists five reasons which may result in a contractor's entitlement to a change in the contractually agreed remuneration.

aa) Change Orders

According to Section 1, No. 3 VOB/B, the principal also has the right to order changes to the building design at any time after conclusion of the construction contract. The building design is deemed to have been changed, for example, when the principal subsequently decides to have the window casements made of aluminium instead of plastic as originally planned. If the contractor's company can perform such work, the contractor must perform the work. While, on the one hand, obliging the contractor to perform the changes to the scope of work made unilaterally by the principal after the conclusion of the contract, the VOB/B, on the other hand, gives the contractor the right to make a corresponding change in his contractually agreed remuneration. If the change to the building design alters the basis of the price for work provided for in the contract, a new price allowing for the higher or lower costs must be agreed, Section 2, No. 5 VOB/B. The higher or lower costs must be taken into account and a new unit price or lump sum price fixed on the basis of the calculations made by the contractor in costing the order. If the contracting parties cannot agree on a new price, an expert appointed, if necessary, by a court will fix the price. Agreement on a new price prior to the performance of work is not necessary. The fact that no agreement has been reached does not fundamentally give the contractor the right to refuse to perform the change in the work (cf. Dresden Higher Regional Court, ruling dated 21 November 1997, file No. 7 U 1905/97, IBR 1998, 369).

> **Practical advice:** If the price is altered as a result of a change in work, the following principle applies: A good price remains a good price and a bad price remains a bad price. For this reason it is recommended to contractually agree that the contractor has to hand over his costing to the principal in a sealed envelope after the order has been placed and prior to the performance of work. In the event of a dispute over a price change, the principal and the contractor will then open the sealed envelope and examine the costing together.

bb) Additional Work

In accordance with Section 1, No. 4, sentence 1 VOB/B, the principal also has the right to subsequently order work which was not originally agreed in the contract but which becomes necessary to perform the contractual work. The contractor must perform such additional work unless his company is not equipped to do so. Such additional work is, for example, if regulations under public law require the building to be erected to meet the needs of the disabled and the principal has failed to plan for an elevator.

Again, while obliging the contractor to perform said work, in Section 2, No. 6 the VOB/B gives the contractor the right to demand additional remuneration. If possible, the remuneration must in turn be determined on the basis of the calculations in the contractor's order costing. As this involves additional work, it is always more difficult to determine than the price for a change in work in accordance with Section 2, No. 5 VOB/B. Specific methods for costing the work are often not available as there are no concrete reference items in the original costing for many individual costs of the additional work.

Contrary to the wording of Section 2, No. 6, para. 1 VOB/B, the remuneration for the additional work does not necessarily have to be agreed prior to performance of the work. In contrast to changes in work, the contractor must, however, explicitly inform the principal before performing the additional work that he will demand special remuneration for the additional work. This duty to inform serves the function of both notifying and **warning** the principal. He is to be made aware of the financial consequences of his instructions regarding the additional work prior to the performance of that work. Any breach by the contractor of this duty to inform automatically means that he loses his right to special remuneration for the additional work performed. This is the major difference to the ordering of changes in work. Since it is difficult to clarify the legal question as to whether the principal is ordering changed or additional work, in practice the contractor should notify the principal of a subsequent price change or additional remuneration for every change in the work made by the principal prior to its performance.

cc) Necessary Work/Agency without Authority

In exceptional cases, the contractor may, in accordance with Section 2, No. 8, para. 2 VOB/B as well as Section 677 et seq. BGB, assert additional or revised claims for remuneration against the principal for work which deviates from the contractually agreed specifications and which the contractor performs without any instructions from the principal.

- In accordance with Section 2, No. 8, para. 1 VOB/B, the principle applies that the contractor may not demand any remuneration for work performed without instructions from the principal which deviates from the order specifications. On the contrary, he must remove this work within a reasonable period at the principal's request. Moreover, he is liable for damage the principal incurs as a result of the performance of different work or its removal.
- In **exceptional** cases, the contractor has, however, claims against the principal for remuneration for such different work subject to Section 2, No. 8, para. 2 VOB/B. This is the case if
  - the principal subsequently approves the work (e.g. by acceptance thereof without any reservations) or
  - the work was necessary to perform the contract, the contractor could presume that principal would wish the work to be done and notified him about the work immediately.

The calculation of the contractor's remuneration is based on the principles of Section 2, No. 5 or No. 6 VOB/B. These have already been described above in sections II., 1., b), aa) and II., 1., b), bb).

- In addition to Section 2, No. 8, para. 2 VOB/B, the provisions concerning agency without authority (Section 677 et. seq. BGB) can also be applied. In practice, this reference has, in principle, **little significance** as these provisions of the BGB have more or less the same contents as Section 2, No. 8, para. 2 VOB/B.

dd) Changes in the Quantity of Work

If the parties agreed a unit price contract even a mere change in the quantities of individual work items actually performed in relation to the quantities indicated in the order specifications may result in a change in the contractor's remuneration if either of the contracting parties **demands** this (Section 2, No. 3 VOB/B). Deviations in quantities of up to +/- 10 % do not justify a change in the unit price contractually agreed for each work item. Larger quantity deviations can be charged at a new unit price. The new price to be calculated is to allow in particular for the fact that the costs of setting up the building site, site overhead costs and general business costs which the contractor spread over the quantities in his costing are now to be spread over larger or smaller quantities.

Section 2, No. 3 VOB/B, however, is only applied if the changes in quantities are not a result of any instructions on the part of the principal or other change in work. Other changes in quantities fall under Section 2, No. 5 or No. 6 VOB/B.

ee) Hindrance and Disruption to Work

The contractor may have additional claims for payment against the principal for disruptions to building progress which are the principal's fault or whose cause is at least the principal's responsibility. Section 6, No. 1 in conjunction with Section 6, No. 6 VOB/B or Section 642 BGB may be considered a basis for such claims.

- If the contractor is hindered in the proper performance of his work and if he has notified the principal without delay of the hindrance and its consequences or if the hindrance was known to the principal, the contractor has the right to **claim damages** from the principal in the amount of the damage verifiably incurred provided that the principal was to blame for the hindrance. The contractor only has a claim to compensation for lost profit in the case of wilful intent or gross negligence by the principal (Section 6, No. 1 VOB/B in conjunction with Section 6, No. 6 VOB/B). It is not a claim for remuneration. These provisions will be dealt with in more detail in Section II., 4. below.
- Section 642 BGB may also be applied in addition to the provisions of the VOB/B. According to this Section, if the principal fails to perform an act which is necessary for the provision or performance of the work and the principal is thus in default of receipt, the contractor has the right to claim reasonable compensation from the principal. This provision becomes relevant, for example, when the principal does not manage to obtain the required building permit in good time for the contractually agreed start of the work by

the contractor and, as a result, the contractor is not allowed to start work. The contractor then receives reasonable compensation for the time of construction standstill until the actual start of construction. The amount of compensation depends on the duration of the delay and the remuneration originally agreed and also takes into consideration what the contractor saves in expenditure or can earn by deploying his workforce elsewhere as a result of the delay (Section 642, para. 2 BGB).

2. General Obligations

The VOB/B contains general obligations of the principal and of the contractor, particularly in Sections 3 and 4 VOB/B. These general obligations are neither final nor can they satisfy any special requirements of the individual construction contract in question. It is therefore always recommended to include provisions in the construction contract laying down the general obligations of the contracting parties which arise from the requirements of the individual case or which are to be regulated in derogation of the general obligations contained in the VOB/B.

a) General Obligations of the Principal

General obligations of the principal contained in the VOB/B are, for example:

- To provide the contractor with the documents necessary for contract performance in good time and free of charge (Section 3, No. 1 VOB/B)
- To mark the main axes of the building site and the boundary of the land and provide the necessary site datums in the direct vicinity of the building site, Section 3, No. 2 VOB/B
- The maintenance of general order on the building site and co-ordination of co-operation between the various contractors, Section 4, No. 4, para 1 VOB/B
- Obtaining the permits under public law – e.g. according to building law, road traffic law, water law, trade law, Section 4, No. 1, para. 1, sentence 2 VOB/B
- Provision free of charge, for use or joint use, of necessary storage and working areas on the building site, existing access roads and railway sidings as well as existing connections for water and energy, Section 4, para. 4 VOB/B

b) General Obligations of the Contractor

General obligations of the contractor contained in the VOB/B are, for example:

- Punctual submission of drawings, calculations, revisions of calculations or other documents which the contractor has to obtain in accordance with the contract, in particular the technical contractual conditions or common practice in this industry or on special request of the principal, Section 3, No. 5 VOB/B
- Management of the performance of his contractually described work and ensuring order on his building site, Section 4, No. 2, para. 1, sentence 3 VOB/B

- Discharge of the statutory and official obligations and those of accident insurance institutions vis-à-vis his employees, Section 4, No. 2, para. 2, sentence 1 VOB/B
- Written notification of his concerns about the type of performance provided for by the principal (also because of precautions against accidents risks), the quality of the materials or elements supplied by the principal or the performance of other contractors, if possible, already before the start of work but at least immediately after the contractor becomes aware of such circumstances, Section 4, No. 3 VOB/B
- Protection of the work performed by the contractor and the items handed over to him for such performance against damage and theft up to acceptance, Section 4, No. 5, sentence 1 VOB/B
- Removal of materials or elements which do not comply with the contract or the samples on the principal's instruction within a period to be determined by the principal, Section 4, No. 6 VOB/B

c) Duty to Co-operate

In addition to the general obligations mentioned in detail in the respective contract text and to those contained in the VOB/B, **unwritten** general obligations and codes of conduct of the contracting parties may arise from the principle of the reciprocal duty to co-operate. According to this duty to co-operate, based on the principles of **good faith,** the parties to a construction contract are obliged to interact in a co-operative manner during the performance of the construction contract. This duty to co-operate also results in duties of the respective contracting party, depending on the individual case, to inform, collaborate and, where applicable, refrain from undertaking action.

3. Period for Completion of Work and Liquidated Damages

Generally the call for tender documents contain, in the form of a general schedule, only the deadlines whose observance is of material importance for the principal. After the order has been placed, the contractor is in most cases obliged to give the principal a detailed schedule, co-ordinated with this general timetable, for the execution and control management of the construction work.

- When indicating the various deadlines for performance, the principal must remember that the VOB/B recognises both **binding** and **non-binding** deadlines. If a deadline is to be binding on the contractor (contractual deadline), it must be expressly indicated as a contractual deadline and agreed in the construction contract, Section 5, No. 1 VOB/B. Exceptions to this are only the indication of the start of construction and the conclusion of the contractually agreed work. The starting and finishing dates for the performance of the total contractually owed work are always contractual deadlines. The need to expressly agree deadlines as contractual deadlines is therefore more important

for intermediate deadlines. The observance of intermediate deadlines can, however, be of major importance for the principal.

- If the contractor culpably exceeds contractual deadlines, he is automatically in default without any additional warning. Moreover, contractual deadlines may be made subject to a claim by the principal against the contractor for liquidated damages/penalty.
- On the other hand, non-binding deadlines help the principal solely to **control** the building work and monitor building progress up to total completion. The principal generally exercises this control on the basis of Section 5, No. 3 and No. 4 VOB/B. At the principal's request, the contractor must take immediate remedial action if there is such a shortage of workers, equipment, scaffolding, materials or elements that the performance deadlines can obviously not be observed. If the contractor does not satisfy this request, the principal may demand damages in accordance with Section 6, No. 6 VOB/B or terminate the construction contract after setting another period of grace in accordance with Section 8, No. 3 VOB/B.
- The parties to the construction contract often agree on **liquidated damages** to be paid if particularly significant contractual deadlines are exceeded. As agreements on liquidated damages are often principal's general terms and conditions, the ruling of the Federal Court of Justice on the effectiveness of liquidated damages clauses must be strictly observed when formulating the agreement of such damages. Practice shows that the majority of liquidated damages clauses are ineffective. Particular **attention** is to be paid to the following:
  - If the liquidated damages are linked to the number of working days by which a deadline is exceeded, a percentage above 0.3 % of the net invoice sum per working day (*Arbeitstag*) is ineffective if the working week is defined as having 5 days (Monday to Friday) and 0.2 % of the net invoice sum per working day (*Werktag*) if the working week is defined as having 6 days (Monday to Saturday) (cf. Federal Court of Justice, ruling dated 1 April 1976, file No. VII ZR 122/74, BauR 1976, 279; Federal Court of Justice, ruling dated 7 March 2002, file No. VII ZR 41/01, IBR 2002, 357).
  - It must also be noted that the reference factor for calculating the liquidated damages per working day (based on a 5 or 6-day week) must be viewed in different ways. If the contractual deadline is an intermediate deadline, only the invoice sum of the work scheduled up to the intermediate deadline may be agreed as the factor. Reference to the total invoice sum or order sum is inadmissible for intermediate deadlines (cf. Jena Higher Regional Court, ruling dated 10 April 2002, file No. 7 U 938/01, IBR 2002, 542).
  - Moreover, the total sum of the liquidated damages must not exceed 5 % of the gross invoice sum (cf. Federal Court of Justice, ruling dated 23 January 2003, file No. VII ZR 210/01, IBR 2003, 291).
  - Furthermore, any liquidated damages incurred must be deducted in full from any actual damages caused by default and subsequently claimed for. Additional reimbursement of the actual damages caused by default may only

be made in the amount by which they exceed the total amount of the liquidated damages agreed (cf. Düsseldorf Higher Regional Court, ruling dated 22 March 2002, file No. 5 U 85/01, IBR 2002, 473).

- The principal must **reserve** the right to claim liquidated damages at the time of acceptance at the latest, Section 11 VOB/B. It may be agreed in the contract that this reservation is still admissible up to the time of final payment. If the reservation is not made on time, the principal may not assert any claim for liquidated damages. However, the assertion of an actual claim for damages caused by default remains unaffected.

Practical advice: The rulings of the Federal Court of Justice on the effectiveness of agreements on liquidated damages have steadily disadvantaged the principal over the past seven years. Therefore, before an agreement is made on liquidated damages as part of general terms and conditions, the current status of court rulings must always be determined exactly. Individual contractual agreements are not affected by this. However, de facto it is now up to the principal to prove that the agreement is an individual contractual agreement (cf. Federal Court of Justice, ruling dated 24 November 2005, file No. VII ZR 87/04, IBR 2006, 78; Federal Court of Justice, ruling dated 19 May 2005, file No. III ZR 437/04, IBR 2005, 519).

4. Hindrance and Disruption to Work

Disruptions to the contractually planned building progress frequently arise during the implementation of construction projects. Section 6 VOB/B governs what claims the contracting parties may have as a result of individual disruptions to the building work.

a) Notification to Principal

If the contractor believes he is being hindered in the proper performance of the work, he must notify the principal of this in writing without delay. If he fails to notify the principal, he only has a claim to have the hindering circumstances taken into consideration if the principal was obviously aware of such circumstances and their hindering effect, Section 6, No. 1 VOB/B. Notification need not be made in writing – contrary to the wording of the regulation (cf. Federal Court of Justice, ruling dated 21 December 1989, file No. VII ZR 132/88, IBR 1990, 212). As the contractor, however, has to verify in any subsequent dispute that notification was made to the principal, it is urgently recommended to adopt the written form in addition to verification of receipt by the principal. There are strict **requirements** on the contents of the notification of hindrance. The contractor not only has to notify the principal of the circumstances impacting on the construction time but also mention the building work which is being hindered, the effect of the hindrance on building progress and notification of whether the disruption will result in an extension of the building time and/or higher costs (cf. Federal Court of

Justice, ruling dated 21 December 1989, file No. VII ZR 132/88, IBR 1990, 212). In practice, most notifications of hindrances do not comply with these requirements. The contractor then frequently risks losing his claim to an extension of the building period or a subsequent claim for damages.

b) Extension of Time

If the hindrance is duly notified by the contractor, the contractor has the right, in accordance with Section 6, No. 2, para. 1 VOB/B, to an extension of the performance deadlines provided the hindrance is caused by:

- circumstances in the area of risk of the principal (e.g. delay in the provision of plans, subsequent requirements in the building permit provided the principal has to obtain this etc.)
- strike or similar
- acts of God or other circumstances which are beyond the contractor's control.

Effects of the weather during the building time which should normally have been expected on submission of the tender are not deemed to be a hindrance, Section 6, No. 2 VOB/B.

The extension of the building time is calculated according to the duration of the hindrance and with a surcharge for the resumption of the work and any postponement to a less favourable season, Section 6, No. 4 VOB/B.

During the period of the interruption the contractor must do everything which can be reasonably expected of him to make the continuation of work possible. The contractor must inform the principal without delay of the end of the hindrance and resume work immediately, Section 6, No. 3 VOB/B.

c) Indemnification

If the circumstances disrupting the building work are the fault of a contracting party, the other contracting party has a claim to the verifiable damage, lost profit, but only in the event of wilful intent or gross negligence, Section 6, No. 6 VOB/B.

The assertion of the claim for damages is always difficult for the contractor and requires at least the preparation of an expertise on the timetable and the manpower schedule (*baubetriebliches Sachverständigengutachten*). The contractor bears the **burden** of **explanation** and **proof** for all preconditions for the facts of the case according to Section 6, No. 6 VOB/B and in particular for the proximate cause and the contributory cause. He must also explain that, at the time of the hindrance, he himself had not already delayed building progress, that he could have performed the hindered work in accordance with the contract at the time of the hindering circumstances, that he could not have made up for the time lost due to the hindrance by changing the building schedule and what damage he actually incurred as a result of the hindrance (cf. Federal Court of Justice, ruling dated 21 March 2002, file No. VII ZR 224/00, IBR 2002, 354). In the case of complex construction projects, it is seldom possible for the contractor to perform this specific verification. It requires detailed documentation of the hindrance and the sequence of the entire building work.

d) Termination

In the event of a prolonged interruption of construction work of up to three months, the contractor has the possibility of issuing an interim invoice in accordance with Section 6, No. 5 VOB/B. If the interruption lasts for more than three months, either contracting party may terminate the construction contract in writing on expiry of the three months and settle the work performed, Section 6, No. 7 VOB/B.

5. Distribution of Risks

Special mention must be made of the following as regards the distribution of risks during the performance of construction contracts:

a) Work Executed Prior to Acceptance

In contrast to the normal BGB contract, it is not the contractor but the principal who bears the risks for the loss of the work prior to acceptance due to events which, objectively speaking, are beyond the contractor's control and for which he is not responsible. If prior to acceptance the work performed in whole or in part is damaged or destroyed by an act of God, war, an uprising or other circumstances which are objectively beyond the contractor's control and for which the contractor is not responsible, the contractor has, in accordance with Section 6, No. 5 VOB/B, the claims for the parts of the work performed; there is no mutual liability to compensate for other damage, Section 7, No. 1 VOB/B.

> **Practical advice:** To safeguard against this risk, the principal, as the developer, always takes out a construction insurance. The principal generally allocates the costs of the insurance premium as a percentage to the contractors involved in the construction project. It is generally agreed that the principal is entitled to deduct 0.3 % from the net invoice sum as a pro-rata contribution to the insurance premium.

b) Ground Risk

The term ground risk (*Baugrundrisiko*) is not defined in law. This term is generally understood to mean the bearing of a risk for a situation where the actual ground conditions are different to those described in the call for tender documents (cf. München Higher Regional Court, ruling dated 15 October 1996, file No. 13 U 5857/95, IBR 1997, 104). The additional time and/or costs connected with such deviations must be borne by the party which also bears the ground risk. Unless otherwise contractually agreed, the **principal** bears the ground risk (cf. München Higher Regional Court, ruling dated 3 September 2002, file No. 13 U 3140/02, IBR 2003, 9).

Practical advice: The ground risk may be reduced by obtaining a subsoil expertise (*Baugrundgutachten*) prior to the preparation of the call for tender documents. The subsoil expertise must then be made part of the call for tender documents and the subsequent construction contract. The more detailed the examination of the ground is, the less chance there is of encountering different ground conditions than those described in the subsoil expertise during the actual performance of work.

6. Termination

The construction contract may always be **terminated without notice** by either contracting party. The preconditions for termination as well as the reasons justifying termination without notice are frequently regulated in the construction contract in derogation of or as a supplement to the provisions of the VOB/B. In addition to the right to terminate the contract without notice, the principal also has the right to **freely terminate** the construction contract at any time unless otherwise contractually agreed.

It must be pointed out that termination of the construction contract without notice is to be viewed as an **ultima ratio** for both contracting parties – not least of all because of both parties' duty to co-operate with each other. If it subsequently turns out that the party which terminated the construction contract without notice actually had no right to do so, the termination without notice is ineffective. Ineffective termination without notice by the principal may be interpreted as a free termination unless the principal has pointed out that such an interpretation is inadmissible as he did not want to freely terminate the contract (cf. Federal Court of Justice, ruling dated 26 July 2001, file No. X ZR 162/99, IBR 2002, 300). Such a reference is therefore generally recommended for the principal.

Termination without notice by a contracting party frequently means that the other contracting party immediately terminates the contract without notice as well. **Unjustified** termination without notice represents per se a reason for termination without notice by the party who receives the ineffective termination (cf. Federal Court of Justice, ruling dated 5 December 1968, file No. VII ZR 127, 128/66, NJW 1969, 419, 420).

Practical advice: Given the high risks involved in ineffective termination without notice, a careful legal examination and preparation of the reasons for termination must also be made prior to termination of the contract without notice – all the more so given the fact that the notification of termination, as a constitutive declaration, cannot be revoked, contested or otherwise retracted. Once the contract has been terminated, this is either effective or ineffective.

a) Termination by Principal

The principal's right of termination is regulated in Section 8 VOB/B.

- In accordance with Section 8, No. 1, para. 1 VOB/B, the principal has the right to **freely terminate** the contract at any time up to the completion of work. This right stems from the freedom of the principal to be able to decide at any time not to further continue the performance of the construction contract.
  While the principal has the freedom to decide not to continue performance of the contract, the contractor has in turn the right, in the event that the principal exercises such right, to demand the contractually agreed remuneration. However, he must deduct whatever costs he saves as a result of the cancellation of the contract or whatever he earns, or maliciously fails to earn, through the deployment of his workers and use of his company elsewhere, Section 8, No. 1, para. 2 VOB/B. A free termination therefore often involves substantial costs for the principal.
- In addition to free termination, the principal has the right to terminate without notice. Reasons which justify termination without notice are also listed in Section 8 VOB/B. These are:
  - Application for or institution of insolvency proceedings or comparable legal proceedings on the assets of the contractor or cessation of payments by the contractor, Section 8, No. 1, para. 1 VOB/B.
  - Defects remaining despite the fact that the principal has granted a period of grace during the construction work prior to acceptance, Section 8, No. 3, para. 1 in conjunction with Section 4, No. 7 VOB/B.
  - Inadmissible performance of the contractually owed work by third parties in spite of a request not to do so, Section 8, No. 3, para. 1 in conjunction with Section 4, No. 8, para. 1 VOB/B.
  - Delay by the contractor in the construction work in spite of a prior request to speed up the work and the setting of a deadline, Section 8, No. 3, para. 1 in conjunction with Section 5, No. 4 VOB/B.
  - Agreements on the part of the contractor restricting competition during the awarding of contracts for construction work, Section 8, No. 4 VOB/B.
  - Any behaviour of the contractor which makes the continuation of the construction contract unreasonable for the principal justifies termination without notice as an **unwritten** reason (e.g. irretrievable loss of trust in the contractor). This unwritten reason for termination also applies, vice versa, to the contractor.
- After termination, the contractor may demand a quantity survey and acceptance of the work he has performed. He must invoice the work he has performed without delay, Section 8, No. 6 VOB/B. The contractor has no further claims to remuneration above and beyond this. The principal may demand that the contractor reimburses the additional costs which the principal incurs as a result of the termination without notice (these are generally the additional costs of completion of the contractually owed construction work by a third-party company).

b) Termination by Contractor

Section 9 VOB/B contains the preconditions under which the contractor may terminate the construction contract without notice. These apply if:

- the principal fails to perform an action for which he is responsible and as a result prevents the contractor from performing the work, Section 9, No. 1, lit. a) VOB/B
- the principal does not make a due payment or otherwise defaults on payment, Section 9, No. 1, lit. b) VOB/B.

Furthermore, both reasons for termination require that the contractor has previously set the principal a reasonable deadline for subsequent performance of the action or for making payment and the deadline has passed to no avail, Section 9, No. 2 VOB/B.

> **Practical advice:** The threat of termination as a result of a default on payment is very risky. Not every default on payment entitles a party to terminate without notice. The principal must default on a substantial part of the claim to total remuneration. There are no fixed principles as to when default on payment is substantial. The evaluation is always made in each individual case.

If the contractor terminates the contract without notice with legal effect, the work previously performed is to be invoiced according to the contract prices. Moreover, the contractor has a right to reasonable compensation in accordance with Section 642 BGB. Any claims above and beyond this also remain unaffected, Section 9, No. 3 VOB/B.

7. Acceptance

Acceptance is a declaration by the principal to the contractor that the latter has essentially performed the contractually owed work in compliance with the contract (cf. Federal Court of Justice, ruling dated 24 November 1969, file No. VII ZR 177/67, NJW 1970, 421). This declaration covers both the actual condition of the structure produced and the time the work was performed. This explains why the principal must reserve the right to assert claims for liquidated damages at the time of the acceptance if he, in derogation of any other contractual agreements, does not want to lose these claims.

a) Acceptance Obligation

The principal is obliged to accept the work if it is free of material defects and the contractor demands acceptance, Section 12, No. 1 VOB/B.

b) Consequences of Acceptance

Acceptance is of major importance for the contractor. It has in particular, the following consequences:

- The acceptance represents the start of the warranty period for all parts to which the acceptance relates and which have been accepted without defect.
- The acceptance declaration reverses the burden of explanation and proof for the contractual performance of work insofar as the work is accepted free of defects. Until the time of acceptance, the contractor bears the burden of explanation and proof for the fact that he has performed his work in compliance with the contract. This burden of explanation and proof passes to the principal at the time of acceptance. This does not apply to those parts of the work which the principal reported as being defective at the time of acceptance (so-called acceptance defects). The contractor must perform this work in compliance with the contract as remaining work still to be completed and explain and prove its compliance with the contract.
- Defects of which the principal is aware at the time of the acceptance but which he does not report during the acceptance need not be subsequently remedied by the contractor in accordance with the contract either as remaining work to be completed or to remedy them as part of the warranty.
- In a BGB contract, acceptance results in the contractor's claim to remuneration becoming due. In a VOB/B contract, acceptance is merely one of the preconditions for the contractor's claim to remuneration becoming due. In exceptional cases, the contractor's remuneration may, however, become due even without acceptance after termination of the construction contract (cf. Federal Court of Justice, ruling dated 22 September 2005, file No. VII ZR 117/03, IBR 2005, 663).
- Complete transfer of the risk of the loss of the building structure to the principal above and beyond the scope mentioned in Section 7, No. 1 VOB/B.

c) Types of Acceptance

There are three types of acceptance:

- Acceptance may take place formally, Section 12, No. 4 VOB/B. **Formal acceptance** means that an acceptance report is made on the acceptance. This contains, in particular, the acceptance defects, the scope of acceptance, the declaration as to whether acceptance has been granted, the declaration as to whether claims to liquidated damages are reserved and the time of the start of the warranty period and in general also its term. It is generally agreed in construction contracts for complex construction projects that acceptance must take place formally.

Practical advice: Formal acceptance is recommended in view of the duty of verification in case of a dispute. An agreement on formal acceptance in the construction contract does not automatically mean that fictitious or implied acceptance is excluded. Formal acceptance must only take place when it is not only agreed but also demanded by either of the parties. Whether this demand can already be effectively made in the construction contract is disputed and cannot be answered with legal certainty. It is therefore always recommended, at least for the principal, to demand formal acceptance vis-à-vis the contractor directly after completion of the entire construction project.

- Acceptance may also take place **fictitiously**. If the contractor has notified the principal in writing of the completion of the work and if, by the expiry of the following 12 working days (*Werktage*) (6-day working week), neither party
  - has demanded acceptance of the work or
  - the principal refuses to accept the work,

the work of the contractor is deemed to be accepted. However, it must be borne in mind that this fictitious acceptance also presupposes that the contractor's work is free from substantial defects and is therefore essentially in compliance with the contract.

Practical advice: As such fictitious acceptance may arise due to an oversight on the part of the principal, it is recommended to exclude the possibility of fictitious acceptance in the construction contract.

- Moreover, acceptance may be declared by estoppel (**implied acceptance**). If no acceptance is demanded and if the principal has started to use the work or part of the work, acceptance is deemed to have been granted on expiry of six working days (*Werktage*) (6-day working week) after the start of use, unless otherwise agreed. The use of parts of a building structure to continue the work is not deemed to be acceptance, Section 12, No. 5, para. 2 VOB/B.

Practical advice: This implied acceptance also presupposes that the contractor's work is largely free of defects and in compliance with the contract (cf. Federal Court of Justice, ruling dated 16 November 1993, file No. X ZR 7/92, NJW 1994, 942). It is also excluded in the vast majority of construction contracts.

8. Liability for Defects

As already mentioned at the outset in Section I.,1., the principle applies that the contractor owes **success** of the contractually agreed work. This principle is specified in more detail in Section 13, No. 1 VOB/B. The contractor has to provide the principal with work which is free of material defects at the time of

acceptance. The work is free of material defects at the time of acceptance if it is in the agreed condition and complies with generally accepted engineering practice. If the condition has not been agreed, the work is free of material defects at the time of acceptance a) if it is suitable for the use presupposed by the contract, otherwise b) suitable for customary use and is in a condition which is usual for structures of the same type and which the principal can expect in line with the type of work.

- One consequence of the contractor owing success is in particular that, regardless of blame, he has to **remedy** any **defects** in the work which occur during performance of the construction work or the warranty period, Section 13, No. 5, sentence 1 VOB/B.
  An exception to this only exists if the defect is attributable to the principal's specifications or instructions, to the materials or elements supplied or prescribed by the principal or to the condition of the previous work of another contractor. In this case, the contractor is not liable if he has pointed out these circumstances to the principal prior to the performance of his work (notification of reservations in accordance with Section 4, No. 3 VOB/B) and the principal has nevertheless wanted the work to be performed, Section 13, No. 3 VOB/B.
- If the contractor does not satisfy a request of the principal to remedy a defect within a reasonably set period, the principal may have the defects remedied by a third party at the **contractor's expense.** Before performance of the work, the principal may demand **payment** of an **advance** from the contractor on the basis of a quotation obtained for the performance of the necessary work. The principal may enforce this claim to an advance payment by taking legal action. After payment of the advance, the principal must perform and pay for the rectification of the defect within one year as otherwise he must pay back the advance to the contractor (cf. Celle Higher Regional Court, ruling dated 12 March 2002, file No. 16 U 138/01, IBR 2002, 308).
- If the contractor cannot be reasonably expected to remedy the defect, if rectification is impossible or if it would involve disproportionately high expenses and if it is therefore rejected by the contractor, the contractor may **reduce** the **remuneration** in a declaration to the principal, Section 3, No. 6 VOB/B. This exception clause of VOB/B only takes effect in the event that it is impossible to remedy the defect and in the case of defects which are solely visible. If the defect reported results in any other way in a functional impairment of the work, it is, according to a ruling of the Federal Court of Justice, no longer a question of whether rectification of the fault is economically disproportionate or not. If possible, the contractor has to remedy the defect. The costs of remedying the defect may, in extreme cases, exceed the total remuneration for work many times over (cf. Frankfurt/Main Higher Regional Court, ruling dated 14 April 2005, file No. 15 U 89/99, IBR 2006, 671).
- In addition to the obligation to remedy defects, the contractor is only liable to the principal when the **additional preconditions** laid down in Section 13, No. 7 VOB/B are met.

- The contractor is liable for damage resulting from injury to life and limb or health in the case of defects for which he is culpable, Section 13, No. 7, para. 1 VOB/B.
- The contractor is liable for all damage in the case of defects caused by wilful intent or gross negligence, Section 13, No. 7, para. 2 VOB/B.
- If there is a major defect which considerably impairs usability and which is the contractor's fault, the contractor must make good the damage to the building structure which the work served to produce, maintain or alter, Section 13, No. 7, para. 3, sentence 1 VOB/B.
- The contractor must only rectify any damage above and beyond the above
  - if the defect is due to an infringement of generally accepted engineering practice
  - if the defect involves the absence of a contractually agreed feature
  - or if the principal could have covered the damage by a statutory third-party liability insurance, Section 13 No. 7, para. 3, sentence 2 VOB/B.

- Section 13, No. 4 VOB/B governs the duration of the period of limitation for claims based on defects. However, the duration is largely regulated in the construction contracts on a case-to-case basis and in derogation of the VOB/B. In principle, a five-year **warranty period** is agreed for building structures. In principle, ten years are always agreed for roofs and water-proof concrete basements ("white tanks"). The warranty for movable or other technical facilities is normally six months to two years. If maintenance contracts are concluded, the contracting parties agree longer warranty periods in this connection.

Practical advice: The term of the warranty can always be freely agreed between the parties. However, there are limits. Warranty agreements which impose on the contractor an endless warranty or merely an unreasonably long warranty are always ineffective (cf. Federal Court of Justice, ruling dated 15 April 1999, file No. VII ZR 415/97, IBR 1999, 307). When agreeing the warranty periods, it is therefore recommended to take the usual times as a basis.

Written **notification** of defects within the limitation period triggers the period for a claim to have the defects remedied. This period is two years calculated from receipt of the written notification of the defect. However, it does not end before expiry of the period of limitation for claims based on defects. Receipt of written notification of a defect on the last day of the period of limitation for claims based on defects therefore means that the principal's claim to rectification of the defect is not statute-barred until two years later, Section 13, No. 5 VOB/B. Acceptance of work performed by the contractor to remedy defects also triggers another two-year period of limitation for this work, which also does not end before expiry of the period of limitation for the claims based on defects, Section 13, No. 5, para. 1, sentence 3 VOB/B. However, if the principal is the user of the VOB/B he should be aware, that the effectiveness of Section 13, No. 5, sentence 2 VOB/B is disputed.

9. Payment

The right of the contractor to instalments and the procedure for the final settlement of payment for the construction project is regulated in Section 16 VOB/B.

- The contractor has the right to **instalments,** Section 16, No. 1, para. 1, sentence 1 VOB/B. He has to list and verify the work to be settled. This list is a rough estimate. The examination of the work contained in the instalment invoice is only provisional. A final examination is not made until the final invoice is submitted. This also applies to supplementary work examined.

> **Practical advice:** In many construction contracts, payment plans are agreed which provide for the payment of a proportion of the amount by the principal as soon as the contractor has reached and verified certain stages of progress of the work mentioned in the payment plan. Any examinations of quantities for the instalment invoices are therefore largely dispensed with.

- The contractor submits the final invoice on completion of the work. The claim to **final payment** becomes due after examination and approval of the final invoices submitted by the contractor, but at the latest within two months from receipt. The examination of the final invoice is to be speeded up if possible. If there is a delay, the undisputed credit is to be paid immediately as an instalment, Section 16, No. 3, para. 1 VOB/B.

The contractor must therefore give the principal a verifiable final invoice in order to make the claim to final payment due. In this connection, a difference must be made between the terms **verifiability** and **correctness** of the final invoice (cf. Federal Court of Justice, ruling dated 13 May 2004, file No. VII ZR 424/02, IBR 2004, 489). It must merely be possible for the principal to examine the work billed in the final invoice. This presupposes that the final invoice is prepared largely in compliance with the order specifications and that all documents (including but not limited to quantity surveys) necessary for examination have been enclosed. However, the final invoice need not be correct in order to make the claim to final payment due. Any factual mistakes in the final invoices do not prevent the claim to final payment becoming due (Federal Court of Justice, see above).

Section 16, No. 5 VOB/B regulates a **delay** in payment by the principal and any default interest incurred on the due payments. Paragraph 5 of this provision also grants the contractor a right to discontinue the work in the event of a default on payment.

Practical advice: The contractor should be extremely careful in making use of this right to discontinue work as the right only exists in the event of default on payment with material claims for payment (cf. Celle Higher Regional Court, ruling dated 26 May 1993, file No. 6 U 139/92, IBR 1995, 415). In addition, the discontinuation of work often conflicts with the contractor's duty to co-operate, taking the circumstances of each case into account. Discontinuation of work is only legally advisable in exceptional cases.

10. Provision of Security

The clauses contained in the VOB/B on the provision of securities, provided such have been contractually agreed, are always supplemented and detailed in the construction contracts as they generally do not satisfactorily allow for the needs of each individual case.

a) Performance Guarantee

If the principal wants to obtain a performance guarantee from the contractor, this must be contractually agreed beforehand. The principal does not have a statutory claim to such a guarantee.

The contracting parties generally agree on the provision of a performance guarantee by the contractor amounting to 10 % of the gross order sum. It must be noted that the principal cannot, in principle, demand payment of this performance guarantee on first demand. The Federal Court of Justice has ruled payment of the performance guarantee on first demand as laid down in general terms and conditions to be ineffective (cf. Federal Court of Justice, ruling dated 13 November 2003, file No. VII ZR 37/01, IBR 2004, 69).

Practical advice: For this reason, reference to a performance guarantee form of the principal enclosed as an annex to the construction contract must be treated with care. If the performance guarantee is not in fact enclosed as an annex, the principle of the Federal Court of Justice on the worst-case interpretation of general terms and conditions for the user (*verwenderfeindlichste Auslegung*) means that the agreement on the provision of security is ineffective as the principal apparently wants to reserve the right to also request a performance guarantee payable on first demand (cf. Federal Court of Justice, ruling dated 25 March 2004, file No. VII ZR 453/02, IBR 2004, 312).

b) Payment/Prepayment Guarantee

The contractor also has no statutory right or a claim arising from the VOB/B to the provision of a payment/prepayment guarantee. Section 16, No. 2 VOB/B only regulates the case where the provision of a payment/prepayment guarantee has

been agreed. The amount of the payment/prepayment guarantee is generally also 10 % of the gross order sum.

Practical advice: To ensure that his claim to the remaining remuneration is not completely unsecured at the end of the construction work, the contractor is recommended to make sure that, in derogation of the provisions of Section 16, No. 2 VOB/B, it is contractually agreed that the prepayment guarantee only expires at the end of the construction project.

c) Warranty Guarantee

Section 17, No. 6 VOB/B contains individual provisions on the warranty guarantee. However, any contract holdback of the principal to be released by the provision of a warranty guarantee must be agreed beforehand in the contract. There is no statutory claim.

Provided it is agreed in the contract, the principal may hold back an amount of up to 10 % of instalments and the final payment as security. It is often contractually agreed that, at the time when the final invoice is issued, the contract holdback is reduced to 5 % and that this is then paid into a blocked account unless the contractor provides a contractually agreed warranty guarantee to release the amount. It must also be noted in this connection that a warranty guarantee payable on first demand can no longer be requested with legal effect in general terms and conditions (cf. Federal Court of Justice, ruling dated 9 December 2004, file No. VII ZR 265/03, IBR 2005, 147).

Practical advice: If the contractor requests the principal to have the amount retained from a final invoice paid into the agreed blocked account, the principal is recommended to comply with this request as soon as possible. If the contractor sets the principal a reasonable period of grace for payment into this account and this period of grace expires to no avail, the contractor may demand, in accordance with Section 17, No. 6, para. 3, sentence 2 VOB/B, the payout of the amount retained from the final invoice. The principal then loses his right to the contract holdback. As a result, the right to the provision of the warranty guarantee is also lost (cf. München Higher Regional Court, ruling dated 4 November 1982, file No. 24 U 137/82, BauR 1984, 188).

d) Contractor's Securities by Law

The contractor has two statutory possibilities to obtain security.

aa) Mortgage

Section 648 BGB grants the contractor a claim to an entry of a building tradesman's security mortgage on the building land of the principal. This claim of the contractor is to be regarded as a "blunt sword" and has only little practical relevance.

It presupposes, on the one hand, that the principal is also the owner of the building land. This is not true in many cases. An economic unit between the principal and the owner of the building land is only sufficient in the exceptional cases of gross abuse of rights (cf. Celle Higher Regional Court, ruling dated 17 December 2004, file No. 6 W 136/04, IBR 2005, 87).

Furthermore, the contractor must already have increased the value of the principal's building land as a result of his work. Normally he can only legitimately demand entry of a building tradesman's security mortgage on the land in an amount corresponding to the increase in value resulting from his work. The principal therefore has the possibility of alleging defects in the contractor's work and setting off the alleged costs of remedying such defects against the unpaid remuneration. In most cases, this leads to a balance of zero. As the contractor has, in most cases, not yet obtained acceptance of the building work, he has to prove that the work he has performed so far is free of defects.

bb) Payment Guarantee, Section 648a BGB

The building tradesman's security in accordance with Section 648a BGB, introduced into the BGB in 1997 is of completely different practical relevance. According to this provision, the contractor has a claim against the principal for the handover of a guarantee in the amount of the remuneration not yet paid but contractually agreed plus 10 % for ancillary claims. Theoretically, the contractor can already demand the handover of this guarantee from the principal at the time when the construction contract becomes effective. The costs of the guarantee to be handed over are borne by the contractor up to a maximum of 2 % per year. Section 648a BGB cannot be modified or made completely subject to contrary agreement to the contractor’s disadvantage. However, it is not used in the case of public works.

However, Section 648a BGB does not give the contractor any **actionable claim** to the provision of the guarantee demanded. If the principal does not provide the guarantee in the period set by the contractor – 14 days are normally regarded as reasonable (cf. Federal Court of Justice, ruling dated 31 March 2005, file No. VII ZR 346/03, IBR 2005, 369) –, the contractor has the right to discontinue his work, Section 648a, para. 5 BGB. After discontinuing his work, the contractor can set the principal a period of grace to provide the guarantee demanded stating that he will otherwise terminate the contract, Section 648a, para. 5, sentence 1 in conjunction with Sections 643 and 645, para. 1 BGB. If the period of grace passes to no avail, the contractor has a claim to remuneration with regard to the work performed and a claim for damages for the outlays not included in the remuneration, Section 648a, para. 1, sentence 1 BGB. Any further liability of the principal due to fault remains unaffected, Section 648, para. 2 BGB. Section 648a BGB is always of crucial importance in cases where the contractor has performed approx. 90% of the total work but the principal has only paid 80% of the remuneration and from then on refuses to pay any further instalments maintaining that there are defects in the contractor’s work. Moreover, Section 648a BGB also applies after acceptance of the total construction work (cf. Federal Court of Justice, ruling dated 22 January 2004, file No. VII ZR 183/02,

IBR 2004, 201). The contractor can refuse to remedy reported defects for as long as the principal does not secure the full amount of the outstanding claim to the remaining remuneration in accordance with Section 648a BGB.

11. Resolution of Disputes

The German civil courts are responsible for disputes arising from construction contracts. A distinct arbitration procedure has so far not been established in Germany for construction matters.

a) Civil Courts

The German regional courts are functionally responsible for legal disputes owing to the generally high amounts in dispute. They deal with legal disputes arising from construction contracts which involve amounts in excess of € 5,000.00 (for less amounts the District Courts are responsible). The local jurisdiction of the civil courts is governed by the location of the registered office of the debtor, Sections 13 and 17 ZPO (Code of Civil Procedure). The location of the branch office of the contracting party may also be chosen as the venue for any disputes, Section 21 ZPO. There is also the possibility of the venue at the place of performance in accordance with Section 29 ZPO. This is basically the location where the construction work is performed. In view of the numerous venues which may be considered the contracting parties always agree in the construction contract on a specific venue. Such an agreement on the venue may be made with legal effect between businessmen in accordance with Section 38 ZPO.

It must be pointed out that disputes arising from construction matters often take a considerable time to process at the courts where the cases are brought. This is not least of all due to the fact that it is often necessary to obtain experts' opinions. A processing time of less than one year is the exception. Legal disputes lasting several years are to be regarded as the norm.

b) Arbitration

In spite of lengthy court proceedings, an arbitration system or procedure based on arbitration principles has so far not been established for construction matters in Germany. Rules of arbitration developed for the construction industry are agreed in many construction contracts. These are the rules of arbitration for the construction industry (*SGOBau*), the conciliation rules for the construction industry (*SOBau*) as well as arbitration rules published by the individual construction industry associations of the German states. If an agreement is made on a court of arbitration, it must be noted that it has to be clearly stipulated which rules of procedure in which version are to be applied to the conductance of the arbitration proceedings and which disputes they are to cover. Otherwise the agreement on the court of arbitration fails due to a lack of certainty and is ineffective (cf. Bavarian Higher Regional Court, ruling dated 28 February 2000, file No. 4 Z Sch 13/99, IBR 2000, 626).

At present, there is a trend towards the contracting parties subsequently agreeing to have specific, already known disputes ruled by arbitrators, who are judges or lawyers with many years of experience in construction law and who quickly make a award on the dispute which is binding on both contracting parties.

Chapter 8 Lease Agreements

I. Introduction

Given the high percentage of commercial real estate, tenancy law is of outstanding importance in the German real estate industry. For the owner (landlord) of business premises which he does not use itself, the rent from such business premises is the legal basis for achieving his desired return on the property. For the owner (landlord) of business premises, the economic importance results in particular from the fact that the sustained value of a commercial property (e.g. an office building, a shop, a hotel) comes mainly from the commercial lease agreements on the building. These establish what returns the landlord can expect on the real estate over what period. If the rented property is sold to an investor, the purchase price is therefore generally determined on the basis of the lease agreements concluded or yet to be concluded and the rental income generated. Generally, the investor is not so much interested in acquiring the real estate itself but the lease agreements on the premises.

The commercial real estate market in Germany breaks down as follows:

- Investment volume

  Commercial real estate in the first half of 2006 (excluded non-performing loans and residential units): € 19.67 billion

- Investors
  - 86 % of the investors are foreigners
  - 14 % of the investors are German

  When preparing and performing the investment, the angle of the investor and the financing bank are naturally different.

The investor focuses on:

- profitability
- financeability
- loan maturity

That is to say:

- income and costs, i.e. lease agreement and operating costs

The financing bank focuses on:

- financeability
- securities/land register
- a secured, steady cash flow
- loan maturity

That is to say:

- real securities
- lease agreement as the only source of income

This chapter has been written by real estate law practitioners with many years of experience in letting and renting business premises. It deals with everything from the term commercial letting to the letting of special real estate, covering all the main subjects and problems which may be of practical significance when letting business premises. It not only presents the legal framework in detail but also the normal contractual provisions and clauses and explains the limits of contractual freedom. Furthermore, valuable practical tips are given on subjects which are either of special significance or where mistakes are often made. It not only identifies problems which often occur but also helps the reader to avoid making such mistakes himself when concluding new lease agreements – something which is even more important in practice.

II. Applicable laws and regulations

The first question to answer when checking the lease on a property is what laws and regulations are applicable.

First of all, it is the commercial lease agreement concluded between the landlord and tenant which governs their legal relationship. Secondly – i.e. if the lease does not contain any particular provisions – the legal relationship between the landlord and the tenant is determined by the statutory provisions, in particular by those governing tenancy law in Section 535 et seq. BGB as well as the Operating Cost Regulations (BetrKV) and the Heating Cost Regulations (HeizKV). Therefore, it is the commercial lease agreement which is the basis for any legal examination. If nothing results from the examination of the commercial lease agreement, the statutory regulations are then consulted.

Practical advice: When evaluating the legal situation regarding a commercial property, special attention must be given to the lease in all phases. All relevant points should be regulated in the lease. If this is not the case, this may cause considerable difficulties.

III. Commercial lease agreement

What is regulated in a German lease on commercial premises?

In a commercial lease agreement, the landlord and the tenant sign a lease on the letting of commercial premises.

Therefore, a lease must first exist. On the basis of the statutory terminology, a "rent" is understood to be the fee which the tenant has to pay the landlord for granting him use of the leased property (Section 535 BGB).

There must be a lease on commercial premises (also called business premises). Commercial premises are understood to mean rooms which are rented for business (in particular trade or freelance) purposes. These also include the leasing of real estate, parts of buildings and rooms as long as these are not used for residential purposes. Commercial or business premises are therefore, for example, office and shop areas, storage and archiving areas, rooms for professional practices, parking spaces for cars, facade and roof areas, undeveloped land, billboards, sports fields, workshops, stands in fair halls. Commercial rooms are therefore not used for residential purposes. This distinction is important as German tenancy law makes a difference between leases on residential units and leases on commercial premises. The regulations on the leases on residential units contain innumerable provisions protecting the tenant, e.g. as regards rights to terminate the lease. In commercial tenancy law, the tenant may only have recourse to provisions which protect him in exceptional cases.

The purpose of the premises which the parties have agreed in the lease or which space (commercial or residential space) characterises the contract (Düsseldorf Higher Regional Court, WuM 2002, 481) is decisive for the classification as commercial premises. If, for example, a contract is called a residential lease, it is then subject to residential tenancy law even if the rooms are only partly used as accommodation and largely used for commercial or freelance purposes, unless the parties wanted to conclude a commercial lease with residential use. Therefore, it is not recommended to sign a commercial lease on a standard residential lease form because the choice of wording "residential lease" can also lead to the legal assignment of the contract to residential tenancy law, especially when the column "purpose" in the contract is not filled in (Hamburg Higher Regional Court, NZM 1998, 507). If the purpose is entered as "use as an office or residential unit", legal rulings have assumed residential tenancy law (Essen Regional Court, WuM 1990, 506) but commercial tenancy law if the designation states "use as commercial premises and residential unit" if the possibility of using the space as

accommodation has only been included as a precaution (Cologne Higher Regional Court, WuM 1996, 266).

The legal assignment of the lease to residential tenancy law or commercial tenancy law does not change when the tenant of commercial premises changes the commercial premises into residential premises. This is also not the case when the landlord knows of the conversion (Federal Court of Justice ZMR 1969, 206). The situation is only different when the landlord and tenant agree on a change in the type of use. If the parties have not made an express agreement on the purpose of the premises, the assignment of the legal relationship depends on the objective characteristics of the rooms, i.e. whether they are clearly for residential or for commercial purposes.

Practical advice: The commercial purpose is always to be clearly indicated. For example, such wording as "the let rooms are to be used exclusively as offices" is to be chosen.

Special case: Mixed lease agreements

A mixed lease agreement is when residential space and commercial space are rented together in one contract (e.g. apartment and restaurant, office and accommodation for a freelancer). It is not permitted to use part of an apartment for commercial purposes if this involves unacceptable disturbance of the other tenants or increased wear on the leased property (Hamburg Regional Court, WuM 1993, 188).

The assignment to residential or commercial tenancy law depends on the so-called predominance theory (*Übergewichtstheorie*) which says that the emphasis of the lease does not depend solely on whether one or another part outweighs the other as far as space is concerned (Federal Court of Justice, WM 1979, 148; Hamm Higher Regional Court, ZMR 1986, 11). The main deciding factor is the declared intention of the parties and the purpose of the lease. Here, it must be examined whether the percentage of leased space and the rent for the one or the other type of use predominate. This can, for example, lead to difficulties as to where to draw the dividing line when the percentages of leased space are the same, but a higher rent has been agreed for the commercial part of the premises than for the residential part. Therefore, it makes sense to have a clear definition. The Federal Court of Justice ruling of 16 April 1986 deals in detail with the question of under what conditions in a mixed lease agreement it can be assumed that the commercial part predominates. The Federal Court of Justice has decided in this ruling as follows: "If a single-family house is let to a lawyer for use as a law office and as accommodation, it must be generally assumed that the let is mainly for commercial purposes. This applies even when the area of the house available for the law office is less than the area designated for residential purposes. For the law firm is, for the lawyer, the place without which he can generally not perform his business activities and earn the money which he needs

to pay for his living, which also includes the rent for the accommodation. The landlord can, in general, demand a higher rent for his house because he is not letting it exclusively for residential purposes but also for the running of the tenant's law firm. The size of the area let only plays a subordinate role unless the area which is used as living accommodation is so much bigger than the area to be "used as the law firm" that the area available for the law firm is only of minor importance for the law firm (Federal Court of Justice, NJW-RR 1986, p. 877 et. seq.).

If the residential and commercial areas are equal, it is debatable whether the parties have the choice to decide that the entire lease is governed by residential tenancy law or by commercial tenancy law. Some assume that a mixed lease agreement always serves primarily for the pursuance of an occupation and that the provisions protecting resident tenants must therefore take second place (Bub/Treier/Reinstorf I 110 et seq.) whilst others are of the opinion that, when residential and commercial areas are equal, residential tenancy law must apply to all rooms as otherwise the protective purpose of residential tenancy law cannot be achieved (Sternel I 156). The agreement of the parties on the legal character of the lease therefore only has its limits where the entire lease is designated as a commercial lease although the majority of the area is for residential purposes and the tenants' rights to protection are therefore prejudiced. A mixed lease agreement with mainly living accommodation cannot be designated as being subject to commercial tenancy law by agreement of the parties (Hamburg Regional Court, WuM 1988, 406). On the other hand, the use of a standard residential lease form always leads, in the opinion of the Hamburg Higher Regional Court, to the application of residential tenancy law (Hamburg Higher Regional Court, NJW-RR 1998, 1382).

IV. Form of the lease

When assessing a property in legal terms, it is crucial to examine the commercial lease. Here, the investor must rely, among other things, on the information which he receives from the owner of the property. The lease documents are of particular interest to the investor. Therefore, the deed itself (commercial lease plus all appendices) must be examined first of all. In some cases, however, the lease documents may not be complete or not available at all. Here, the investor must ask himself whether a legally effective lease exists at all or whether it is ineffective due to a formal defect. Can a lease, if necessary, also be concluded verbally?

1. Verbal lease agreement

In principle, a verbal lease agreement is legally enforceable. However, for reasons of proof, a written lease should always be concluded. This is particularly important with regard to the many supplementary agreements (utility and service

charges (*Nebenkosten*), duty to renovate) as without an express agreement only the statutory regulations apply, which neither provide for the onward-charging of utility and service charges nor for any obligations of the tenant to perform renovation work (cf. Section 335, para. 1 BGB).

> **Practical advice:** It is advisable when entering into *serious contract negotiations* to expressly agree with the other party to the lease that the lease is only to be deemed to have been concluded with legal effect when the written lease has been signed by both parties and this agreement is to be confirmed in writing so that receipt can also be proved (e.g. confirmation of receipt on the copy).

2. Written lease agreement

According to Section 550 BGB, a lease with a term of more than one year must be made in writing as otherwise it applies indefinitely. As the law does not stipulate otherwise for a lease agreement, the prescribed written form may be replaced by the electronic form (Section 126, para. 3 and Section 126 a BGB). The issuer must add his name to the electronic declaration (the name must be at the end of the document) and the electronic document must bear a qualified electronic signature in accordance with the Electronic Signature Act (*Signaturgesetz*). With an electronic contract, the parties must each sign an electronic document with identical wording and send it to the other contracting party (Section 126, para. 2 BGB).

All main provisions of the lease agreement must be unequivocally laid down in writing in the lease itself or in its properly included appendices, namely:

- Parties to the lease; if signed by the representative: name of the representative and designation of the type of representation (power of attorney [*Vollmacht*], managing director);
- Location of the leased property;
- Rent;
- Term of lease.

If there is more than one person on the landlord's or the tenant's side, all must sign. If only one shareholder or a representative signs, the position of representation must be designated appropriately in conjunction with an indication of whether this position of representation results from a power of attorney or from appointment as managing director (e.g. in the articles of association).

An imprecise designation of the property can also lead to a formal defect (Federal Court of Justice, NZM 1999, 763), as can unclear or contradictory statements on the term of the lease, e.g. an option without any exact indication of the period in which the option can be exercised (Federal Court of Justice, NJW-RR 1987, 1227 et seq.) or a contradiction between a long lease term and the

possibility to serve notice. The lease is then deemed to have been signed for an indefinite period (Cologne Higher Regional Court, NZM 1999, 1142).

> **Practical advice:** If a standard lease form is used which gives several possibilities for the term of the lease, all passages which are not to apply (e.g. those on leases for indefinite periods) should be expressly deleted.

Section 550 BGB is mandatory and cannot be set aside by verbal agreements. This provision is mainly designed to protect the interest of any potential purchaser of the property in obtaining information (RGZ 86, 30 et seq.) The Federal Court of Justice has also applied the wording of Section 550 BGB mutatis mutandis to sub-leases (BGHZ 81, 46 et seq.). Court rulings and literature increasingly stress the warning and verification function of the provision (BGHZ 136, 357 et seq.; Bub/Treier/Heile II 727 et seq.; Heile NJW 1991, 6; Derleder/Pellegrino NZM 1998, 550).

3. Consequences of non-observance

If (only) the written form is not observed, the lease is not legally ineffective as a result. It is only deemed to have been concluded for an indefinite period provided the parties have, in principle, concluded a legally effective lease. However, notice of termination cannot be served before at least one year has passed since the leased property has been handed over for use (Section 550, sentence 2 BGB). If there is no agreement on major points in the lease (parties to the lease, leased property, rent), no contract exists.

4. Uniform deed

The parties must sign the same deed (Section 126, para. 2 BGB) with a personal signature; a written offer and its written acceptance (each in a separate letter) do not satisfy the legal written form requirements (Federal Court of Justice, NJW-RR 1994, 280). However, it is sufficient when a contract offer is countersigned on the same deed (Federal Court of Justice, NZM, 2004, 738). However, if the offer is only accepted with changes, a countersignature on the offer is not sufficient (Federal Court of Justice, NJW 2001, 221).

With electronic contracts, the parties must each electronically sign a (complete) contract document with the same wording and send it to the other party and not just declare that they accept an offer. They can also both sign the same document or one may sign an electronic document and the other a written document.

The earlier court ruling, according to which several pages of a contract and the appendices and supplementary deeds must be permanently attached to each other so that it is only possible to detach pages by destroying the document itself, i.e. no use of staples or filing strips, has since been superseded by the so-called "loose page ruling" of the Federal Court of Justice. The form requirement of Section 126

BGB is now regarded as having been fulfilled if the unity of the contract results unequivocally from consecutively numbered pages, the consecutive numbering of the individual provisions, a uniform graphic layout, a content connection in the text or other features (Federal Court of Justice, NJW 1998, 59).

The following applies to supplements: The strict opinion formerly held that the original lease and the amendments to or extensions of a lease must form one deed and that the prescribed written form was only satisfied if the new deed was enclosed as an appendix and these were physically attached to each other by stapling, gluing or binding has now been relaxed to a certain extent. It is, of course, easiest if the amendment is entered in the original deed. However, today it is assumed that the physical attachment of the two is no longer necessary if the new deed itself contains the main components of a lease and refers to the original deed which was drawn up in the proper form (BGHZ 42, 33); in the case of an extension of the lease: if the designation of the leased property and the other main components of the lease are listed (BGHZ 52, 25) or if the supplementary deed refers to the original lease and expressly mentions that the original contract is to remain otherwise unaffected (Federal Court of Justice ZMR 1988, 133). When reference is made to leases which have been concluded by other parties, extensions or supplements must therefore still be physically attached to the main lease at the time of their signature according to the intention of both parties (Palandt/Weidenkaff, BGB commentary, Section 566, BGB, margin No. 17).

Practical advice: The investor must definitely ensure that all contractual documents are handed over. Appendices, supplementary deeds and supplements belong to the contract. The investor is advised to have the owner confirm in writing that he has handed over all documents. Furthermore, notwithstanding the ruling of the Federal Court of Justice, it is urgently recommended to punch holes in the lease agreements and their appendices to avoid any mix-up of individual pages and at least to make it more difficult to falsify the documents. All pages should be initialled. The tiresome copying of bound contracts can be avoided by having an unbound copy for making photocopies.

5. Authentication by a notary

A lease agreement must, in exceptional cases, be authenticated by a notary if the obligation to sell or acquire a piece of real estate is contained in one contract in addition to agreements solely covered by tenancy law (Section 311 b BGB, Munich Higher Regional Court, NJW-RR 1987, 1042).

This happens in practice particularly in the case of a lease-purchase agreement or when the tenant is granted a pre-emptive right to buy the real estate, e.g. to safeguard considerable investments.

The obligation to have the agreement authenticated by a notary not only covers the actual obligations to sell and purchase but also the contract as a whole. It is

sufficient when one party wants to make the agreement an integral part of the contract and the other recognises and accepts this (Federal Court of Justice NJW 1982, 434).

V. Term of lease

1. Start of the lease

The landlord's obligation to hand over the leased property for use can be laid down in the agreement with a fixed date. This date is then binding on the landlord.

In the case of property let from the drawing board, i.e. the commercial property is still in the planning stage, it is usual and permissible not to set the start of the lease for certain fixed date but to make this start date variable (within limits), e.g. by wording such as

- start of lease after completion of the building ready for use,
- start of lease after handover of the leased property,
- x weeks after notification by the landlord of the date fixed for moving into the building
- x weeks after completion of the building shell etc.

These wordings contain no condition but only a determination of the time. Such clauses are only legally effective if they set a timeframe after the expiry of which handover must take place.

> **Practical advice:** If there is no particular time set for the start of the lease, always fix an earliest and a latest date for handover. The start of a lease earlier than expected can also cause the tenant problems.

2. Leases for an indefinite period

Commercial leases concluded for an indefinite period are characterised by the fact that they can be terminated by either party serving notice not later than the third working day (*Werktag*) of a quarter after expiry of the lease at the end of the next quarter (Section 560 a, para. 2 BGB). (In Germany, there are six working days [*Werktage*] in a week). The period of notice does not automatically increase the longer the tenant has been in the property. It can only be increased by contractual agreements.

3. Fixed lease term

The term of the lease can be set for a certain period previously determined, which is binding on both parties. The lease ends on the expiry of this period without any

notice having to be served unless it is terminated without notice in the cases permitted by law or is extended by the parties.

a) Tacit continuation of the lease

If the lease is continued tacitly after expiry of the fixed lease term without an extension clause being applied or an option being exercised, the lease is deemed, in accordance with Section 545 BGB, to have been extended for an indefinite period (this means that it can be terminated by serving the statutory notice). The provision contained in Section 545 BGB is not mandatory but can be modified – also by a standard clause in the lease.

If the time limit for lodging an objection stipulated in Section 545 BGB has elapsed, notice may be served with the statutory period of notice but this can lead to considerable delays in a dispute about eviction and to considerable loss of rental income if the tenant refuses to pay the rent. It also gives the tenant the chance to make it impossible for the landlord to terminate the lease again without notice by paying any rental arrears.

> **Practical advice:** If the lease is terminated without notice, an objection in accordance with Section 545 BGB to an extension of the lease through continued use should always be included in the notice of termination to be on the safe side even when the exclusion of Section 545 BGB has already been contractually agreed.

b) Extension clause

In long-term leases, it is usual to include clauses according to which the lease is extended after the end of a fixed lease term by a certain period (e.g. three years) if neither the landlord nor the tenant has notified the other party by a certain period in advance of the end of the lease (in most cases six months) that it does not wish to extend the lease. Through the extension clause the old lease continues (Federal Court of Justice, NZM 2002, 604).

If the subsequently agreed extension clause extends the lease by more than one year, the written form (Section 550 BGB) and the principle of uniformity of the deed (see above) are again to be complied with.

c) Option clause

The option gives the tenant the right to bring about an extension of a lease concluded for a certain period for another certain period by making a unilateral declaration to the landlord.

If the tenant is granted the right (either immediately or subsequently) to extend the lease by more than one year, the written form requirement clause also applies to this option.

An express declaration of the tenant is necessary to exercise this option. It is not enough for the tenant to tacitly continue the lease for this would possibly only bring about the provision of Section 545 BGB (tacit extension of the lease term for

an indefinite period) or, if an extension clause is contained in the lease, bring about the legal consequences of the extension clause.

As the landlord must know for certain in good time whether the tenant will exercise his option or not, a period for exercising the option should be agreed in the lease. However, leases often simply contain such wording as: "The tenant has an option on another five years." This wording does not say anything about when the option has to be exercised. If a period of notice is agreed in the same lease in the event of the lease being tacitly extended beyond the fixed term, the option is also to be interpreted in such a way that it must be exercised within the same period for such a notice provision shows that both parties want to have a clear situation well before the end of the lease (Federal Court of Justice, NJW 1985, 2581). Court rulings tend to interpret the option provisions in leases with due consideration for the interests of both parties as the tenant exercising his option on the last day of the lease (or not exercising said option) is a completely unacceptable situation for the landlord. Therefore, in a case where an exercise period had been agreed in the original lease but the extension lease in which a further option had been granted did not mention the exercise period again, the Düsseldorf Higher Regional Court ruled that the originally agreed exercise period also applies to the extension period if the parties have not expressly agreed otherwise (Düsseldorf Higher Regional Court, ZMR 1991, 378).

If a period for the exercise of the option or a provision on the serving of notice has not been agreed, the tenant can exercise the option on the last day of the contractual term.

According to Section 566 BGB, the option can be exercised against the new owner if the leased property has been sold. If the tenant has exercised his option against the old landlord, not knowing that ownership has changed, this option is legally effective for the new landlord (Federal Court of Justice, NJW-RR 2002, 730).

A frequent point of dispute in the exercising of an option is the question of whether the landlord can increase the rent after expiry of the original lease term or whether he can only continue to demand a fixed rent, as in the original lease, or whether the escalation clause continues to apply. As the option, in principle, extends the lease in its existing form, the previously agreed rent also continues to apply. The landlord could otherwise circumvent the option by demanding an exorbitant rent increase. Therefore, if a rent increase is to be allowed after the exercising of the option, this must be expressly agreed in the lease. Without the landlord reserving the right in the lease to increase the rent, it would be a question of interpretation as to whether there are indications in the lease that the rent can be increased (Düsseldorf Higher Regional Court, NZM 2000, 462).

Practical advice: A legally effective clause on the option could be: "The landlord grants the tenant the option to extend the lease by another five years starting from the end of the lease in accordance with Section x of this lease. The option must be exercised by the tenant in a written declaration which the landlord must have received not later than six months before expiry of the regular lease term. Otherwise the option extinguishes."

VI. Rent

1. Amount of rent which can be charged

In contrast to residential tenancy law, the amount of rent charged for commercial premises can be agreed more or less freely. In commercial tenancy law, the principle of contractual freedom applies to the amount of rent which can be charged. The termination of a lease in order to increase the rent is also not considered to be unconscionable in the sense of contrary to public policy (*sittenwidrig*). The agreement of the payment of a premium by a new tenant to obtain the lease does not constitute a contractual penalty. The amount cannot be reduced, the clause is legally effective (Munich Higher Regional Court, NJW-E MietR 1996, 9).

In a free market economy in which the prospective lesser and the prospective lessees are free to decide by themselves and the balance between supply and demand can, among other things, be regulated by competition and price, even a conspicuous imbalance between performance and counter-performance cannot alone substantiate the legal ineffectiveness of the lease. For usury to apply in accordance with Section 138, para. 2 BGB, the following further points must be added: exploitation by one party of the other party's predicament, inexperience, inability to judge or considerable weakness of will in order to gain a pecuniary benefit for himself or a third party which is clearly disproportionate to the service performed. If the tenant has negotiated cleverly in reducing the rent, this speaks against his inexperience (Naumburg Higher Regional Court, GuT 2002, 15). Tenants of commercial premises very rarely act under duress, in normal circumstances it cannot be said that they were not able to judge the situation or were very weak-willed. Inexperience, at least in the commercial/business sector, can hardly be spoken of especially since everybody is free to obtain expert advice before a contract is concluded.

In the case of a legal transaction contrary to public policy (*sittenwidriges Rechtsgeschäft*) in accordance with Section 138, para. 1 BGB, there must not only be a conspicuous imbalance between performance and counter-performance, there must also be an unconscionable intention. A conspicuous imbalance is defined as a rent which exceeds the normal rent in the area by 100 % (Düsseldorf Higher Regional Court, NZM 1999, 461; Stuttgart Higher Regional Court, NJW-RR 1993, 654). The suspicion of an unconscionable intention when the market rent is

exceeded by 100 % does not, however, apply to a lease concluded with an entrepreneur (*Unternehmer*) within the meaning of Section 14 BGB (KG, MDR 2002, 999). For example, the Frankfurt am Main Regional Court and, following this ruling, the Munich Higher Regional Court have assumed that a lease is contrary to public policy because the tenant was only able to meet the costs of the leased property but not make any profit for himself which the landlord knew from the previous tenant's situation (Frankfurt Regional Court, NJW-RR 1988, 334; Munich Higher Regional Court, NZM 1999, 224).

2. Rent based on turnover

With a rent based on turnover, the tenant has to pay a certain percentage of his turnover as the rent (J. Fritz, Gewerberaummietrecht, 4th edition, margin No. 94).

The agreement of a rent based on turnover is in principle permitted except for pharmacies (Section 8 of the Pharmacy Act [*Apothekengesetz*]) where the agreement of a rent based on turnover is only possible within the strict provisions of Section 8 ApothekenG; if a rent based on turnover has inadmissibly been agreed for a pharmacy, the lease must be changed (Oldenburg Higher Regional Court, NJW-RR 1990, 84).

With a rent based on turnover, the landlord also shares, by way of exception, the tenant's business risk. This risk is normally limited by agreeing a certain minimum rent. The tenant, on the other hand, runs the risk that, if his turnover increases, he will not necessarily earn a higher profit as he must pay a higher rent compared with what he would pay for other commercial premises. This risk can also be limited by agreeing a minimum and a maximum rent (basic rent). Such a limit is also urgently recommended as the rent based on turnover can lead to the tenant indirectly being forced to restrict his business activities to avoid a higher rent.

An exact definition of the term turnover is important. The basis for the lease is normally the net turnover excluding VAT. However, other transitory items which do not affect the profit, such as deposits on bottles in a drinks supermarket, can also be excluded from the calculation.

The agreement of a rent based on turnover alone does not constitute an obligation of the tenant to run a business operation or an obligation to generate high turnover or profits. However, the tenant must pay the rent which would normally be due if the building was used for a corresponding commercial operation (Federal Court of Justice, NJW 1979, 2351). However, the landlord should expressly agree with the tenant an obligation to run a business operation.

Practical advice: As with all hypothetical statements, such clauses lay the seed for dispute so that it is recommended to set a fictive rent based on turnover or a fixed rent which is to be paid if the tenant violates his obligation to run a business operation. Such an obligation should be negotiated and included in the lease. With a rent based on turnover, the landlord has a right to monitor by inspecting the tenant's books without this having been expressly agreed (Wolf/Eckert/Ball, margin No. 395; Bub/Treier III, 23). However, it is recommended to expressly agree in the lease the right to monitor as well as the tenant's obligation to bill, particularly when this monitoring function is to be performed by third parties (e.g. tax advisors, auditors).

3. Value-added tax

Rental income is, in accordance with Section 4, No. 12 a of the Value-added Tax Act (UStG), in principle, not subject to VAT with the exception of the isolated letting of garages and vehicle parking spaces; the isolated letting/leasing of garages or vehicle parking spaces is subject to VAT (Section 4, No. 12, sentence 2 UStG) unless a garage or a parking space is let together with a residential or commercial unit as only then can the letting of a garage be regarded as an ancillary service which is tax free in accordance with Section 4, No. 12 a UStG.

In accordance with Section 9, para. 1 UStG, the landlord may treat his rental income as being subject to VAT if the property has been let to another entrepreneur for his business. In accordance with Section 9, para. 2 UStG, the option is only permissible when the tenant exclusively generates turnover which does not exclude deduction of input tax or if he intends to conduct such a business operation. This provision does not apply to commercially used buildings whose construction was started before 11 November 1993 and which were completed before 1 January 1998 (transitional provision in Section 27, para. 2 UStG). Minimal turnover which is free from VAT is not damaging (limit for minor amounts 5 %, Section 148 a, para. 3 UStG).

The landlord has to prove that the appropriate preconditions exist, therefore he must agree a duty to provide proof with his tenant. He can only demand the VAT in addition to the rent if this has been expressly agreed in the lease (Bochum Regional Court, ZMR 1987, 58). This can also be achieved by a standard clause but not if the tenant is not entitled to deduct input tax.

The tenant has the right to insist that the VAT is shown separately and that he is given an invoice for it (Munich Higher Regional Court, NJW E MietR 1996, 270). He can, in turn, deduct the amount as input tax (Section 15 UStG).

The landlord is, in principle, not obliged to opt for VAT (Naumburg Higher Regional Court, ZMR 2000, 291). If, however, he obliges the tenant to pay VAT, he must also opt for and stay with it (Hamm Higher Regional Court, ZMR 1997, 457).

If it has been agreed in the lease that the rent is to be paid plus VAT, then this also applies to the utility and service charges by way of supplementary interpretation of the lease, even if this has not been expressly mentioned, as utility and service charges are always treated like the rent. VAT is to be paid on all utility and service charges (Hamburg Regional Court, ZMR 1998, 294).

VII. Increasing or reducing the rent

1. Termination with the option of altered lease conditions

The rent may by adjusted by an agreement between the parties or unilaterally by a termination of the lease by the landlord or the tenant with the option of continuing the lease with different conditions. Such a termination presupposes that the lease has been concluded for an indefinite period. In the case of a lease with a fixed term, the adjustment requires a clause with a reservation to increase or change the rent. Termination of the lease merely for the purpose of increasing the rent is admissible.

2. Sliding scale rent

The restrictions of residential tenancy law (sliding scale rent only for a period of up to 10 years, rent increase otherwise excluded, rent must stay unchanged for at least a year and the amount must be shown) do not apply to the commercial sector. The agreement of a sliding scale rent means that subsequent rent rises are already fixed in advance when the lease is concluded. The higher rent then replaces the previous rent at the agreed time without the landlord having to make any special demand. Any uncertainty is avoided by quoting the amounts to be paid after each rent rise. It is also recommended not to choose too long a period of time covered by the sliding scale rent agreement so as to avoid the sliding scale rent being too much above or below the average market rent.

3. Stable value clause

The stable value clause is an escalation clause which links the rent to a certain indicator (e.g. the cost-of-living index). If the cost-of-living index increases by a certain number of points, the rent automatically increases by a corresponding percentage without the parties to the lease undertaking anything (e.g. index rises from 110 to 114 points = 3.64 % increase).

If the parties only become aware later that the indicator has changed, the increased rent is to be paid with retroactive effect if the claim is not already statute-barred or forfeited.

The parties can also agree that, when the indicator changes, the landlord must still send the tenant a letter demanding the higher rent together with a calculation of the new rent so that in this case the increased rent is only payable once the tenant has received this letter, or they may also agree that the rent increase occurs automatically and immediately but that the tenant is not in default until he receives the letter from the landlord.

4. Comparable rent clause

With a comparable rent clause, the stable value of the rent is ensured by the fact that the rent changes as a function of a reference value which must be the same or at least comparable (Federal Court of Justice, NJW-RR 1986, 877). The question is what value can be compared with the letting of premises so that a reference to this value is admissible. Rent for residential units and commercial units cannot be compared (Bub/Treier/Schultz III A 239). The rent agreed in another commercial lease can be regarded as a comparable value (Federal Court of Justice, NJW-RR 1986, 877).

5. Reservation of right to demand counter-performance

The reservation of a right to demand counter-performance says that the landlord reserves the right to reset the counter-performance for the letting of the premises (rent) either by a unilateral right to determine the counter-performance or by an agreement between the parties or by the fixing of the rent by a third party (independent arbitrator).

6. Rent increase after modernisation

Whilst a rent increase for residential units is possible, in accordance with Section 559 BGB, through a unilateral declaration of the landlord (if this is not excluded in the lease), with commercial premises the rent increase after modernisation must be contractually agreed as the rent law only applies to residential tenancy law. A reference to provisions in the rent law in commercial leases is only permissible as an individual agreement and must be interpreted narrowly. A sliding scale rent with a one-off rent increase after the completion of modernisation work can also be agreed or a reservation of right to demand counter-performance.

Practical advice: The rent increase after modernisation should be included in the lease in the section on rent and not under the heading "obligation to tolerate".

VIII. Operating costs / Utility and service charges

For the investor and the financing bank, it is of particular interest to examine the operating costs (*Betriebskosten*) which can be passed on to the tenant and which are also called utility and service charges (*Nebenkosten*) in German law. For if the operating costs are paid by the tenant, this maximises the return on the investment. In contrast to Anglo-American law, German law does not know any triple-net or double-net rent. *Triple-net* is a rent where the tenant not only pays the basic rent but also taxes and duties, insurance costs, operating costs as well as maintenance and repair costs (also for roof and structure) (Lindner-Figura/Oprée/Stellmann, Geschäftsraummiete, Chapter 10, margin No. 19; Moeser/Ekkehard, NZM 2003, 425 et seq.). By contrast, a rent is double-net if the tenant pays not only the basic rent but all costs of the leased property, with the exception of the maintenance and repair of the roof and structure (Lindner-Figura/Oprée/Stellmann, Geschäftsraummiete, Chapter 10, margin No. 20; Moeser/Ekkehard, NZM 2003, 425 et. seq.). Whilst in Anglo-American law, the tenant has to bear nearly all the operating costs, this is only possible to a limited extent in German law. In Germany, the admissibility of the onward-charging of operating costs is regulated in detail in laws and regulations.

What is to be understood by the term *operating costs* is already regulated by law. The definition of the term operating costs is to be found in Section 19, para. 2, sentence 1 of the Federal Housing Act (*Wohnraumförderungsgesetz*) (*WoFG*). According to this law, operating costs are the costs which the owner continuously incurs through the ownership of the real estate or through the use of the building, building extensions, facilities, amenities and the land in accordance with their purpose. As the operating costs of a commercial property are a considerable cost factor in addition to the basic rent and there is great potential for dispute about this issue, the agreement on the tenant's obligation to pay operating costs and the operating cost prepayments are to be treated with special care.

In German law, the onward charging of operating costs to the tenant must be expressly agreed because the operating costs are otherwise, in principle, to be borne by the landlord according to the law (Section 535, para. 1, sentence 3 BGB).

> **Practical advice:** If German law is applied, it must definitely be agreed that the tenant is to pay the operating costs. If there is no provision in the lease to this effect, the landlord must pay these costs.

Errors in the contract drafting which mean that no or not all operating costs can be onward-charged cannot be unilaterally corrected by the landlord. If the landlord has forgotten to include certain utility or service charges in the lease when it was concluded, he cannot subsequently demand a change in the lease (Federal Court of Justice WuM 1970, 74). He can only terminate the lease with the option of signing a new lease under different conditions as soon as this is permissible. The Hamburg Higher Regional Court has, by way of exception, found in favour of the principal lessor who had concluded a long-term lease with a commercial intermediate lessee

without mentioning the operating costs. In this ruling, the court assumed that the intermediate lessee was obliged to bear the utility and service charges because he could then also pass on these costs to the users of the residential units (sub-tenants). This was a supplementary interpretation of the lease (Hamburg Higher Regional Court, NJW-RR 1988, 399).

1. Specified list

It is safest to pass on the utility and service charges to the tenant by making a *specified list* of the operating costs which are to be onward-charged to the tenant especially since the legally regulated operating costs in the commercial sector are often not sufficiently defined (cf. Celle Higher Regional Court, NZM 1999, 501). A statutory list of the operating costs is to be found in the Operating Cost Regulations in accordance with Section 19 WoFG (formerly Appendix 3 to Section 27 of the Ordinance on Calculations for Residential Properties, Second Calculation Ordinance [*Verordnung über wohnungswirtschaftliche Berechnungen, Zweite Berechnungsverordnung*]).

Typical operating costs which can be onward-charged and which should be included in the lease as required are:

a) Guarding and security costs

- alarm system,
- CCTV surveillance, video systems,
- automatic closing systems (roll shutters, sliding gates, barrier systems, car park/underground garage),
- door and gate closing systems, code card systems,
- entry phone systems,
- costs of security company,
- emergency call systems,
- emergency generators,
- house detectives and guards,
- porters, night watchmen.

b) Fire protection

- checking of fire extinguishers (outside the central heating boiler room),
- sprinkler systems,
- fire and smoke detection systems,
- wall-mounted hydrants and hose boxes,
- pressure pipes and pressure-boosting stations,
- water systems for fire-fighting,
- smoke extraction systems,
- lightning conductor systems,
- in-house fire service.

c) Garbage disposal

- garbage collection,
- garbage chutes,
- central garbage collection systems,
- garbage compressors and garbage grinders,
- costs of sorting and determining the volume of garbage,
- clearing out of cellars and common rooms, cost for the removal of bulky refuse items, also one-off costs.

d) Heating, ventilation and hot water

- costs of fuels for space heating and hot water production and their delivery,
- costs of operating a central heating system including the flue gas system, electricity for running the system, cost of operating, monitoring and looking after the system,
- costs of district heat which can be allocated in their entirety to the tenants without deducting plant depreciation,
- cleaning and maintaining single-story heating systems,
- cost of operating the central hot water supply system,
- cost of operating, cleaning and maintaining ventilation and air conditioning systems,
- ventilation system inspections,
- solar and wind power systems,
- heat recovery systems,
- supply of district heat and district hot water including the cost of operating the in-house systems,
- filtering and cleaning of flue gases, flue gas blowers and flue gas catalytic converters,
- tank cleaning, tank measuring equipment, leak warning systems,
- cost of changing over to a combined natural gas/heating oil burner,
- cleaning and maintaining hot water boilers,
- costs of metering and recording consumption,
- costs of renting or other forms of leasing heat meters as well as costs for their use including the costs of calculating and allocating consumption, costs of remote-meter reading.

e) Water and waste water systems

- the cost of supplying water and water drainage from the building, car parks and outdoor facilities, including garages and annexes, including the waste water costs which are calculated according to areas built on, roofed areas or paved areas (rain water),
- costs of renting or other forms of leasing water meters as well as costs for their use including the costs of calculating and allocating consumption,
- cleaning of drain pipes, drainage channels and gutters, drains and filters,

- cleaning and maintaining backflow safety devices such as costs for the hygiene inspection of welds and waste water systems or waste water collectors,
- flow limiters,
- costs of operating the building's own water supply system and a water treatment system including the water treatment materials,
- costs of the building's own sewage treatment system and operating a drainage pump,
- costs of cleaning the waste water,
- hygiene examination of the waste water (e.g. clinic, doctors' practice),
- costs of using grey water (maintenance, filter, pump flow),
- costs of cleaning guttering,
- gutter heating systems.

f) Cleaning and lighting

- costs of cleaning and lighting the façade, doors and windows of communal facilities,
- costs of pest control, also one-off action,
- cleaning and lighting of car parks, access paths and communal facilities,
- cleaning and lighting of the entrance areas and stairs and corridors, elevators as well as communal rooms such as cellars, attics, laundry rooms etc., including the replacement of light bulbs and florescent tubes (staff and material costs),
- costs of neon signs and tenant's outdoor advertising unless the tenant has a separate meter and pays the costs himself.

g) Building electrics and telecommunications

- building electrics (protective earthing, ground fault circuit breakers, equipotential bonding, safety lighting),
- solar and wind power system maintenance (if this is not included in the heating costs),
- cable TV,
- communal antenna,
- parabolic antennas,
- media connections,
- in-house data communications, optical fibre technology,
- door entry phone and opening systems,
- video surveillance.

h) Property insurance, third party liability and special insurances

- insurance of a building against fire, storm and water damage including water damage caused by leaking pipes,
- glass insurance for the communal areas and rooms if the tenant has no own glass insurance for his rooms,

- landlord's third-party liability insurance for the building, the oil tank and the elevator,
- damage caused by natural forces (e.g. earthquakes).

i) Transportation equipment

- elevators,
- escalators,
- moving walkways,
- goods elevators.

j) Communal facilities

- swimming pool,
- sauna,
- playgrounds (replacement of sand, maintenance of playground equipment including painting),
- laundry facilities,
- garden maintenance including the replacement of plants, bushes and trees.

k) Staff costs

- staff for the common reception/common telephone switchboard,
- caretaker/concierge, any costs of having an external service instead of a caretaker
- porter/night porter.

l) Other operating costs

- which regularly occur through the use of the building, annexes, plant and installations and the land in accordance with its purpose.

m) Fees and duties

- real property tax,
- dyke charge,
- charges for street cleaning, fees and costs of corresponding non-public work,
- chimney-cleaning costs.

n) Administration and management costs

- administration costs,
- rent administration costs,
- condominium management costs,
- centre management costs (mostly expressed in % of annual net rent).

Membership of and fees for a marketing association, e.g. when all tenants of a shopping centre are contractually obliged to join a marketing association; the marketing association membership fees can be allocated on a pro-rata basis.

City management costs. These are groups of commercial landlords and commercial tenants who get together to improve the local tenant structure (branch mix) and for joint advertising purposes.

> **Practical advice:** This list is only an indication of what operating costs can occur. However, the list is not exhaustive and should be added to as required and in line with the local circumstances. Other operating costs which are not contained in this list may possibly have to be added. It is imperative to check this for each commercial property!

2. Other operating costs

The other operating costs are considered to be a catch-all clause but their use for the onward-charging of operating costs which are not listed individually is only limited. The following costs can also be passed on if they are expressly listed individually:

Operation, inspection and maintenance of:

- garbage chutes, central garbage collection systems, garbage presses,
- ventilation systems,
- lightning conductor systems, fire extinguishers, fire and smoke detectors, smoke extraction systems and sprinklers,
- gutter heating systems (including electricity costs), removal of leaves from the guttering,
- swimming pool and sauna,
- backflow safety devices,
- emergency generators for safety lighting of escape routes (where this is prescribed by law),
- waste water treatment systems including filters and garbage separators,
- fire alarm systems, CCTV surveillance, intercom systems and door entry phone and opening systems.

> **Practical advice:** It is urgently recommended to check whether such other operating costs occur. These must then be listed separately in the lease as costs which can be onward-charged.

3. New operating costs

Increasing competitive pressure has induced many landlords to improve the range of services they offer to take into account the tenants' increased demands for

greater comfort. The standard wording of leases is often not enough to enable the landlord to onward-charge these new operating costs to the tenants. Clauses according to which the tenant has to bear new operating costs as soon as they are incurred without any further details or limitations as to what these costs might be infringe the transparency requirement and are thus legally ineffective.

Practical advice: If new costs are already foreseeable at the time the lease is concluded, it is advisable to make an individual list or at least make a reference to the areas where new costs could arise with an additional phrase such as "after completion of modernisation work". If such a clause is not contained in the lease, a supplementary interpretation of the lease is to be examined or the question of whether the tenant is obliged in good faith to agree to a change in the lease. The agreement on the assumption of new operating costs should be carefully explained to the tenant and negotiated with him.

4. Heating Cost Regulations

In Germany, the Heating Costs Regulations (*Heizkostenverordnung – HeizkV*) dated 20 January 1989 prescribes that the owner of the building must record the pro-rata heat and hot water consumption of the users (Section 4 HeizkV) and that a minimum of 50 % and a maximum of 70 % of the costs of operating the central heating system and the central hot water production system must be billed according to the metered heat or hot water consumption (Section 7 HeizkV). Therefore, whereas with the other operating costs the landlord is free to choose what kind of billing formula he uses (allocating the costs per m² of living area, by person or by consumption) he does not have this choice for billing heating costs. The Heating Cost Regulations are mandatory law apart from the fact that it can also be agreed that more than 70 % up to 100 % of the costs are to be billed according to consumption (Section 10 HeizkV).

It therefore follows that the agreement of lump sums for utility and service charges or all-inclusive rents is not permissible as far as heating costs are included (Hamm Higher Regional Court, NJW-RR 1987, 8). If this provision is infringed, heating costs must, if they are included in the lump sum or in the all-inclusive rent, be deducted with a fictitious amount, which means that the lump sum or the all-inclusive or partly inclusive rent is reduced correspondingly. The heating costs are then billed in addition according to the actual consumption in line with the stipulations of the Heating Cost Regulations. The tenant can deduct 15 % of the heating costs from his utility and service charges bill if the leased property is, contrary to the provisions of the Heating Cost Regulations, not equipped with heat meters (Section 12 HeizkV). If the existing heat meters have only failed, no deduction is to be made (Düsseldorf Higher Regional Court, ZMR 2003, 569).

A word on heat contracting

Heat contracting is a service generally offered by heating system installation companies as well as publicly and privately owned energy suppliers which has been used increasingly by house-owners and landlords since the 1990s, above all in Germany. The essence of this business is the outsourcing of investments for the first-time installation or modernisation of central heating systems by the owner of the building to the heat supplier (contractor). In a heat supply agreement with a long term (10 to 15 years) the building owner gives the contractor the exclusive right to provide his tenants or his property with heat for space heating and, if appropriate, hot water from a central heating system. Thanks to the long-term contract, the contractor can spread his investment costs in the heating system over 10 to 15 annual instalments. As the new modern heating systems save a lot of energy with their often good efficiencies, most tenants do not immediately notice the investment cost surcharge spread over the years and charged in the annual heating bill when they check their heating costs for plausibility.

Thousands of landlords have taken advantage of this new service in recent years. In Germany, the heat contracting market has now attained an annual turnover volume of approx. € 1 billion. This service is always to be regarded as critical if the tenants have already been charged the investment costs for the heating system on a pro-rata basis as part of the "net cold rent" or a modernisation surcharge has already been added to the "net cold rent" and now the same costs are being charged a second time to the tenants by the contractor with the permission of the landlord but spread over 15 years in the heating bill. The legislator has so far failed to regulate this by law so heat contracting currently exists in a legal grey zone and is highly controversial. Both tenant protection associations and the heat contracting industry itself hope that the Federal Court of Justice will clarify the situation by making a High Court ruling.

However, in its ruling of 6 April 2005, the Federal Court of Justice caused a great stir in the contracting industry because, in the judges' opinion, the often higher costs of contracting compared with heat supplies for a property organised by the landlord himself can only be passed on to the tenants if this has been agreed in the lease (Federal Court of Justice, ZMR 2005, 606). Basically, it is a question of how a so-called unreasonable double charging of the tenant with the investment costs for the heating system is to be dealt with in legal terms.

However, in principle, the Federal Court of Justice seems to have a positive attitude towards the innovative service, contracting. However, the current legislation and legal situation is so clear that it was simply not possible to decide in favour of the heat supplier or landlords. Therefore, one Federal Court of Justice judge suggested in a paper presented at the Berlin energy conference in May 2006 (*Berliner Energietage*) that the legal situation should be changed. However, this has not happened so far.

The trend in court rulings is now that the landlord is allowed, without the tenants' consent, to change over from so-called own supplies of space heating (supply by the landlord) to heat contracting (supply by third parties) but is only allowed to pass on the full heating costs (generally higher because of the investments and company profits) to the tenants with their consent. Therefore, the tenants will refuse to give their consent if the landlord is not willing, at the same

time, to reduce the "net cold rent" by the amount which he has previously calculated and included in the rent for the provision of the heating system and which has been clearly shifted to the utility and service charges as a result of heat contracting. Here, the tenants will always put forward the argument of unreasonable double charging.

Practical advice: Therefore, the landlord is advised to include heat contracting in the operating costs in new leases. The costs then incurred through heat contracting can be onward-charged to the tenants. If – as is normally the case – there is no such provision in old contracts, the landlord should try to get the tenants' consent. If the tenants do not agree to it, he should consider a termination of the lease with the option of a new lease with different conditions. This is particularly worth considering if the cost-saving potential is high.

5. Prepayments

For reasons of liquidity and to minimise his non-payment risk, the landlord should set the prepayment instalments at roughly the amount of the expected costs, particularly since he must always pay a number of the costs in advance (real property tax, insurance premiums, heating costs etc.).

However, he can only demand an increase in the prepayments if he has expressly reserved the right to do so in the appropriate form when the lease was concluded or by terminating the lease with the option of concluding a new lease under changed conditions. An agreement on the amount to be made as prepayments "based on the costs incurred for the previous year" is permissible (Dresden Higher Regional Court, NZM 2002, 437).

Practical advice: As part of a tenancy law due diligence, it is regularly examined whether the prepayments adequately cover the actual operating costs incurred. Should this not be the case, an adjustment must be made as quickly as possible so that the landlord does not have to make advance payments unnecessarily.

6. Billing and billing period

A utility and service charges bill must contain the following information:

- list of the entire costs,
- indication and explanation of the cost distribution formula used,
- calculation of the tenant's share of the costs and
- deduction of any prepayments made by the tenant.

The billing period is one year. However, in contrast to residential tenancy law – the annual period is not a preclusive period (Limburg Regional Court, WuM 1997, 120).

An agreement that the bill is deemed to have been accepted if the tenant does not object within four weeks is legally effective if a reference is made to this period for the lodging of objections to the bill (Düsseldorf Higher Regional Court, ZMR 2000, 452). The due date of the utility and service charges bill as a whole is not affected by the fact that some items are wrong (Düsseldorf Higher Regional Court, WuM 2003, 387).

7. Mistakes in the bill (reservation of right to correct)

If the landlord has made a mistake in the bill, e.g. he has only taken one bill for heating oil into consideration although he received two or he has onward-charged operating costs to the tenants which he was not entitled to charge according to the lease, the following applies: The landlord has exercised his right to determine his performance in accordance with Section 316 BGB when preparing the bill. This cannot, in principle, be revoked and therefore cannot be changed (J. Fritz, Gewerberaummietrecht, 4th edition, margin No. 138 et seq.).

> **Practical advice:** Therefore, it is recommended to include a *reservation of right to correct* in the bills, particularly when it is known that additional charges are due to come later, e.g. an amended real property tax notice as a result of a new development.

IX. Ending the lease

As part of a tenancy law due diligence, special attention is paid to the ending of the lease. For considerable increases in return can depend on this, e.g. if the rent currently charged by the landlord is far below the normal market rent. If the landlord and tenant cannot reach agreement on a new reasonable rent, the profit can be maximised by terminating the existing lease and re-letting.

There are various regulations applicable in Germany to the termination of leases which are to be found in lease agreements. The following are possibilities:

1. Expiry of a certain period

If the lease has been concluded for a fixed term (without an automatic extension), it ends, in accordance with Section 542 BGB, on expiry of the period for which it was entered into without special notice having to be served. The same applies if an option to extend the lease has been agreed in the lease and this option is not exercised.

However, it must be remembered that, in accordance with Section 545 BGB, an extension of the lease for an indefinite period occurs when the tenant continues to use the leased property after expiry of the fixed lease term and neither the landlord nor the tenant informs the other party within a period of two weeks that a tacit extension of the lease is not desired. This provision is excluded in most leases in a standard clause which is permissible or the objection to an extension is declared in the notice of termination. Prospective investors need to watch out for this point.

2. Notice

Furthermore, the lease can be terminated by one of the parties serving notice. Here, a difference must be made between serving due notice on leases concluded for an indefinite period, the special right of notice for long-term leases and termination without notice for good cause.

a) Form of the notice

In principle, it is possible to give serve notice on commercial leases in no particular form unless the lease stipulates – as is normal – the written form for the notice. The written form for notice is to be recommended so that proof of notice can be produced.

If the written form has been agreed, a telecommunications form of transmission, i.e. telegram, telefax or e-mail (Section 127, para. 2 BGB) is sufficient for the observance of the written form. The telefax is also enough if it has been agreed that notice must be served by registered letter (Frankfurt Higher Regional Court, NJW-RR 1999, 955) but, just like a telegram or an e-mail, it is not a safe means to prove receipt of the notice. However, fax machines which print a receipt on the copy of the document sent are to be given preference to old machines which only confirm that the document has been sent. It must be clear from the letter who the sender is and who is serving notice (cf. J. Fritz, Gewerberaummietrecht, 4th edition, margin No. 372 et seq.).

b) Contents of the notice

The notice must clearly express that termination of the lease is desired. The wording is not decisive as long as it can be clearly gathered from the notice that it is a notice of termination of the lease. A declaration by the tenant that he will not move into the leased property is, for example, to be regarded as notice of termination (Federal Court of Justice, NZM 2001, 1077).

c) Period of notice

When commercial premises are rented, it is permitted to serve notice not later than the third working day of a quarter for the end of the next quarter (Section 580 a, para. 2 BGB) whilst notice in accordance with Section 580 a, para. 1, No. 3 BGB for *undeveloped land* used for commercial purposes, *rooms which are not business premises* and *ships entered in the ships register* may be served not later

than the third working day of a calendar month to take effect at the end of the next month but one, but only at the end of a quarter if the rent is paid monthly or payment is made at longer intervals.

The indication of the wrong notice date in a written notice does not mean that the entire notice is ineffective (Federal Court of Justice, NJW-RR 1996, 144; Hamm Higher Regional Court, MDR 1994, 56), the notice is then effective for the next permitted notice date.

Even with long-term leases, the period of notice does not change for the parties (contrary to the period of notice for landlords of residential units in accordance with Section 573 c BGB). This provision has been contested many times on the grounds that a commercial tenant may, under certain circumstances, be more worthy of protection than a tenant of residential property as the tenant of residential property can move without far-reaching consequences for his life whilst the tenant of a shop could, under certain circumstances, lose his livelihood. As all initiatives in this direction have failed so far, the tenant of a German property is frequently advised to ensure that his livelihood is not endangered by insisting on certain provisions in the lease, in particular on an option to extend the lease. The investor should be prepared for this when examining the leases.

d) Special rights of the landlord and the tenant to serve notice

In exceptional cases, it is possible to have special rights to serve notice of termination (also called "extraordinary notice") with a shorter statutory period of notice in the case of long-term leases or leases which grant the tenant the option to extend the lease once or several times, in which, in principle, a statutory or contractual notice of termination is excluded or in leases with an agreed long period of notice in those cases provided for by law. In addition the parties may agree a special right of notice, under certain circumstances, in the lease by way of an individual agreement. Such special rights of notice are, however, always to be interpreted restrictively (Federal Court of Justice, NZM 2003, 62).

The following special rights of notice of termination are provided for in German tenancy law:

aa) Lease for more than 30 years

In accordance with Section 544 BGB, a lease can be terminated by either party serving the statutory notice after 30 years calculated from the date on which the leased property was to be handed over for use in accordance with the lease unless the lease was concluded for the lifetime of the landlord or the tenant. This provision only relates to leases which were long term from the very beginning and not to several leases concluded one after the other without duress (so-called 'chain contracts' (*Kettenverträge*).

bb) Death of the tenant

In accordance with Section 580 BGB, if the tenant dies, both the heir and the landlord can terminate the lease by serving statutory notice within one month from becoming aware of the tenant's death. As Section 580 BGB is not mandatory, the

provision can be excluded by an individual agreement or varied by agreeing a longer period of notice (German Federal Constitutional Court, WuM 1997, 321).

cc) Refusal to allow sub-letting

Under commercial tenancy law, the landlord is, in principle, not obliged to accept a sub-tenant. If the landlord refuses to permit sub-letting, the tenant can, however, terminate the lease by serving the statutory notice provided the choice of the sub-tenant does not constitute good cause for the landlord to refuse sub-letting (Section 540, para. 1, sentence 2 BGB). The tenant's right to serve notice may be modified by an individual agreement.

dd) Termination because of planned improvements to the leased property

The tenant may terminate the lease in accordance with Section 554, para. 3, sentence 1 and Section 578 BGB before the end of the month following receipt of notice to take effect at the end of the next month but one if he does not want to accept measures planned by the landlord to improve the building structure which he is not forced to tolerate in accordance with Section 554, para. 2 and Section 578 BGB unless the building project would only have an insignificant impact on the leased premises. The landlord may, despite the tenant's notice, make preparations for the conversion work in the leased premises (take measurements, have tradesmen look at the premises etc.), which the tenant must tolerate to a reasonable extent.

e) Termination without notice by the landlord

Termination without notice ends the lease *with immediate effect*. The tenant is obliged to return the leased property, he cannot demand a period of grace for vacating the property. The landlord's claim to payment of the rent turns into a claim for compensation for use. The landlord can set a so-called expiry period (*Auslauffrist*) in the notification of termination without notice and already grant the tenant *a period to vacate the premises* in the letter of termination in order to have time to search for a replacement tenant. However, the expiry period should not exceed the statutory period of notice (Düsseldorf Higher Regional Court, ZMR 1997, 596). Too long a period could throw doubt on the landlord's assertion that it is unacceptable for him to continue the lease.

Under commercial tenancy law, no reason has to be given for termination without notice. The terminating party must, however, inform the other party without delay of the reason of termination if requested to do so (Palandt/Heinrichs, BGB commentary, Section 314 BGB, margin No. 110), so it is recommended to always include a reason for the termination without notice in the letter.

aa) Default in payment

The landlord is entitled to terminate the lease without notice in accordance with Section 543, para. 2, No. 3 BGB if the tenant has failed to make two complete consecutive rent payments or if he has failed to make part of two consecutive rent

payments and the total amount outstanding is more than one month's rent or if he fails to pay part of the rent over a longer period and the arrears amount to more than two month's rent (Section 543, para. 2, No. 3 b BGB).

Termination without notice is also justified if the tenant is only in arrears with **operating cost prepayments** and these arrears are equivalent to two month's rent or if the arrears result from advances on operating costs some of which have not been paid (Berlin Regional Court, NJW-RR 1986, 236).

bb) Substantial violation of the lease agreement

There is also a right to termination without notice in accordance with Section 543 para. 1 BGB if one of the contracting parties *violates its obligations under the lease so seriously* that the other party can no longer be expected to continue the lease. Termination presupposes fault, slight negligence being sufficient. The tenant is liable for agents acting on his behalf (*Erfüllungsgehilfe*) (Section 278 BGB) who perform his contractual obligations to maintain and take care of the property, i.e. for the tradesmen who work on the leased property or for his agents (Karlsruhe Higher Regional Court, ZMR 1988, 52). Customers and visitors are not agents; liability clauses in standard lease agreements which include this group of people in the tenant's liability are ineffective.

Notice of termination in accordance with Section 543, para. 1 BGB is permitted if there is considerable disturbance of the neighbours, e.g. through noise or serious, repeated insults or violence (Berlin Regional Court, WuM 1987, 56) as well as violence towards the property manager (Cologne Regional Court, WuM 1981, 233). An indication of disturbance of the other tenants by the tenant is the fact that other tenants reduce the rent (J. Fritz, Gewerberaummietrecht, 4th edition, margin No. 410).

If the tenant has made false declarations about his financial situation during the lease negotiations, the landlord is entitled to terminate without notice (Wuppertal Regional Court, WuM 1999, 39).

A substantial violation of the lease within the meaning of Section 543, para. 1 BGB is, for example, when the tenant constantly pays the rent late. A right to terminate is already assumed when the delay is only a few days and when this happens over a period of a few months. In accordance with Section 543, para. 3 BGB, the landlord must, however, give the tenant a *written warning* before termination without notice. Threat of termination without notice is not absolutely necessary but is to be recommended, an earlier (ineffective) notice of termination being equated with a written warning (Hamburg Regional Court, ZMR 1985, 385; Dortmund Regional Court, NJW-RR 1987, 77).

If the landlord has tolerated late payment of the rent for a prolonged period, he must expressly point out to the tenant that he no longer wishes to tolerate this in future or must send another written warning and threaten termination without notice. In any case, once the landlord has tolerated late payments for a lengthy period, strict requirements are placed on the statement of the landlord's claim of unacceptability (Karlsruhe Higher Regional Court, NJW 2003, 2759).

cc) Use contrary to the terms of the lease

If the tenant uses the leased property in a manner contrary to the terms of the lease, the landlord not only has a claim to compel the tenant to refrain from such use in accordance with Section 541 BGB but also the right to terminate the lease without notice in accordance with Section 543, para. 2, No. 2 BGB. However, this is only the case when the rights of the landlord are considerably infringed and when the tenant has previously been set a period in which to take remedial action or has been sent a written warning to no avail (Section 543, para. 3 BGB).

Unallowed sub-letting or unauthorised use of the leased property by a third party entitles the landlord to send a written warning of termination without notice if a landlord's rights have been considerably violated. Unallowed sub-letting is already in violation of the landlord's rights. However, this violation of rights is only considerable if there are other attendant circumstances. This is in particular the case when the landlord is entitled to refuse sub-letting for good cause, e.g. because the sub-tenant violates the protection against competition which the principal landlord must grant to another tenant.

Use contrary to the terms of the lease includes the tenant's failure to heat the leased property during the winter when the temperature is well below zero. Exposure to danger is sufficient, damage to the leased property need not have occurred (Görlitz Regional Court, WuM 1994, 669).

f) Termination without notice by the tenant

Under German law, the tenant is also entitled to terminate the lease without notice in various cases. When valuing a commercial property, the investor should always check whether there is a threat of termination without notice by the tenant. For planned income may be lost in such a case.

The following facts entitle the tenant to terminate without notice:

aa) Use is not granted

In accordance with Section 543, para. 2, No. 1 BGB, the tenant has the right to terminate the lease without notice if the leased property is not handed over, either in whole or in part, in time or is withdrawn again or if it is so defective that it is unacceptable for the tenant to take over the leased property or to continue the lease. A prerequisite for termination without notice is that the tenant sets the landlord a reasonable period in which to take remedial action to make the leased property free of defects (Section 543, para. 3 BGB). This setting of a deadline can only be dispensed with if the leased property is no longer interesting to the tenant as a result of the non-granting of use, e.g., in the case of a fair stand, or the setting of a period obviously does not hold promise of success. If the landlord does not start with work to remedy defects which will take several days until the last day of the period set for rectification, the tenant can terminate the lease without notice if he cannot be expected to wait any longer unless the period he set was unacceptably short (Düsseldorf Higher Regional Court, NJW-RR 1995, 1353).

bb) Danger to health

The tenant has the same right if the leased premises are intended for human use but such use would present a danger to the health of people. This also applies to shops, offices etc. in which people only stay for some hours (also to warehouses).

Considerable danger to health includes the penetration of unbearable smells or unbearable noise, dangerous conditions of floors and stairs, damp or insufficient possibility to heat the premises as well as excessive formaldehyde concentrations (Cologne Local Court, NJW-RR 1987, 972).

cc) Culpable neglect of duties

The tenant can also terminate the lease without notice if the landlord constantly or considerably offends him or uses violence against him; also if the landlord opens mail addressed to the tenant.

dd) Unreasonable continuation of the lease

If the tenant has to cease operating his business for economic reasons or due to a serious illness, this is not a reason for him to terminate the lease without notice even if his livelihood is jeopardised as the economic business risk and his personal health risk are solely his responsibility (Düsseldorf Higher Regional Court, ZMR 2004, 506).

g) Elimination of reason for termination by set-off and payment

If termination of the lease without notice is based on the tenant being in arrears with his payments in accordance with Section 543, para. 2, sentence 1, No. 3 BGB, termination is excluded if the landlord's claims are satisfied in full before the tenant receives notice (Section 543, para. 2, sentence 2 BGB). Notice of termination becomes legally ineffective if the tenant declares, immediately after receipt of notice and with legal effect, set-off against a counter-claim (Section 543, para. 2, sentence 3 BGB). A period of two weeks is only regarded in exceptional cases as the upper limit when the tenant needs a lengthy period to examine and consider the situation. The set-off situation must have existed before the tenant received notice of termination (Federal Court of Justice, NJW 1959, 2017). Contractual exclusion of the possibility of set-off is also to be noted in this connection.

If termination of the lease is not in accordance with formal requirements (e.g. because the agent of the landlord (*Bevollmächtigter*) has not presented the original power of agency from the landlord), the tenant may reject the notice and, at the same time, pay the arrears.

However, if notice has been served, there is no possibility for a tenant of commercial premises – in contrast to a tenant of a residential property – to stop an action for eviction by paying the rent arrears within a certain period unless the notice was contrary to public policy and should, without exception, have first been served after a written warning.

If the landlord has terminated the lease without notice in accordance with Section 543 para. 1 BGB due to constant late payment of the rent and if the tenant

pays the arrears after receipt of notice and also continues to pay the rent punctually until the action for eviction is filed, this behaviour does not cancel the landlord's right to have the tenant evicted (Federal Court of Justice, NJW-RR 1988, 77).

Practical advice: Termination without notice may sometimes be unsuccessful if the tenant shows signs of good behaviour. Therefore, re-letting should take place at the right time with the right agreements. Otherwise, the investor may have to face the justified claims of an upset new tenant.

3. Cancellation agreement

The parties can cancel the lease at any time by mutual agreement. The declarations must be clear but can also be given tacitly (e.g. the tenant moves out following the landlord's offer to cancel the lease). If one of the parties offers to cancel the lease and the other party does not comment on this offer, this is understood among businessmen to mean that the other party rejects the offer (Federal Court of Justice, NJW 1981, 43). There is also no obligation under the lease to answer such a letter.

If the tenant moves out of the leased premises at an inappropriate time and returns the key, the tacit conclusion of a cancellation agreement cannot be deduced from the acceptance of the key. Acceptance of the key and any re-letting are generally seen in the context of the obligation to minimise loss (Cologne Higher Regional Court, ZMR 1998, 91).

The conclusion of a cancellation agreement does not necessarily mean a waiver of claims for damages. It must, however, be checked in each case to see whether a waiver of claims for damages was desired and agreed with the conclusion of the cancellation agreement. There is also a danger of the party obliged to pay compensation claiming forfeiture if the party entitled to claim has not upheld his claims in the cancellation agreement. Therefore, it is recommended to clarify this situation by a note to the effect that the lease is otherwise to be fulfilled to its end without restriction, that, for example, interior decorative repairs are to be performed and whether all claims of the parties against each other are to be settled by the cancellation agreement or whether one of the parties reserves the right to assert claims for damages. A set-off clause excludes claims for damages and the demand for the return of a deposit (Düsseldorf Higher Regional Court, ZMR 1997, 178).

Practical advice: In principle, termination of the lease by a cancellation agreement is to be recommended. For all points can be settled by mutual agreement in it. It is important that nothing crucial is forgotten. The cancellation agreement should terminate the lease by mutual agreement and not provide further potential for dispute. Here, it is a question of the balanced negotiation and drafting of the agreement.

Chapter 9 Facility Management

I. Corporate Real Estate, Asset and Facility Management – the Interaction of Forces

Real estate has taken on a major asset and cost dimension in German companies. According to the latest surveys, roughly 60 % of all existing areas are currently owned by the users, corresponding to roughly € 1,500 billion of tied-up capital. At the same time, these companies spend up to several hundred million euros every year on ongoing operational costs for their real estate.

However, in recent years German companies have increasingly started to professionalise the management of their real estate. In an international comparison, new approaches such as operator models with an investment share, so-called public private partnerships (PPPs) or private financial initiatives (PFIs), play a much more important role in Anglo-American countries for example than here in Germany.

Moreover, the Anglo-American market is much more value-driven and flexible. Real estate investment trusts (REITs) are widespread whereas this subject is currently still being discussed in Germany.

At present, numerous different terms, such as corporate real estate, asset and facility management, are used on the German real estate service market. However, the contents of these services are often not transparent and clearly defined. Therefore, it is difficult for real estate owners to know what they are getting or compare service providers.

Whereas corporate real estate management is the generic term for the entire strategic and operational management of properties, asset management focuses on real estate as an investment. Facility management, on the other hand, covers the entire field of managing real estate over its life cycle.

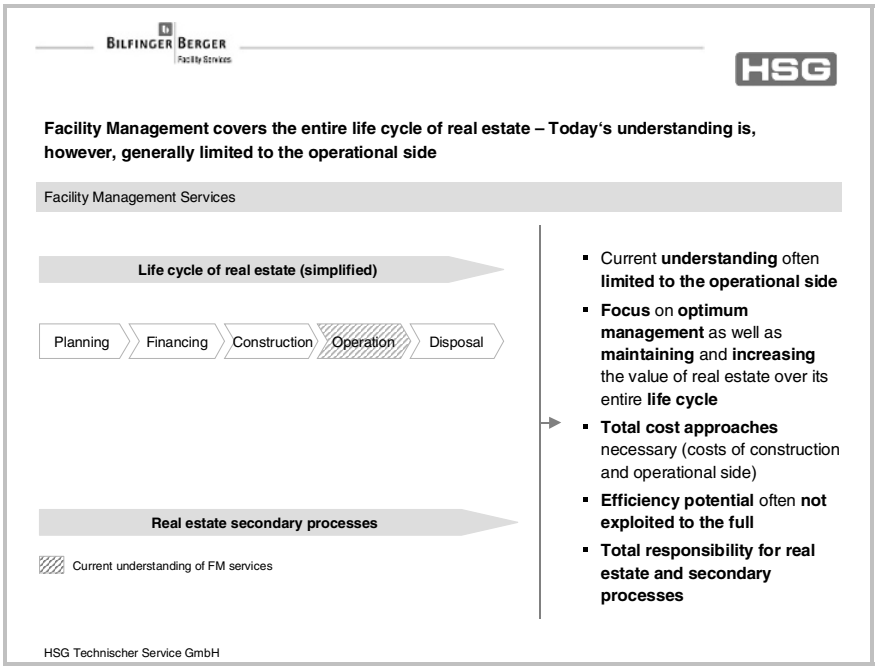


Figure 1. Facility Management covers the entire life cycle of real estate – Today's understanding is, however, generally limited to the operational side

However, facility management on the German market is frequently still regarded as being restricted to purely the operational side. This is obvious from the fact that service companies are mostly not involved in the planning phases of revitalisation and new construction projects and are not generally called in until the planning and construction phases have been fully completed. Recent surveys indicate that, at present, well under 5 % of all projects are implemented with the early involvement of the subsequent service partner.

However, it would be important to do so as some 80 % of the future real estate operational costs are already determined in the planning phase. The amount and structure of operational costs are, for example, governed to a great extent by a building's architectural design and the standard of the areas as well as the technical equipment. By not consulting a facility management company at an early stage, a whole wealth of experience gained in everyday operational management is completely lost.

Results from projects where the service partners are already involved in the planning phase prove that the annual operational costs can be reduced by up to 25 %, in some cases by even more, by drawing on their expertise.

This constitutes a considerable savings potential given that the running operational costs for a building are roughly three to five times the construction costs assuming a property life cycle of about 20 years before the first

revitalisation. That is to say if the property costs € 50 million to build, for example, between € 150 and 250 million has to be spent on operational costs over the above period.

II. Facility Management in Germany – How the Branch Will Develop in the Future

Nowadays, approx. € 35 billion is already spent on outsourcing in Germany, one of the largest markets for facility management services with a total market volume of some € 50 billion. However, the market will tend to stagnate overall in the years to come as a result of two opposing effects. On the one hand, there will tend to be a further increase in the areas available, especially in major cities and conurbations. By contrast, using an external partner to provide services previously performed by in-house staff should considerably cut costs.

The proportion of single services outsourced will continue to increase at a rate of about 3 % per annum and will amount to roughly € 34 billion in 2010. The main reasons for greater outsourcing are the tendency of companies in all branches of industry to concentrate on their core business and the further professionalisation of services. The proportion of integrated facility management services, where several types of service are outsourced in a package, will grow even faster than the services outsourced individually, at a rate of roughly 12 % per annum.

Market research companies expect integrated services to grow up to roughly € 8.7 billion in 2010.

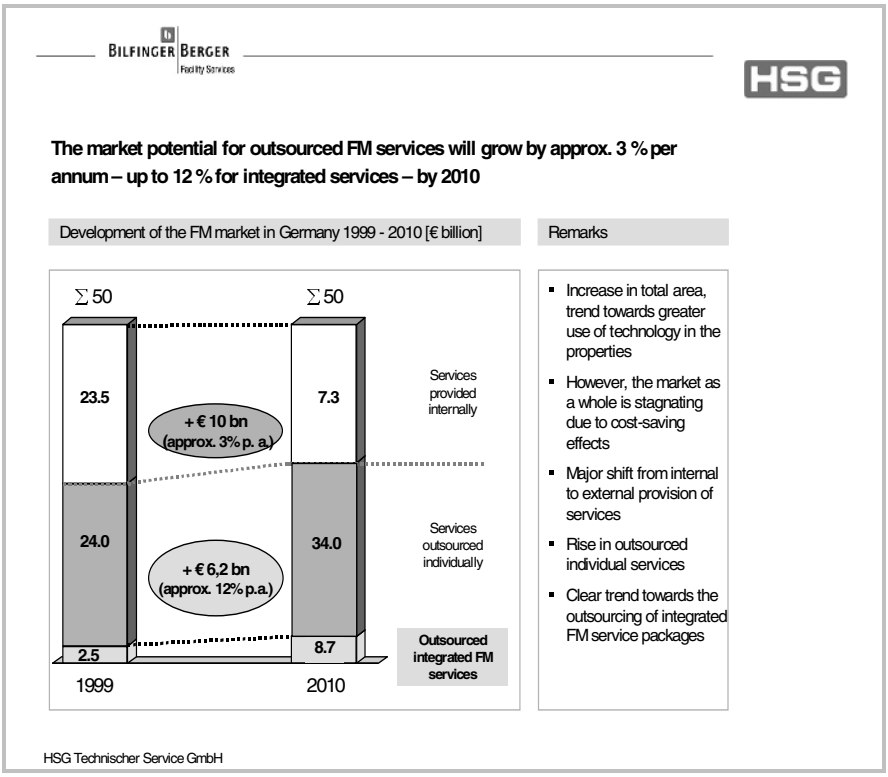


Figure 2. The market for outsourced FM services will grow by approx. 3 % per annum – up to 12 % for integrated services – by 2010

A comparison with facility management markets such as the USA and Great Britain which are much more developed shows major differences to the situation in Germany. Certain features of these markets can be transferred to Germany but not all of their market characteristics. Therefore, it is only possible to forecast individual trends for the German market.

The top players on the facility management market in Great Britain, for example, have greatly boosted their growth in recent years by offering PPP models. The spread of privatisation and the takeover of real estate owned by public authorities, such as schools and hospitals, and their all-inclusive management were the crucial factors in this development. The service providers act as all-round suppliers, providing commercial, technical and infrastructure services all from one source. In order to exploit their own optimisation potential after the assumption of the business risks, they even provide corporate real estate and asset management services, for example renting and letting or investment controlling. However, apart from this involvement on the investment side, there tends to be little overlap between classic real estate managers and facility management companies.

There are also some initial success stories in Germany with PPP models. However, the number of such models is much smaller and the speed at which they are spreading is much slower than on the Anglo-American markets.

The facility management market in Germany is dominated by two sustained developments. Firstly, there is increasing pressure on customers from almost all branches of industry to outsource all services not associated with their core business as quickly as possible to external providers for organisational and financial reasons. Secondly, the strained economic situation means that there is tremendous pressure on the prices of facility management service companies, at least as far as standard services are concerned.

At the same time, customer demands on the quality of the services, professionalism as well as performance and cost transparency are constantly rising.

On the whole, only two groups can successfully cope with the above market situation with its price sensitivity and rising demands: Firstly, the major providers, who achieve scale effects in terms of price and performance thanks to the variety and number of orders placed with them, and secondly, small providers, who concentrate on one service and/or one region and are thus able to react flexibly to the demands of this niche market.

The top 10 facility management service providers on the German market currently have different key services and those who are company groups have a very high in-house share of their business, which means that they have a small share of the third-party market and are highly dependent on their parent company.

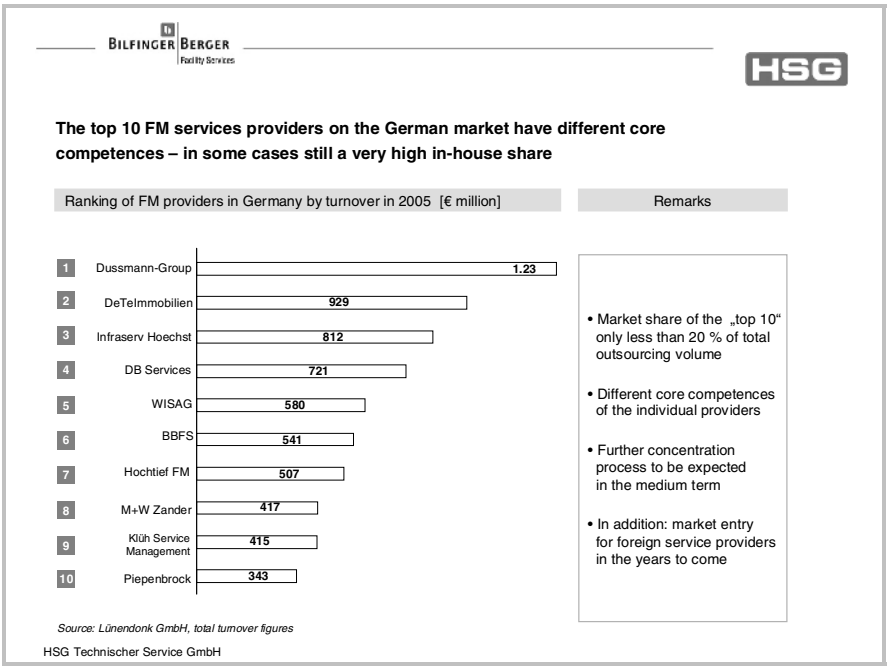


Figure 3. The top 10 services providers on the German market have different core competences – in some cases still a very high in-house share

Altogether, the top 10 facility management service providers record a total turnover of roughly € 6.5 billion and, given that the total service volume currently outsourced in Germany amounts to some € 35 billion, only have a market share of less than 20 %.

It can be assumed that in the medium term the trend towards increasing concentration seen since about 2002 will continue, also among the above-mentioned top 10 in Germany.

Thus, established market players like HSG (purchased by the Bilfinger Berger Group in 2002), Siemens Gebäudemanagement (purchased by Hochtief FM in 2003), Lufthansa Gebäudemanagement (purchased by Hochtief FM in 2004), ThyssenKrupp Hi Serv (in 2004 the commercial division was purchased by HSG and the technical division and plant engineering division by WISAG) and M+W Zander (purchased by the financial investor Springwater Kapital in 2005) all changed owners for a variety of reasons.

Furthermore, foreign providers are also expected to enter the market in the next few years.

III. Integrated Outsourcing of Facility Management Services – the Future Trend

Facility management is still one of the most dynamic market segments in Germany in terms of the range of services currently offered and the services and service solution concepts now being developed.

An analysis of the major forms of outsourcing on the German market shows that outsourcing of individual services and service packages predominates whereas the completely integrated outsourcing of facility management services plays a minor role as yet.

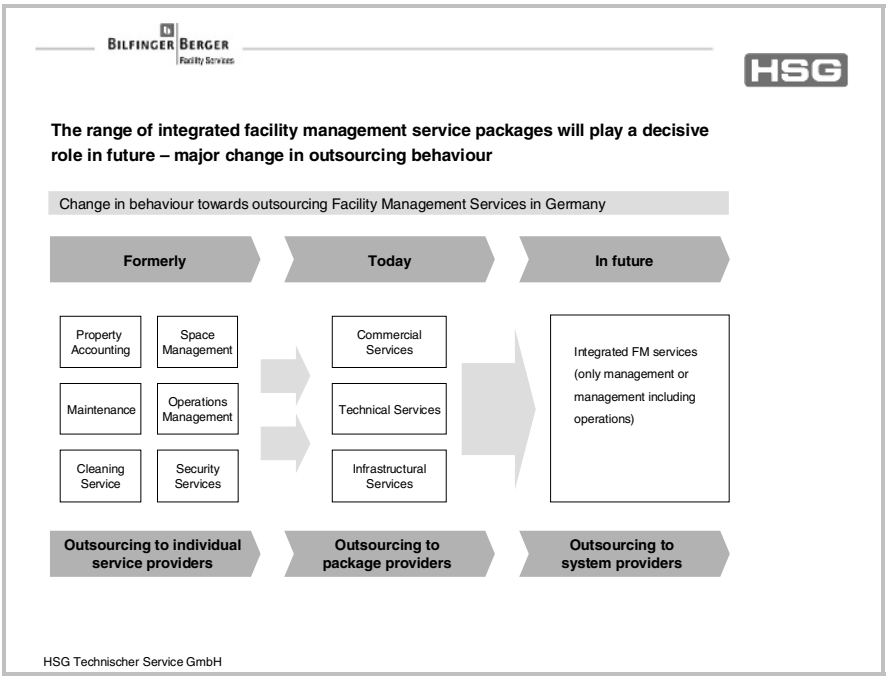


Figure 4 . The range of integrated facility management service packages will play a decisive role in future – major change in outsourcing behaviour

Companies mainly opt for integrated outsourcing in an effort to minimise complexity and the amount of management work involved as well as to achieve cost savings and synergies where possible. Other factors such as quality improvement thanks to the harmonisation of interfaces, standardisation of service levels, the exploitation of external know-how and concentration on core business also play a role.

The main argument against integrated outsourcing is generally the fear of losing knowledge and the ability to reliably assess and control the service partner

in the medium to long term. Moreover, customers do not currently trust every provider to have a reasonable level of competence in all areas.

In the long term, however, there will be the same trend as in the automobile and its supply industry in Germany which used to work with a large number of different suppliers but now concentrates on a few system leaders for selected modules and components.

In the short term, a greater concentration of technical facility management services (TFM) and infrastructural facility management services (IFM) can be expected on the outsourcing market. At present, companies still view the outsourcing of commercial facility management services (CFM) with some scepticism. They frequently still regard this area as part of their core business and fear a loss of control and expertise.

If the demands of various industry branches as a whole are considered, it becomes clear that a high level of technical competence is an important prerequisite for a company wishing to be successful in the integrated services market segment. Companies tend to believe that service providers with a high degree of technical competence are more likely to be capable of providing other services as well. Almost all customers are sceptical about outsourcing complex services to service partners who cannot demonstrate that they have this experience.

Apart from having the right performance credentials, it is of key importance for potential service providers to establish long-term partnerships with customers.

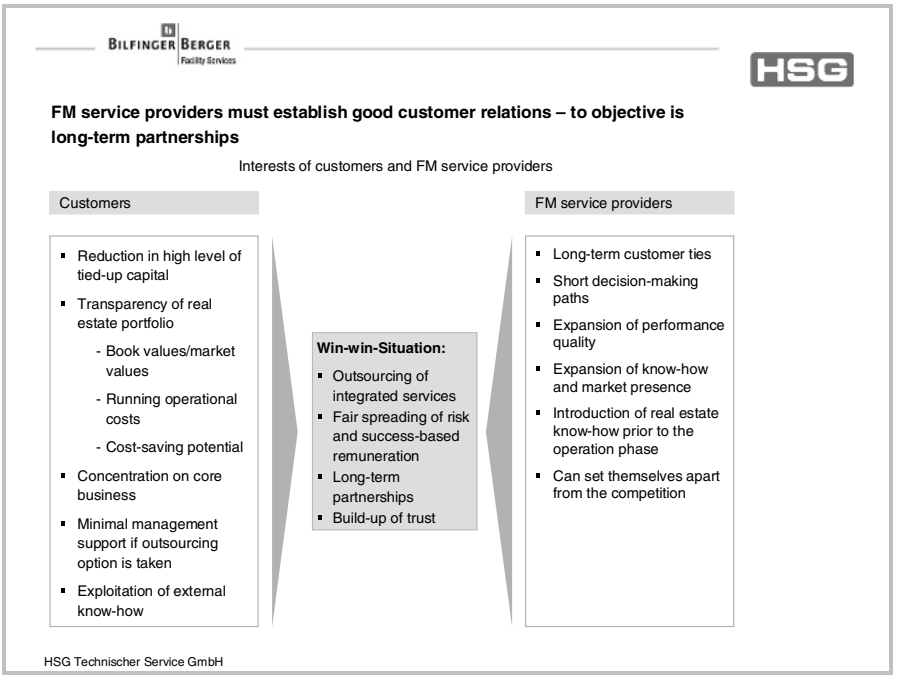


Figure 5. FM service providers must establish good customer relations – to objective is long-term partnerships

At the same time, the significance of innovative remuneration and contract models will continue to increase in the years to come.

Success-based remuneration, the assumption of budget responsibility and the agreement of cost-cutting consequences should be mentioned in this respect. Success-based remuneration models in particular are so far not in widespread use on the German market. However, bonus/penalty arrangements on the basis of so-called key performance indicators (KPIs) can already be found in some cases.

A high degree of flexibility is expected from service partners in that they have to be positive and open-minded about different forms of co-operation. This may start with a simple service contract and lead to a joint venture with the customer. The joint venture model is particularly worth considering when the service provider assumes takes over functions in this partnership which are very closely related to the customer's core business. The service partner must always be in a position to change the form of co-operation during the partnership.

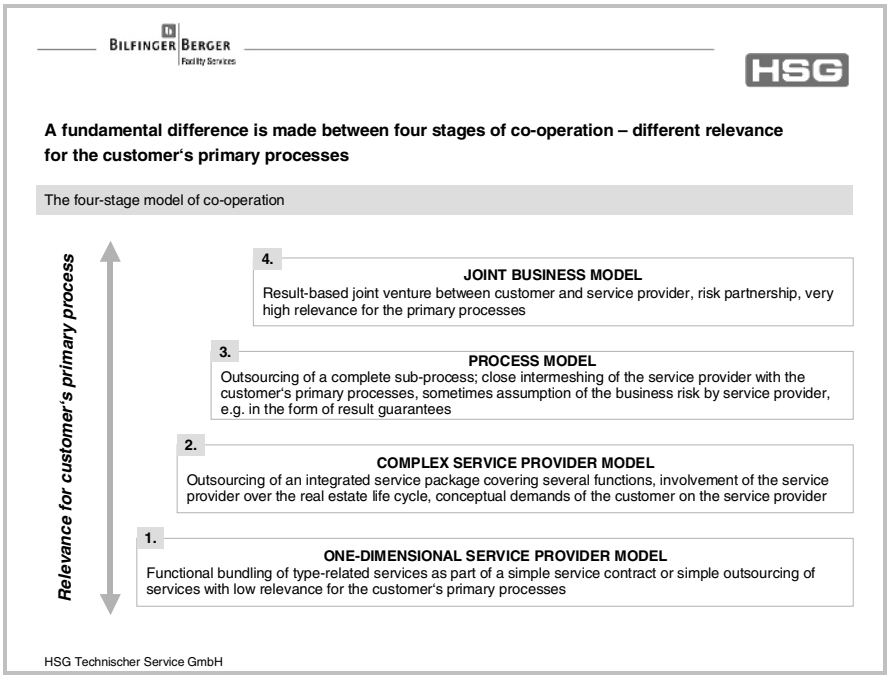


Figure 6. A fundamental difference is made between four stages of co-operation – different relevance for the customer's primary processes

Basically, the developments on the German market for facility management services vary greatly depending on the particular industry involved. The industries have different focuses for their facility management activities depending on the importance which they attach to real estate as a cost, quality, value or technology factor. Other factors such as the degree of centralisation and the regional spread of the companies' real estate portfolio also impact on their outsourcing policy.

Outsourcing and the demands placed on service providers also differ greatly depending on whether the real estate involved is used by the company or third parties. With real estate used by the company, issues such as security and availability play an important role. With real estate used by others, requirements such as maintaining the value and safeguarding returns are the main considerations.

The public authorities see the real estate they own even more as a cost factor than industrial companies. The outsourcing rate is still very low in all areas of facility management services; complex areas of responsibility and organisational structures also make outsourcing more difficult.

As can be seen from the example of the Anglo-American markets, value orientation and value-enhancing facility management are also becoming more and more important in Germany. The increasing outsourcing of the services for entire real estate portfolios by major German companies and greater activity of Anglo-

American investors in the German real estate industry are the main factors which will govern the development on the facility management services market in the future. Further consolidation and internationalisation of the service providers will follow in line with the change in the demand structure.

IV. The BMW factory in Leipzig – An innovative example of integrated outsourcing

In 2000, the BMW Group announced that it intended to build a new vehicle factory in Europe in order to make its global production network fit for the future in line with the product and market campaign initiated the same year. In response, more than 250 European towns and cities submitted documents in the following weeks to attract BMW to a site in their locality.

After a detailed evaluation, the decision was announced on 18 July 2001. The new car factory was to be built on some 208 hectares of land in the Leipzig-Nord industrial park. There were reasons in favour of this location in Germany, including the right infrastructure for its smooth integration into the BMW production network. However, flexibility, pragmatism and the speed of implementation on the part of the offices and authorities responsible for this industrial development were also crucial.

Production of the new BMW series 3 cars started in Leipzig on 1 March 2005 exactly to schedule, after less than three years of construction, machinery installation and testing. In the medium term, 650 vehicles a day will be rolling off the production line and the series 1 range is also to be manufactured at this site from March 2007. In addition to the roughly 5,500 jobs planned on the works premises, more jobs are expected to be created in the surrounding area in the medium term.

The project management team already decided in the planning phase of the factory to develop and implement a facility management concept which was then new to the BMW Group. Major elements in this were the redefinition of the scope of BMW's own work and the establishment of system partnerships with qualified service providers for the entire range of operator tasks. Here, BMW was able to draw on many years of experience in the successful set-up of comparable models in the classic supplier industry.

In the model chosen, the role of a service partner goes well beyond the usual standard. The service provider assumes broad-based responsibility for all the facility management processes and, at the same time, has the task of controlling his work with a high degree of self-responsibility. The provider is therefore not only responsible for maintaining the installed functionalities and for smooth, cost-effective operations but, in the sense of a comprehensive partnership, is also involved in strategy and concepts with a view to achieving sustained management of the assets, i.e. investments, entrusted to him.

Moreover, the service partner also assumes joint responsibility for the factory's productivity. Together with the department responsible for overall management,

the provider ensures the commercial, technical and infrastructural facility management services for the in-house customers on the basis of service specifications, service level agreements and interface agreements.

In the last quarter of 2002 and therefore more than two years prior to the start of series production, the BMW team responsible for the project, comprising members of the works organisation and various central departments, started to sound out the market for potential service partners in Germany.

A key element in the selection process was a concept competition, which was conducted after an initial pre-selection and prior to the actual call for tenders. In addition to general proof of competence, the candidates had to develop their own approaches for the sustained management of the factory location in Leipzig.

By taking this new step for BMW, the client was putting its own concept ideas to the test by the potential service providers. On the other hand, the participants in the concept competition were given the chance to convince BMW not only with their price but in particular with their strategic and conceptual competence. Moreover, BMW placed special emphasis on capacity flexibility.

The concept competition ended with detailed presentations by the participants and intensive discussions. After another evaluation by BMW, the participants were short-listed for the actual call for tenders.

The dispatch of the tender documents in April 2003 and their subsequent processing by the participants was followed in the months thereafter by a detailed analysis phase. The key criteria for assessment were the quality of the documents, flexibility to changes in the call for tenders and plausibility of the overall bid with regard to professional/content and monetary aspects. After several negotiation meetings, the decision was taken in August 2003, just 9 months after the start of the project. In addition to a partner for infrastructural services, HSG Technischer Service GmbH, a wholly owned subsidiary of the Bilfinger Berger Multi Service Group, was chosen as the service provider for commercial and technical facility management.

Immediately after the decision to place the order, the first steps were taken to establish the future facility management community at the BMW factory in Leipzig in September 2003. HSG decided to use its own central start-up competence centre, which supported the new project manager and his team for roughly 10 months. The first key tasks for the team were not only to familiarise themselves with the factory processes and structures as quickly as possible but also the final acceptance and takeover of the facilities.

At the same time, a detailed description and reports were prepared for 23 individual project processes as the main contents of the project documentation; these were also supplemented by emergency plans. Furthermore, a quality management system was set up which was based on the HSG system but also took the statutory and BMW requirements placed on occupational safety and health and environmental protection into consideration.

Today's HSG project team with roughly 30 employees at the factory is responsible for commercial and technical facility management processes such as tenant support and space management as well as the maintenance, service, repair,

operation, management and energy management of all facilities. These are all part of the standard services it has to provide.

One key facility management function of HSG is the entire supply of energies and media. BMW decided to set up an energy centre in Leipzig into which electricity, gas and water are fed. The operational management of this energy centre including supervision and control of all the plants installed was transferred completely to HSG.

HSG is also responsible for the so-called help-desk: Here, appropriately trained staff deal with reports of faults of any kind around the clock every day of the year; orders to rectify the faults are generated and monitored until the fault has been successfully eliminated and feedback received.

For control purposes, BMW and its partners introduced a multi-stage communication model directly after the start of the project. In line with this model, regular management, control and operations meetings are held to deal with various issues. At the same time, a performance measurement and assessment system was developed on the basis of key performance indicators (KPI).

Selected functions, such as the help-desk, are assessed on a regular basis, for example with regard to the staff's communications skills, the quality of fault analysis and speed of handling. Additional factors are also plant availability and observance of the contractually agreed response times.

In its new factory in Leipzig, the car producer BMW opted for a facility management approach which was both innovative and trend-setting. The project was also a particular challenge for the service partner HSG. Roles and responsibilities had to be redefined and co-ordinated on both sides, detailed documentation prepared for all major processes, key performance indicators laid down and an extensive and intensively used communications network set up. These were the key factors to the success of the joint project.

For BMW the facility management concept at the Leipzig factory is also a strategic decision which will have a crucial impact on further developments in operational facility management within the BMW Group, also with regard to the ongoing discussion about a company's own core work.

Chapter 10 Public Procurement and PPP

I. Obligation to Issue Calls for Tenders

In Europe the individual states, state-controlled companies and enterprises which operate in special sectors (e.g. power and water supply, transport sector) are subject to European public procurement law for the procurement of building work and services if certain contract values are exceeded.

In Germany, European public procurement law (in particular EU directives and rulings of the European Court of Justice [*EuGH*]) is transposed into national law above certain contract values:

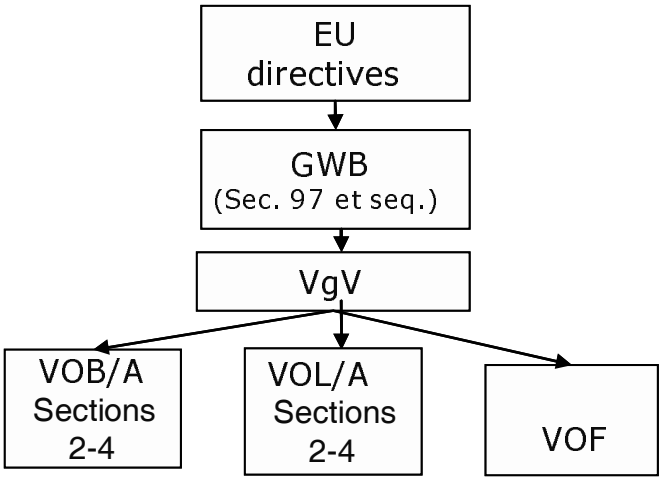


Figure 1. European and national public procurement law

The German Act on Restraints on Competition (*GWB*) regulates in Sections 97 et seq. who the public contracting entity is and stipulates the legal protection possibilities in the event of award infringements for contracts above the thresholds.

The Regulations on the Award of Public Contracts (*VgV*) stipulate the contract values above which the provisions of the GWB have to be observed and therefore

a pan-European call for tenders has to be issued (thresholds). Moreover, the VgV lays down which sections of the national Contracting Rules for the Award of Public Works Contracts (*Verdingungsordnungen* [*VOB/A, VOL/A and VOF*]) apply.

The provisions of European public procurement law, the Act on Restraints on Competition and the Regulations on the Award of Public Contracts do not have to be observed for contracts below the thresholds. National public procurement law in accordance with the Contracting Rules for the Award of Public Works Contracts applies here:

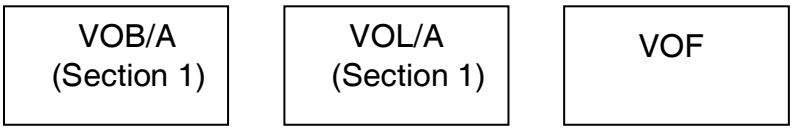


Figure 2. Contracts below Threshold

The procurement of building work and services is subject to a call for tenders if

- a public contracting entity awards
- a public contract.

The provisions of European public procurement law have to be observed for contracts above the thresholds. The national public procurement regulations have to be observed for contracts below the thresholds.

1. Public Contracting Entity

a) State Contracting Entities

The contracting entities which are part of the state are subject to the strictest obligations under public procurement law and they must observe Section 2 of the Contracting Rules for the Award of Public Works Contracts and the VOF (Contracting Rules for the Award of Contracts for Freelance Services) for contracts above the thresholds. For contracts below the thresholds these so-called institutional contracting entities are obliged, according to budget law, to apply Section 1 of the Contracting Rules for the Award of Public Works Contracts (basic paragraphs).

Below the thresholds, the nature of the contracting entity is solely governed by German budget law. According to this law, the contracting entities which have to observe the federal budget regulations and the state budget regulations must always issue a public call for tenders for contracts for work and services. The federal budget regulations and the state budget regulations must be observed by the following institutions:

- the federal and state governments and municipalities

- special funds of the federal and state governments and municipalities,
- public corporations and public law institutions.

b) State-controlled Contracting Entities

The legal persons under public and private law, which were established for the specific purpose of performing non-commercial tasks in the public interest and are managed or financed under state control, fall under Section 98, No. 2 GWB. Contracting entities under private law in accordance with Section 98, No. 2 GWB have to observe Section 2 of the VOB/A and VOL/A for contracts above the thresholds. There is no obligation to apply public procurement law to contracts below the thresholds

Legal persons under public law are public corporations, institutions and foundations having legal capacity. Organisational units which have partial legal capacity as well as private companies granted sovereign rights to perform services for the public do not fall under Section 98, No. 2 GWB. As regards the faculties of universities, Section 98, No. 2 GWB is to apply mutatis mutandis (cf. Boesen, Section 98, margin No. 34).

Legal persons under private law are, for example, stock corporations, limited liability companies, partnerships limited by shares, registered associations and co-operatives, mutual insurance companies and foundations having legal capacity. A company prior to registration, i.e. a company which is founded by a partnership agreement, subject to registration but not yet registered, is also a legal person under private law (cf. Boesen, Section 98, margin No. 37). Limited commercial partnerships and general commercial partnerships which do not represent legal persons are to be included in the scope of the provisions of Section 98, No. 2 GWB (cf. Dreher, DB 1998, 2579 et seq. [2580]; Boesen, Section 98, No. 39; contrary to the Brandenburg Contract Award Supervisory Office [VÜA], ruling dated 9 May 1996, 1st VÜA 3/96).

What tasks are in the public interest has to be determined on the basis of European Community law. Here, a difference must be made between public interests and private interests (so-called theory of interests). Public interest covers, for example, the services for the public, such as refuse collection. The fact that a task can also be performed by private persons does not conflict with the existence of a task in the public interest (cf. EuGH, ruling dated 10 November 1998, IBR 1999, 345). Public interest also exists when the state exerts influence on the discharge of the task in order to achieve political objectives.

The term non-commercial tasks must be interpreted on the basis of the provisions of European law. The purpose of this constituent fact is to exempt contracting entities from the form requirements of public procurement law which are already adequately controlled by existing competition. Established competition is therefore an indication of the commercial nature of the task and contradicts the applicability of public procurement law (cf. EuGH, ruling dated 10 November 1998, IBR 1999, 345). Other indications of the existence of a commercial task are, according to Dreher, (DB 1998, 2579 et seq.), the intention of recording a profit. On the other hand, an indication of the existence of a non-commercial task is

when economic mismanagement in performing the task would not result in the insolvency of the contracting entity. Another indication of the existence of a non-commercial task is when the costs which the contracting entity incurs in performing the task are covered by public funds regardless of the income recorded.

Section 98, No. 2 GWB can only be applied if the contracting entity had intended, at the time of establishment, to perform non-commercial tasks in the public interest. The purpose of establishment can be frequently concluded from the act of establishment (articles of incorporation, articles of partnership, statutes etc.). The tasks stipulated there alone are embraced by the purpose of establishment and govern whether the contracting entity satisfies the special purpose of establishment pursuant to Section 98, No. 2 GWB. By contrast, it is not sufficient if the contracting entity merely performs the non-commercial tasks in the public interest without these being embraced by the purpose of establishment (according to Boesen, Section 98, margin No. 58).

Section 98, No. 2 GWB also applies if the contracting entities are controlled by bodies in accordance with Section 98, Nos 1, 2 or 3 GWB in that these bodies supervise the appointment of the management or supervisory boards of the legal person or determine the bodies appointed for supervision. Section 17 AktG determines when such control exists. According to this, it is sufficient that the possibility of exerting such influence exists but it is necessary for this control to be secured on the basis of company law or by a control agreement. Indirect dependencies, e.g. in the form of loan or supply agreements, are insignificant. Control of the management or the supervisory bodies of the contracting entity exists when the representing and supervisory bodies prescribed by law or alternative bodies are controlled accordingly. If the client has several bodies, i.e. a management board and advisory board, it is sufficient for one of the bodies to be controlled.

A contracting entity is predominantly financed by bodies which fall under Section 98, Nos 1, 2 or 3 GWB when these bodies provide more than 50% of the total funds required by the contracting entity. The crucial factor is frequently the last financial year. Funding may be provided by means of equity, payments in kind, the provision of material, loans, shareholdings or subsidies. The provision of the majority of funds by the bodies mentioned in Section 98, Nos 1, 2 or 3 GWB also exists when not one but several bodies together contribute more than 50% of the funds required by the contracting entity.

There are differences of opinion regarding the following contracting entities as to whether they are to be classified as public contracting entities:

- Savings banks, regional banks and freely competing insurance companies fall under Section 98, No. 2 GWB according to the European Commission (also acc. to Franke/Häfler/Bayer, II.1 margin No. 23 et seq., old edition Boesen, Section 98, margin No. 70 et seq.).
- Radio stations under public law are subject to Section 98, No. 2 GWB (acc. to Reidt/Stickler/Glahs, Section 98, margin No. 33 et seq.; for the application of public procurement law Boesen, Section 98, margin No. 72).

- *Deutsche Post AG* falls under Section 98, No. 2 GWB (acc. to Boesen, Section 98, margin No. 77 et seq.; old edition Reidt/Stickler/Glahs, Section 98, margin No. 40).
- *Deutsche Bahn AG* falls under Section 98, No. 2 GWB (Boesen, Section 98 margin No. 81 et seq.; old edition Reidt/Stickler/Glahs, Section 98 margin No. 38 et seq.);
- *Deutsche Telekom AG* operates commercially and does not fall under Section 98, No. 2 GWB.
- Churches and religious communities do not fall under Section 98, No. 2 GWB (Boesen, Section 98, No. 86 et seq.; Reidt/Stickler/Glahs, Section 98,GWB, margin No. 36).
- Publicly funded housing associations must be viewed on a case-to-case basis, depending on the purpose of their establishment.
- Trade fair companies do not fall under Section 98, No. 2 GWB.

Note:
Annex I to the Construction Co-ordination Directive has an indicative effect in relation to the applicability to people of Section 98, No. 2 GWB. As a result, an assumption – to be rejected on a case-to-case basis – suggests that the legal persons mentioned in the German section of the directive, appendix I, are to be classified under national law as public contracting entities in accordance with Section 98, No. 2 GWB.
Legal persons under public law
The federal and state governments, municipalities, direct corporate bodies, institutions and foundations under public law, in particular in the following sectors:

Corporate bodies
- Technical universities and constituted students' organisations,
- Professional associations (chambers of lawyers, notaries, tax consultants, auditors, architects, doctors and pharmacists),
- Industrial associations (chambers of agriculture, crafts, industry and commerce, craft guilds, tradesmen's associations)
- Social insurance funds (health insurance funds, accident and pension insurance funds),
- Registered doctors' associations,
- Co-operatives and associations.

Institutions and foundations
The non-commercial facilities subject to state control and active in the public interest, in particular in the following sectors:
- Federal institutions having legal capacity,
- Welfare institutions and student welfare organisations,
- Cultural, welfare and aid foundations.

Legal persons under private law
The non-commercial facilities subject to state control and active in the public interest including the municipal utilities:

- Health service (hospitals, spa companies, medical research facilities, examination and animal cadaver disposal institutes),
- Culture (public stages, orchestras, museums, libraries, archives, zoological and botanical gardens),
- Social amenities (nursery schools, children's day centres, recreation facilities, children's homes and youth centres, leisure facilities, community centres, women's refuges, senior citizens' homes, accommodation for the homeless),
- Sports amenities (public swimming baths, sports grounds and facilities),
- Safety (fire brigades, rescue services),
- Education
- (Retraining, vocational and further training facilities, adult education centres),
- Science, research and development (major research facilities, scientific companies and associations, science advancement establishments),
- Waste disposal (road cleaning, waste and sewage disposal),
- Building industry and housing sector (urban planning, urban development, housing companies, accommodation search services),
- Economy (companies promoting economic development),
- Cemeteries and funeral directors,
- Co-operation with the developing countries (financing, technical co-operation, development aid, vocational training).

c) Contracting Entities with a State Function

Contracting entities in accordance with Section 98, Nos 1 to 3 GWB which pursue an activity in the field of drinking water supplies, ports or public commuter transport (so-called functional contracting entities) must observe the provisions of the 3rd Section of the VOB/A and VOL/A for contracts above the thresholds.

These include:

- Drinking water supplies: The provision and operation of fixed networks to supply the public in connection with the production, transport or distribution of drinking water as well as the supply of these networks with drinking water; this also applies if this activity is related to the discharge and treatment of waste water or to hydraulic engineering projects as well as irrigation and drainage projects provided the water volume intended for drinking water accounts for more than 20% of the total water volume made available by the project or irrigation and drainage facilities;
- Transport sector: The use of a geographically delimited area to provide transport companies involved in ocean-going and inland waterway transport with ports and other transport facilities.

- Transport sector: The operation of networks to provide the public with railway, tram and other rail services, in public transport with motorised buses and trolley buses, with cable cars and automatic systems. In the transport sector, a network exists if the transport services are provided on the basis of a requirement imposed by the authorities; this includes establishing the routes, transport capacities or timetables.

d) Sectoral Contracting Entities

Contracting entities which operate in the drinking water, power supply and air traffic sectors must observe the 4th Section of the Contracting Rules for the Award of Public Works Contracts for contracts above the thresholds.

Contracting entities in accordance with Section 98, No. 1, 2 or 3 GWB which pursue activities in the field of electricity and gas supply, heat supply and the supply of airlines must also observe the 4th Section of the Contracting Rules for the Award of Public Works Contracts. These include the following activities:

- Electricity and gas supply: The provision and operation of fixed networks to supply the public in connection with the generation, transmission and distribution of electricity or the production of gas and the supply of these networks with electricity or gas by companies;
- Heat supply: The provision and operation of fixed networks to supply the public in connection with the generation, transmission or distribution of electricity or the production of gas as well as the supply of these networks with electricity or gas by companies.

In addition, the classic sectoral contracting entities according to Section 98, No. 4 GWB must also apply the 4th Section of the Contracting Rules for the Award of Public Works Contracts. Contracting entities according to Section 98, No. 4 GWB are natural or legal persons under private law which are active in the field of drinking water and energy supply or transport or telecommunications if these activities are pursued on the basis of special or exclusive rights or if contracting entities according to Section 98, No. 1, 2 or 3 GWB can exert a controlling influence on this natural or legal person under private law, either individually or jointly.

Former municipal companies which now operate in a private legal form to provide services to the public are covered by the wording of both Section 98, No. 2 and Section 98, No. 4 GWB (for example, municipal transport companies in a private legal form, subsidiaries of Deutsche Bahn AG etc.). According to the prevailing opinion, Section 98, No. 2 GWB takes priority, as a lex specialis, and so contracting entities which fall under both Section 98, No. 2 and Section 98, No. 4 GWB have to observe the stricter provisions of the 2nd Section.

A special or exclusive right exists if the sectoral contracting entity is permitted to pursue a certain activity on the basis of a single-case decision by an authority on the basis of a corresponding law. The following in particular are viewed as exclusive or special rights:

- Right to perform the activity due to a licensing agreement (for example acc. to the German Passenger Transport Law);
- Administrative act to supply the population of the municipality with drinking water on the basis of an ordinance;
- Permission to supply the population with electricity or gas on the basis of an express permit acc. to Section 3 EnWG (Energy Industry Act);
- Supply of heat to the population on the basis of a corresponding municipal ordinance or by-law;
- Special rights in the field of transport in connection with the obligation to obtain a permit under Section 2, Section 9 et seq. PBefG (Passenger Transport Act) and Section 5 AEG (General Railway Act);
- In the telecommunications sector the special rights are granted by issuing a licence in accordance with Sections 6, 8 TKG (Telecommunications Act).

If the sectoral contracting entity is controlled by other contracting entities within the meaning of Section 98, No. 1, 2 or 3 GWB, this entity is also covered by Section 98, No. 4 GWB and must apply the provisions of the 4th Section of the Contracting Rules for the Award of Public Works Contracts. To this extent, reference is made to the above statements on control.

2. Public Contract

According to Section 98, para. 1 GWB, public contracts are supply, construction or service contracts in return for payment between public contracting entities and companies. The crucial feature is that the work or services are provided on the basis of a contract in return for payment between two different legal persons. The following procedures are also regarded as public contracts:

- Prolongations of and supplements to contracts
- Conclusion of framework agreements
- Public tendering procedures and competitions, in particular in the fields of regional development, urban planning, architecture, the construction industry and data processing
- Conclusion of partnership agreements
- Granting of service licenses
- In-house transactions unless both contracting parties are 100% publicly owned
- Inter-municipal co-operation
- Participation of private persons in publicly controlled companies if contracts are acquired as a result.

If the contractual relationship relates to the construction and planning of building structures, building projects or building work/services, the VOB/A applies to the organisation of the award procedure. All other contracts fall under the VOL/A. One exception applies to work/services which cannot be described clearly and exhaustively in advance: Here, the call for tenders must be made in accordance

with the provisions of the VOF (for example, creative planning and engineering work etc.).

3. Thresholds

The contract value is crucial for answering the question as to whether a pan-European call for tenders must be made or whether, if applicable, only a national call for tenders has to be made or no call for tenders at all. In case of doubt, all work which is to be the subject matter of the contract is to be included in calculating the contract value. This applies in particular to:

- Fixed-term contracts: All work which can be ordered and received during the term of the contract is to be allowed for in this case.
- Framework agreements
- In the case of batch contract awarding, the value of all batches is to be added up
- If optional work is provided for, its value must also be allowed for in the calculation of the contract value.

The net prices are crucial in each case. A pan-European call for tenders is necessary in Germany if the following contract values are exceeded:

Table 1. net prices

	VgV Germany
Supply and service contracts	**€ 211,000** (Sect. 2, No. 3)
Construction contracts and construction licenses	**€ 5,278,000** (Sect. 2, No. 4)
Supply and service contracts in the field of drinking water supply, in the energy and transport sectors	**€ 422,000** (Sect. 2, No. 1)

4. Exceptions

In exceptional cases there is no need for a call for tenders even though a public contracting entity is awarding a public contract. For contracts above the thresholds, these exceptions are regulated in Section 100, para. 2 GWB and cover the following cases:

- Contracts of international organisations
- Contracts which are declared to be **secret** in compliance with the statutory and administrative regulations of the Federal Republic of Germany
- The awarding of contracts to public contracting entities which have a state monopoly

- Land purchase contracts or leases for land or existing buildings and the corresponding right to land or existing buildings (inheritable building rights etc.)

Exceptions to the obligation to issue calls for tenders are therefore also contracts involving the letting or acquisition of real estate. If an existing building is let or sold, there is no need for a call for tenders. However, the situation is different when the contractor is obliged to first erect the building structure to be acquired in accordance with individual specifications of the contracting entity (contract with a property developer). In such cases the entire contract – sale and erection of building - are subject to a call for tenders.

Moreover, according to rulings of the European Court of Justice (*EuGH*), contracts between a public contracting entity and a legal person who is legally different from this entity are not subject to calls for tenders if the contracting entity exerts the same control through the subsidiary as through one of its own branch offices and the subsidiary largely pursues its activities for the public contracting entity (in-house award). Another crucial factor is that the subsidiary is wholly publicly owned: Any participation of whatever nature by a private company means that this is not an in-house transaction exempt from calls for tenders. As a result, the latitude for an in-house award without a call for tenders has been considerably restricted by the new ruling of the EuGH (EuGH, ruling dated 11 January 2005, IBR 2005).

II. Award Procedures

Procurement requiring calls for tenders is subject to strict form requirements. Procedural irregularities on the part of the award office may lead to the entire call for tenders being terminated and re-started. Procedural irregularities frequently arise in practice in the following situations:

- Assessment of the obligation to issue calls for tenders
- Calculation of the threshold
- Wording of the announcement
- Lack of notification of the suitability and award criteria and their importance
- Selection of the type of procedure
- Form of the tendering documents
- Correspondence with tenderers
- Extension of time limits
- Reaction to procedural complaints
- Examination of tenders
- Assessment of tenders
- Wording and dispatch of preliminary information
- Documentation/Award file

Infringements of the form requirement by the tenderers may result in their participation application or their tender having to be excluded from the assessment. Participation applications and tenders must be excluded from the assessment in the following circumstances:

- Deadlines set by the award office are not observed
- Missing or ineffective signature
- Missing or incomplete details, the inclusion of which was made mandatory by the award office
- Deviations from specifications made mandatory by the award office.

Court rulings are becoming increasingly stricter as regards the form requirements placed on participation applications and tenders: If any mandatory detail is missing, even if it is only the indication of a product as part of the bill of quantities, this results in mandatory exclusion of the tender. The tenderer is therefore well advised to complain to the award office if the tendering documents make it more difficult for him or even prevent him from preparing a tender. This applies mutatis mutandis if, from the tenderer's viewpoint, the tendering documents contain unacceptable risks, for example with regard to the spreading of risk or in the specifications. Such a complaint not only means that the award office might correct its mistake. Such a complaint is also required from a procedural point of view in order to maintain the possibilities of legal protection. If the tenderer fails to complain, he then has no possibility of going to the award panels and acquiring the contract by legal procedure.

It is also necessary for the tenderer to report any objections immediately, i.e. without a culpable delay, to the contracting entity. An upper limit of one week is set as the reference value for this immediacy (Dresden Higher Regional Court, ruling dated 6 April 2004, IBR 2004, 454). Infringements which are obvious from the announcement must also be reported without delay, but no later than the time of submission of the participation application or the tender (Section 107, para. 3, sentence 2 GWB). Otherwise a complaint is excluded (preclusion).

The complaint does not have to have any particular form but should be made in writing so the tenderer has proof that he has complained. A fax is sufficient.

1. Types of Call for Tenders

Three different sets of contracting rules apply to the awarding of public contracts: the VOB/A for awarding contracts for construction work, the VOL/A for awarding contracts for other work and supplies and the VOF for awarding contracts for freelance services.

Whereas the calls for tenders for construction work according to VOB/A and the calls for tenders for other work and supplies according to VOL/A are more or less the same, contracts for freelance services are all awarded in a negotiated procedure. The differences between the types of procedure are as follows:

In the open procedure, which is called a public call for tenders for the award of national contracts, an unlimited number of companies from all member states of

the EU may participate in the call for tenders. The companies usually request the tender documentation on the basis of the announcement (these documents are to be issued free of charge by the award office) and they submit a tender on this basis. The suitability of the tenderer and his tender are assessed by the award office as part of the tender review. The open procedure must be pursued unless, as an exception, the restricted procedure, the negotiated procedure or the competitive dialogue procedure is admissible.

The restricted procedure (restricted call for tenders) is admissible if, for example, only a limited group of companies is at all suitable to perform the work involved or if the implementation of an open procedure has not produced any acceptable result. The restricted procedure comprises two stages: It consists of a public participation competition in which the suitability of the tenderer is reviewed with regard to expertise, efficiency and reliability on the basis of the publicised participation criteria. In the second stage, the selected participants are requested to submit a tender. This tender is then assessed on the basis of the publicised award criteria. The tenderer who has submitted the most economic tender on this basis is awarded the contract.

As an exception, a negotiated procedure (discretionary award of contract) is permitted if, for particular reasons (i.e. patent protection, special experience or equipment), only one company can be considered for performing the work or if the work cannot be clearly and exhaustively defined prior to the award of the contract. The negotiated procedure is regarded as admissible especially in the area of complex PPP projects. The negotiated procedure also involves two stages in which tenderers are requested to submit a tender after the participation competition has been held. In contrast to the restricted procedure, it is admissible within certain limits in a negotiated procedure to negotiate the contents of the work and the price. Moreover, the award office can decide on the structural organisation of the procedure – regardless of the principles of equal treatment and transparency. For example, the award office can organise the procedure in such a way that it can continue to negotiate with all tenderers until an optimum result is achieved (parallel strategy) or it can organise the procedure so that it only negotiates with a few or even just one tenderer on the work and price (linear strategy). The tenderer has no right to negotiations. However, the award office is limited in its powers of negotiation in that it must inform all tenderers of the progress of the procedure. Moreover, major changes to the work itself may not be made. Major is understood to mean, for example, changes to the subject matter of the contract which increase or decrease the work volume by more than 10%.

2. Time Limits

The entire award procedure is not only subject to strict form requirements but also strict time limits. Depending on the type of procedure, the tenderer is given a period of 37 calendar days to prepare the participation application. To prepare the tender, the tenderer is given a period of up to 52 days or – in the case of complex

PPP projects even longer in certain cases. The following time limits must be observed in each case:

Table 2. Award procedure (*VOB/A*)

Open procedure	**Contract award announcement**	**Tender period** 52 days		**Opening date**	**Award period** 30 days	**Contract award**
Restricted procedure		**Application period** 37 days	**Tender period** 40 days		**Award period** 30 days	
Negotiated procedure		**Application period** 37 days	**Tender period** to be determined by negotiation		**Award period** as short as possible	

Table 3. Award procedure (*VOL/A*)

Open procedure	**Contract award announcement**	**Tender period** 52 days		**Opening date**	**Award period** as short as possible	**Contract award**
Restricted procedure		**Application period** 37 days	**Tender period** 40 days		**Award period** as short as possible	
Negotiated procedure		**Application period** 37 days	**Tender period** to be determined by negotiation		**Award period** as short as possible	

Table 4. Award procedure (*VOF*)

Negotiated procedure	**Contract award announcement**	**Participation competition** 37 days	**Contract award**

The time limits are indicated in the announcement and, if the tenderer considers them to be too short, he must complain immediately. Application and tender periods which are too short mean that the entire call for tenders is contestable.

3. Suitability Review

Public contracts may only be awarded to tenderers who have proven their expertise, efficiency and reliability. The criteria which the applicant must fulfil must be contained in the announcement. It should also indicate what significance these criteria have in the assessment of suitability.

The review of expertise must focus on determining whether the tenderer has the necessary know-how, experience and skills to perform the contract work. Specific experience with comparable projects, for example, is of crucial importance and so the client frequently requests proof of reference projects.

The efficiency of a tenderer is determined by whether he has the technical, commercial, manpower and financial resources necessary to perform the work involved professionally and to schedule. For example, he must explain that he has the necessary equipment and tools. From the commercial aspect, it is necessary for the company to be properly run as a commercial enterprise. Manpower efficiency is to be assumed if the tenderer's company has enough of its own suitably skilled employees; companies which do not have their own workforce and have all work performed by subcontractors (so-called prime contractor) have to verify, as part of the participation application, that they have direct access to subcontractors and that the latter are suitable in line with the announcement.

The crucial aspect in the review of the reliability of the tenderer is whether he has discharged his statutory obligations and whether faultless performance of the work including the warranty can be expected. The tenderer must be assumed to be unreliable if he can be accused of serious misconduct, criminal acts, bribery, illegal employment, failure to pay taxes and duties properly. Any entry in the

corruption register of the federal state in question also means that a tenderer cannot be regarded as being suitable.

In order to simplify the suitability review for standard contract awards, the award offices have been given the possibility of obtaining information on the suitability of tenderers as part of a standardised pre-qualification procedure. The companies which want to apply for standard public contracts can prove their suitability at one of the approved pre-qualification offices. If a company proves its pre-qualification by reference to its entry in the list of the association for pre-qualification, the following suitability criteria are fulfilled:

- Proof of registration as a business and entry in the commercial register or professional register
- Proof that there are no entries in the central business register
- Proof that there is no entry in the state corruption register
- Proof of the total turnover
- Proof of the performance of work in compliance with orders

The entry can be called up at www.pq-verein.de.

As part of the suitability review, the award office must check to determine whether the applicant has submitted all the documents evidencing proof of suitability demanded in the announcement or the tendering documents or is to be regarded as suitable due to an appropriate entry in the pre-qualification register. If one of the documents evidencing proof of suitability is missing, the applicant must definitely be excluded from further assessment. The award office has no discretion whatsoever in its review of completeness. The award office merely has some latitude in its assessment as part of the review of the suitability. It can assess on its own responsibility and on the basis of the criteria previously publicised which applicant is more or less suitable. A court may only review the latitude for assessment to the extent that it may examine whether the award office was guided by motives unrelated to the contract award or made an arbitrary decision. For example, the assessment of aspects unrelated to the contract award is inadmissible. The following in particular are deemed to be aspects unrelated to the contract award:

- Location of the company's registered office (local company)
- Restriction of the applicants to certain groups of people
- Scientology declaration if the contract involves work which is not influenced by membership of the Scientology sect
- Environmental criteria are now regarded as admissible award criteria if they can be objectified and their compliance can be verified.

4. Submission

Tenders are submitted on expiry of the tender period. A submission report to be prepared by the award office lays down which tenderers have submitted tenders on time and what conditions these tenders contain. The submission date is made public as part of the open and restricted procedures. Tenderers and subcontractors may participate. By contrast, the submission date is not publicised in the negotiated procedure and in the field subject to the VOL/A.

5. Tender Examination

After the opening date, the tenders are examined. This comprises the form examination and the factual examination.

The examination of compliance with form requirements comprises the following points:

- Was the tender submitted on time?
- Is the tender signed with legal effect?
- Does the tender contain all the mandatory documents and declarations?
- Did the tenderer make any inadmissible changes to his entries?

If the tenders do not fulfil the above-mentioned conditions, they are definitely to be excluded by the award office.

The mathematical and technical aspects of the tender are checked as part of the factual examination. The aim of the mathematical examination is to determine whether the amounts entered by the tenderer in his tender have been calculated correctly. The award office can make corrections here if there are any mathematical errors. If, on the other hand, the tenderer has costed his tender incorrectly, no corrections are admissible. The tenderer is bound by his tender in the event of a miscalculation.

If a tender contains a large number of mathematical errors, this may result in the tenderer being excluded from the assessment owing to unsuitability.

The tender must also be excluded if it can be seen from it that the tenderer has given so-called mixed prices for the items requested.

6. Tender Assessment

The tender is assessed in four stages:

1st stage: Formal examination
2nd stage: Suitability examination
3rd stage: Examination of the reasonability of the prices
4th stage: Determination of the most economic tender

After the formal examination of the tenders and the suitability examination (see section 2.3 above), the award office has to assess whether the prices quoted by the tenderer are reasonable. The contract must not be awarded to a tender with an unreasonably high or low price. An unreasonably low price is, for example, when the price is more than 10-15% under the costing of the award office or the tender of the next lowest tenderer. If the award office discovers such an undercut, it must hold talks with the tenderer to clarify whether his tender is nevertheless reasonable. If the tenderer cannot provide any proof of the reasonability of his tender, for example by submitting the original calculation etc., he is to be excluded from the further procedure.

The contract is to be awarded to the most economic tender with due consideration for the publicised award criteria and their importance. The award office may select criteria which are important for the performance of the work (e.g. prices, design, technical quality and the like) and give these criteria different weightings in an assessment matrix. However, the price must make up at least 30% of the total number of points that can be attained.

7. Informing the Tenderers

On conclusion of the tender examination and assessment, the award office must inform the tenderers whose tenders are not to be accepted. In accordance with Section 13 VgV, the tenderers who have lost the contract are to be notified of the name of the tenderer whose tender is to be accepted and the reason why their tender is not being considered. This information for the tenderers is to be dispatched in text form no later than 14 calendar days prior to the contract being awarded. It is recommended to send this information to the tenderers who have lost the contract in advance by fax so that there is proof of notification.

A contract which is concluded without the tenderers being informed or before the expiry of the period of 14 calendar days is null and void.

8. Contract Award

The award office must award the contract to the most economic tender. The crucial factors for the question as to which tender is the most economic are the award criteria publicised in advance by the award office.

When the contract is awarded, a legally effective contract comes into effect between the award office and the tenderer who has submitted the most economic tender. The situation is slightly different when, for example, the tender of the tenderer or the award documents have been changed in the negotiated procedure. In this case, it is necessary for the tenderer to confirm separately that he accepts the contract award.

III. Legal Protection

1. Contracts Below the Thresholds

In the case of contracts below the thresholds, those involved in the award procedure only have limited legal protection at their disposal in the event of procedural infringements by the award office. Procedural irregularities can frequently only be pursued with the aim of claiming damages for unnecessary tender costs (negative interest). Any claims for damages above and beyond this due to lost profit are subject to strict obligations to show cause and produce evidence. For example, it must in particular be shown that, if the procedural irregularity had not occurred, the contract would have been placed with the claimant.

In addition to claims for damages, it is possible to appeal to the legal and professional supervisory body of the award office and to lodge an appeal for administrative review with the administrative supervisory authority. However, the tenderer has no entitlement to have any action taken in response to such an appeal.

Therefore, the tenderers frequently do not have a possibility under national law, in the case of contracts below the thresholds, to legally enforce a claim to be awarded the contract. According to a ruling of the Federal Constitutional Court (*BVerfG*) (ruling dated 13 June 2006, IBR 2006, 684), this can be reconciled with the Basic Law.

The prevailing opinion is that recourse to the ordinary courts is possible for disputes in award procedures relating to contracts below the thresholds (Berlin-Brandenburg Higher Administrative Court, ruling dated 28 July 2006, IBR 2006, 1413; in the opinion of the Lower Saxony Higher Administrative Court, ruling dated 14 July 2006, IBR 2006, 631, on the other hand, recourse to the

administrative courts is possible). However, the trend - even after the cited ruling of the Federal Constitutional Court – is to choose legal recourse to the civil courts for legal disputes in award procedures for contracts below the thresholds.

2. Contracts Above the Thresholds

By contrast, in the case of contracts above the thresholds, the tenderers have the possibility of demanding that the contract be awarded to them by initiating a review procedure with the regional award panels responsible.

An application for review is admissible if the tenderer has explained that his rights have been injured by a procedural infringement by the award office. It is also necessary for the tenderer to have immediately made a submission to the award office.

The award panel has to make a decision on the review application of the tenderer within a period of five weeks. The award panel decides on the basis of the award file sent to it by the award office. This file must document in detail the entire procedure as well as all important decisions (selection of the type of award, choice of the applicants, selection of the tenderers, tender assessment etc.). Documentation errors may mean that the entire call for tenders has to be cancelled. The award panel determines the facts of the case ex officio and is entitled to establish to whom the contract has to be awarded if public procurement law is correctly applied. In the event that the award error cannot be otherwise rectified, the award panel is also entitled to demand the cancellation of the call for tenders.

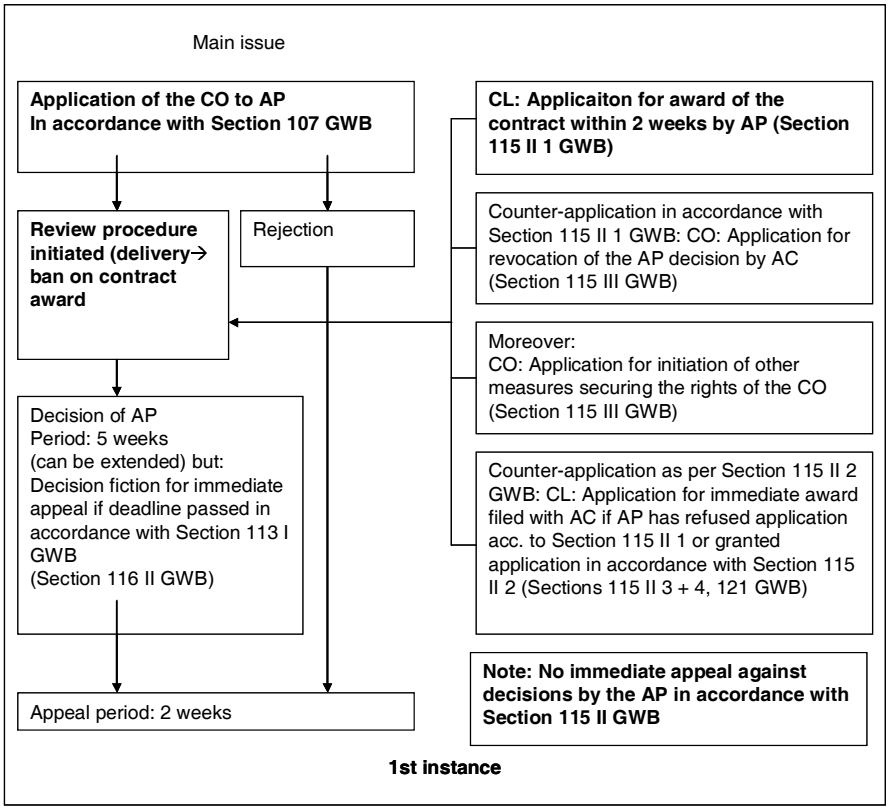


Figure 3. Contracts above the Threshold (1st instance)

It is permitted to lodge an immediate appeal against the decision of the award panel with the local Higher Regional Court responsible within a period of two weeks from delivery of the decision. The immediate appeal must be submitted in writing and substantiated by a lawyer registered at the Higher Regional Court. The Higher Regional Court reviews the entire procedure on the basis of the briefs submitted, the decision of the award panel and the award file. The principle of ex officio examination (*Amtsermittlungsgrundsatz*) also applies before the Higher Regional Courts in matters of contract awards.

Both the filing of a review application and an immediate appeal means that the award office may not award the contract for the duration of the procedure (suspensive effect).

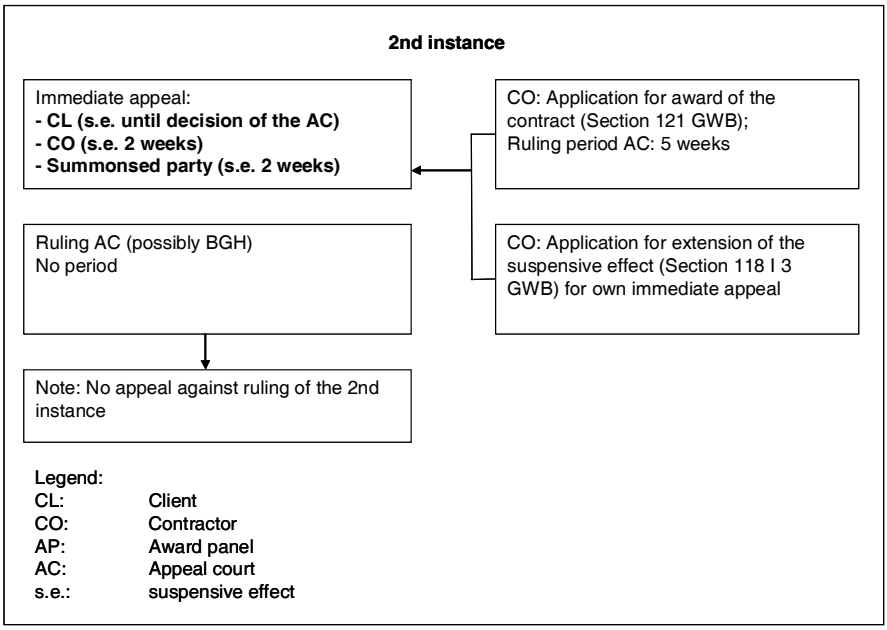


Figure 4. Contracts above the Threshold (2nd instance)

There is no appeal against the decision of the appeal court. In exceptional cases, however, the filing of a constitutional complaint may be admissible, for example if, from the viewpoint of one party, the application is rightly seen as inadmissible and therefore the legal protection as a whole is frustrated.

If an appeal court makes a different ruling to that of another Higher Regional Court, it must make a submission to the Federal Court of Justice (*BGH*). The BGH decides in this case on the complaint itself or returns it to the Higher Regional Court.

Moreover, the tenderers may assert claims for damages. Here, reference is made to the statements on legal protection for contracts below the thresholds.

IV. Risk of Public Procurement Law

There are numerous sources of error in a public call for tenders both for the tenderers and the award office. Thus a careful examination must be made at the start of the conception of the project to determine whether regulations relating to public procurement law have to be observed during its implementation. Otherwise, there is a risk that the procedure as a whole will be performed on the basis of ineffective contracts (so-called de facto award without a call for tenders) or it may be contested by companies passed over in the procedure. This may not only result

in claims for damages but also cause major delays due to the conductance of review procedures. A careful examination based on public procurement law is therefore indispensable for successful project implementation.

Chapter 11 German Tax Environment of Real Estate

I. The Scope of German Taxation

The taxation basis for income derived from real estate property in Germany is determined in accordance with the provisions of German Income Tax Law. The taxable income may result from current income or capital gains and is levied irrespective, whether the owner is a private individual or a company, resident or non-resident in Germany.

According to the German Income Tax Act (ITA-*Einkommensteuergesetz*, *EStG*), non-residents are basically liable to federal German income tax only on their German source income, which includes the income derived from real property situated in Germany. Non-residents are thus referred to as having a "limited income tax liability".

Additionally, according to the German Trade Income Tax Act (TITA - *Gewerbesteuergesetz*, *GewStG*), non-resident taxpayers deriving income through a permanent establishment, are subject to local tax as well. The international tax treaties concluded by Germany with various countries, provide that the right to tax income, derived from such real property, lies with Germany (see also Art. 6 of the OECD-Model Convention).

Indirect tax regimes, such as Value Added Tax (VAT) and Real Estate Transfer Tax (RETT) apply to transactions, involving or relating to German real estate. Annual land tax is payable to the city, in which the real estate is located in Germany.

II. Tax Types

1. Income Tax (Individual and Corporate)

a) Resident Companies

German income taxation mainly depends on the status of the taxpayer as well as on the category of income, derived from an activity.

The status of a partnership (such as companies under civil law “GbR”, general commercial partnerships “OHG”, and limited commercial partnerships “KG”)

does not constitute the company to be a taxable entity for income tax purposes. The income of a partnership is attributed directly to the individual partners and taxed on their level according to the ITA. However, a partnership is usually treated as a taxable entity for trade tax purposes.

Legal entities, in particular corporations (such as a limited liability company "GmbH", stock corporation "AG" and commercial partnerships limited by shares "KGaA", which have their seat or place of management in Germany, are taxable entities at the level of the company and referred to as having an "unlimited tax liability" in Germany. This means that their worldwide income falls within the scope of the German Corporate Income Tax Act (CITA - *Körperschaftsteuergesetz, KStG*) in conjunction with the ITA. This applies also to foreign legal entities, which have their seat or place of management in Germany.

Note: Activities, which are tax exempt and which could be of interest for a real estate investment are, e.g., public, political, welfare, certain health, insurance and pension funds. Currently, this exemption applies to German institutions only, which, however, this may violate EU law.

German Income Tax Law differentiates between 7 categories of taxable income. For real estate related transactions the differentiation between

- business income (*Einkünfte aus Gewerbebetrieb*) and
- rental income (*Einkünfte aus Vermietung und Verpachtung*) and
- other income (*Sonstige Einkünfte*), in particular capital gains

is of essence.

Business income: Income is classified as "business income" either by statutory definition or by judgment of the nature of the activity.

Business income is given, if the real estate activity exceeds the mere letting of land and building. Further, business income is in particular assumed, in case more than three (small) real estate units are purchased and sold within 5 years (e.g. developer; for more details please refer to Chapter 12, IV. 1. a) below).

Corporations, which, under civil law, have to comply with the accounting requirements contained in the German Commercial Code (CC – *Handelsgesetzbuch, HGB*), particularly the GmbH or AG, derive business income by statutory definition, regardless of whether their actual activities can be characterized as a business activity or not.

Generally, partnerships, such as the OHG, KG or GbR generate rental income and not business income, as long as their activities are restricted to the mere holding and administration of real estate (*Vermögensverwaltung*).

In the following cases, exceptions apply:

- A GmbH & Co. KG, a commonly used partnership form, is deemed to generate business income.

- In case a partnership pursues several activities and any one of these is judged as being a business activity, it is most likely that the entire income of the partnership will be deemed as business income.
- Limited partnerships –KG's-, where the limited partners are not authorized to manage the partnership and the general partners consist exclusively of corporations, are deemed to generate business income, even if they do not pursue business activities.

Business income is generally determined on an accruals basis (*Betriebsvermögensvergleich*) and includes also capital gains and capital losses. The income is attributed to the year to which it economically belongs. Accounting records must be kept and financial statements must be prepared.

Starting point for the determination of the taxable income is the income reported in the German GAAP single financial statements. As a basic rule, all expenses relating to the business can (immediately) be deducted, unless they constitute acquisition or construction cost. In these cases, they have to be capitalized.

Practical Advice: Due to the minimum taxation rules applicable (see below), it has to be carefully observed to exercise all election rights provided by the German GAAP in such a way that income is generated in the year, in which loss carry forwards can be fully utilized. Therefore, it may recommendable to qualify certain costs not as business expenses (immediately deductible) but as acquisition, or in particular, erection costs (depreciated over a certain period) .

As a next step, some still relatively few adjustments have to be made, in order to bring the figures according to German GAAP in line with the tax accounting rules.

The taxpayer's income basis can be reduced by deductible expenses connected to real estate. These are depreciation of buildings allowances, repair, maintenance and financing costs, e.g., interest expenses on loans taken out to finance the acquisition of the real estate (please refer to Chapter 12, V. 1. c) for more details)..

Most tangible and intangible fixed assets are regularly depreciable, except for land. The regular depreciation rules are described in more detail under Chapter 12, I. 1. a), cc).

However, in the exceptional case, in which the property is held as current asset, these depreciation rules are basically not applicable. It is extremely difficult to get extraordinary depreciations acknowledged and recaptures might become necessary.

The corporate income tax rate applicable since 2001 amounts to 25 % (it is proposed to lower this rate from 2008 onwards to 15 %). In order to finance the German unification costs, an additional 5.5 % solidarity surcharge is still levied

on the corporate and/or income tax payable, leading currently to an effective corporate tax rate of 26.375% (as of 2008 15.825 %).

Trade Tax, which is levied on business income of resident corporations and partnerships (and of non-resident companies, deriving income through a permanent establishment) amounts currently to around 20 % and shall be reduced to about 15 % from 2008 onwards as well. However, it is possibly then no longer deductible for its own calculations and for corporation tax purposes (see below under 2.2).

Overall, the effective tax rate (including trade tax) could be reduced for corporate taxpayers from currently around 40 % to around 30 % as of 2008, whereby trade tax constitutes around half of this decrease.

Income and trade tax prepayments are required to be made each quarter throughout the business year, usually based on the last annual assessment.

Tax returns have to be filed annually, generally not later than 5 months after the calendar year end or within an extended period upon application (tax consultants are normally granted a 12 months filing time). The tax will then be assessed by the authorities based on information provided in the tax returns and will become payable one month after the tax assessment is issued at the latest. The tax assessment is usually made under reservation of reexamination (*Vorbehalt der Nachprüfung*). A final assessment is often issued only after an external audit of the financial authorities has been executed.

The statute of limitations' period is 4 years and commences to run from the end of the calendar year, in which the tax return has been filed with the tax authorities. This period of 4 years may, however, be extended to 5 or 10 years in case of tax fraud. After expiration of the limitation period, the tax assessment cannot be altered, rectified or rescinded.

For income tax purposes, losses suffered by companies (also through participations in transparent partnerships) may either be carried back for one year (maximum limit of Euro 511,500) or carried forward with the following restrictions under the "minimum taxation rules" (*Mindestbesteuerung*):

While the first Euro 1 million of loss carry forwards may be offset in full against the taxable income of a subsequent year, the taxable income in excess of this figure may only be offset with losses to the extent of 60 %. As a result, a minimum of 40 % of the income exceeding Euro 1 million is subject to taxation..

Note - Special rules for partnerships: For limited partners of a partnership, special rules apply insofar as the losses, generally those in excess of the equity, can only be carried forward unrestrictedly on the level attributable to the partnership level, i.e., they cannot be used to balance other German taxable income of the limited partner or trade tax income of another partnership of the same partner.
Note - Special rules for changes in the ownership of shares in a corporation: the CITA currently prohibits the utilization of loss carry forwards of a company, if both of the following conditions are fulfilled:

- There is a change of direct shareholding of more than 50% and
- The company continues its business with predominantly new asses (broad ly speaking an injection of assets, leading to a doubling of the assets).

However, the German Federal Fiscal Court (*Bundesfinanzhof, BFH*), stated in a recent decision that the 5 years threshold is not applicable and only the continuation of the business with predominantly new assets within 3 years would block the utilisation of losses. However, the tax authorities expressed their firm opinion to apply the 5 years threshold regardless of the court decision.

The legislator is in the process to change the law as of 2008.

For transactions conducted after January 1st , 2009, the rule shall be as follows: a direct of indirect transfer of more than 50% of the shares will trigger a complete elimination of all loss carry forwards. If an acquirer or related person acquires within a period of 5 years more than 25 % in the target entity -directly or indirectly-, the loss carry forward is lost in the same ratio.

Tax losses are also lost, in case a company is merged or transformed into a partnership.

For trade tax purposes, losses can also be carried forward but not carried back. The relief for loss carry forwards follows the income tax rules. Accordingly, the maximum loss, which may be offset in any one year, is restricted to Euro 1 million plus 60 % of the amount exceeding Euro 1 million.

German tax regulations require that inter-company transactions comply with arms' length principles, in order to be accepted for tax purposes (please refer to Chapter 12, V. for more details). Otherwise, the transaction may be considered as hidden profit distribution, leading to additional tax payment.

For example: in case the compensation paid by a German subsidiary to its foreign parent company exceeds the amount, which would have been paid to an independent third party, the excess amount is considered to be a hidden profit distribution.

Such a constructive dividend is non-deductible in determining the subsidiary's taxable income.

Practical Advice: in case a hidden profit distribution has been assessed, the competent authority conflict rules (*Verständigungsverfahren*) might grant relief.

There are detailed transfer pricing documentation obligations, which will have to be observed in order to avoid the assumptions of constructive dividends/hidden profit distributions as well as the imposition of penalties for failure to comply. More specifically, failure to produce the necessary records in a satisfactory man-

ner within 60 days of a request by the tax authorities may trigger the following sanctions in addition of a correction of the taxable income:

- refutable presumption that the income was underreported and entitling the tax authorities to estimate the income at the less favourable end of the price range;
- penalties in the amount of 5 % to 10 % of the additional income and
- penalties for delayed production of documents up to a maximum fine of Euro 1 million.

Further, dividend withholding tax at a standard rate of 20 % (from 2009 onwards envisaged at 25 %) plus 5.5 % solidarity surcharge on the 20 % (effectively 21.1 %) may be levied on distributions of resident corporations to their foreign shareholder, whereby the international Double Taxation Agreements (DTA) may lead to reduced rates.

> **Practical Advice:** A refund of the tax withheld is possible. It is also possible to apply for a certificate, enabling the immediate application of the treaty rate. This application must be filed before the dividend is paid. The treaty benefits are not granted under German domestic law in case of so-called “treaty shopping"!

Rental income: Private individuals and, as mentioned above, partnerships, generate rental income, which is taxable at the individual income tax rate. An exemption is applicable for private housing. This is deemed as a non-taxable activity, as long as the rent is below 56% of the market rent. In case rental income is between 75 % and 56% of the market rent, it is deemed that there is partly taxable income generated with a proportional disallowance of expenses. In case the rent exceeds 75% of the market rent, the entire income is subject to taxation.

Further, in contrast to business income, rental income is determined on a cash basis (*Einnahmen-Überschuss-Rechnung*). Accordingly, income and expense must be reported in the calendar year in which it is received or paid respectively. There are rather generous regular depreciation allowances on the building (please refer to Chapter 12, I. 1. a), cc) for more details)

Other income: If a corporation, other than a *Kapitalgesellschaft*, such as an association or a public law corporation, earns capital gains upon sale, these are taxable within the income category called other income (*Sonstige Einkünfte*) under certain conditions only. These are the same rules as for private individuals earning rental and not business income.

Capital gains are taxable only, in case the income is derived from the disposal of major real estate within 10 years of the date of acquisition of the property and are regularly classified as other income. Capital losses can only be offset against last year's or future years capital gains. In all other cases of corporate taxpayers capital gains are taxable when they occur.

b) Non-resident Companies

Income derived by non-resident corporations from German real estate is generally subject to taxation under the ITA. In principle, the same income determination rules apply as for resident companies. The corporate income tax rate applicable to non-resident corporate investors is the same as for resident ones: currently 26.375 % (namely 25 % + 5.5 % solidarity surcharge thereon),;as of 2008 probably 15.825 % (15 % + 5.5 %).

Unlike German corporations, foreign corporations are not deemed to generate business income just as a result of their legal form. Only the nature of the German activities is taken into consideration for tax purposes.

Among the types, business and rental income as well as other income, i.e., capital gain income, realized on a sale of the real estate, is of relevance for the taxable income derived from real estate transactions.

Rental income: A non-resident company generates rental income if it is engaged in the mere letting and administration of property, even if a large number of properties is held or the letting of property is of considerable size and requires substantial administrative effort. Whether the property is let for housing or business purposes is not relevant.

Business income: In case movable assets are let or certain additional services by the lessor to the tenants are provided, this leads to the income being classified as income from a business activity.

Further, business income from real estate transactions is always derived, in case a non-resident company pursues business activities via a permanent establishment or a permanent representative in Germany. Business income of a foreign company can be determined in Germany either on a cash basis like rental income or on the basis on German GAAP rules adjusted by some tax rules.

For income tax purposes, a business activity is defined as an independent ongoing activity on the market with the aim to derive profits. This is for example given, if an investor provides additional services to the lessee (e.g. cleaning services) besides letting and administration activities, or if a property is let under short-term contracts with high tenant turnover. Furthermore, the operation of a hotel, the letting of exhibition space and booths as well as parking sites or the short-term letting of convention halls is considered as a business activity.

If business activity is carried out, but no permanent establishment or permanent representation is existing, the income of the foreign corporation is taxable as rental income.

Other income: Capital gains realized on the sale of German real estate by non-resident companies either held directly or through partnerships are taxable at least as deemed business income, irrespective of a holding period. Capital losses are always deductible.

Non-resident taxpayers are subject to certain restrictions with regard to the determination of the taxation basis. Expenses are only tax deductible in case they are economically connected to the taxable German income, in particular, income that is not rated as tax free. The treatment of the income in the home country is irrelevant.

With respect to the possibility to carry tax losses back or forward in Germany, the provisions mentioned above under 2.1.1 for resident companies are basically also applicable for non-resident companies. Precondition is that the losses occurred in connection with what would have constituted German income. The losses can be offset against both, operating income and capital gains realized on the sale of German property. Income, being subject to withholding tax, can in general not be offset against losses from other categories' income.

A foreign resident is not subject to dividend withholding tax.

Practical Advice: If business is conducted through a permanent establishment, e.g. office, fixed installation or construction or engineering sites, which are kept more than six months (according to most DTT's usually 12 months), the income of the permanent establishment becomes subject to trade tax.

c) Resident Individuals

Under the ITA, individuals who have a residence in Germany or are physically present in Germany for more than six months (including short breaks), are subject to "unlimited tax liability", i.e., they are taxable on their worldwide income in Germany. According to the German Inheritance Act (*Erbschaftsteuergesetz, ErbStG*), persons who had been resident in Germany for more than 5 years during the last 10 years and German nationals, having lived not more than 5 years abroad, are subject to inheritance and gift tax as heir or as donor or donee. There are quite a limited number of DTT's in this area.

A German resident individual, who receives income from real property is deemed to generate rental income, unless he performs business activities and the real property is attributable to the business. The net rental or the business income derived from the property is subject to German income tax. The international DTT allow Germany the application of this right to tax. There may be additional home country taxation depending on the home country's tax regime.

The taxation of gains realized on the sale of real property depends on the tax classification of income derived. In case the property does not form part of a business, gains on a sale are subject to income tax at normal tax rates, if the sale is made before it has been legally acquired or within 10 years after the date of acquisition. If the sale is not concluded within the aforementioned timeframe, capital gains are tax free unless the property forms a part of the business.

Investment income from shares in corporations held privately are taxed by including 50 % (as of 2009: 60 %) of the gross dividend under full tax credit of the

withholding tax levied. From 2009 onwards, the withholding tax in general is a final tax. Currently, capital gains from investments below 1 % are tax exempt after a holding period of one year from the date of the acquisition. For acquisitions made on or after January 1st 2009, capital gains are taxed at 60% without the 1 % threshold relief.

Business income (which includes capital gains) is subject to trade tax.

The depreciation rules, applying to companies are also applicable to real property, owned by individuals.

The ITA provides for a rate scale, which is proportional at lower and higher income level but progressive for middle income level. The tax rate varies from 15 % to 45 % since 2007, in each case + 5.5 % solidarity Surcharge thereon and with a tax free amount of Euro 7.664 (since tax year 2005). Trade tax is – simplified – credited on the income tax.

d) Non-resident Individuals

Individuals, who are not resident in Germany, are subject to limited tax liability, meaning that they are principally taxable only on their German source income, in particular of relevance in this context is business or rental income or income from capital gains. The determination of a tax base itself does not differ in principle from that in the case of resident individuals described above.

Trade tax applies, like in case of non-resident companies, only, if there is a permanent establishment in Germany.

Note: Personal deductions are partly limited. However, in case, broadly speaking 90% of the income is earned in Germany or in the EU, the limitations are less strict. Further, certain income, like dividend income, is taxed exclusively on a withholding tax basis, whereby the minimum tax rate amounts to 25 %. According to the wording of the law, domestic loss carry forwards can only be used if the bookkeeping is kept in Germany.

2. Trade Tax

a) General

The character of trade tax is that of an additional business income tax. The idea is to compensate local costs, caused by conducting the enterprise at the municipality and thus to levy a tax correspondingly on the locally generated income.

Each corporation or taxpayer with business activities *and* a permanent establishment located in Germany is subject to trade tax (*Gewerbesteuer*), a tax payable to the municipalities. The rate of tax depends on the (adjusted) income and the location of the enterprise. In general: municipalities with low services offer low rates.

To limit the use of trade tax havens, the Trade Tax Reform Bill 2004 introduced a minimum local tax rate (*Hebesatz*) of 200 %, giving rise to a minimum effective trade tax burden of 9.1 % (a reduction of ¼ can be expected as of 2008)

for corporations. For partnerships, certain lower taxed brackets are available for income up to EUR 72,500. From 2008 onwards, this treatment shall be, however, abolished. The maximum tax rates amount up to 490 %, leading to a tax burden of around 20 % (again, a reduction of ¼ can be expected from 2008 onwards). Trade tax is currently deductible for its own calculation as well as for (corporate) income tax purposes (this is expected to change from 2008 onwards).

Rental income as defined above under II. 1. a) is basically not subject to trade tax unless

- generated by a corporation (since the income of a corporation is categorized as business income) or
- generated by another entity subject to trade tax by statutory definitions.

Trade income is determined based on a taxable income calculated for (corporate) income tax purposes, adjusted by certain add-backs and deductions. Besides a participation exemption, the most important deduction from a real estate point of view is the extended trade tax deduction as described below under 2.2.2 in more detail.

Moreover, upon computing the tax base for trade tax, currently only 50 % (probably lowered to 25% as of 2008) of the interest paid on long-term loans can be deducted. Long-term loans are, broadly speaking, those having a (actual) term of more than 1 year. Acquisition loans are long-term loans by nature. Under current trade tax law, rental contracts, in which the remuneration contains a major interest portion, are not divided into an interest and service portion, where the interest portion could be added back. In addition, rentals of real estate were specifically excluded. This is still a quite interesting benefit, being one aspect for leasing rather than owning real estate as a company.

However, according to the currently available information, the legislator envisages to include also the interest portion of rentals in the add back provisions, i.e., 75% of the total rent of real estate will be treated as deemed interest portion.

Furthermore, 1.2 % of a so-called unitary tax value (*Einheitswert*) of real estate belonging to the business assets can be deducted in determining the income for trade tax purposes. This is a so-called simple trade tax deduction in contrast to the extended trade tax deduction described below in the next paragraph. The unitary tax value is calculated on a valuation basis as per January 1st 1964 in the territory of former West Germany and as per January 1st 1935 in the territory of former East Germany. It is considerably lower than the fair market value. Thus, the deductions usually cannot compensate the add backs, which may lead to a significant tax burden.

It is intended by the legislator to replace the present disallowance of 50 % of long-term loan interest by a blanket disallowance of 25 % of 20% of the total of all interest for all rental and lease payments for plant and equipment and to 25% of 75 % for all rentals for immovable assets. This total is to be reduced by € 100.000 before calculating the 25 % blanket.

b) Extended Trade Tax Deduction

Even in case a taxpayer's activities are treated in principle as being subject to trade tax, trade tax may not be levied (typically: domestic corporation or business partnerships) on the basis of a year-by-year application. Taxpayers engaged only in the mere administration of real estate may apply for the "extended trade tax reduction" (*erweiterte Gewerbesteuerkürzung*). This allows a deduction from the tax base for trade tax purposes for income derived from these passive rental activities, thus reducing the tax base for such activities to nil and effectively granting exemption from trade tax. A number of restrictions or pre-requisites have to be considered in order to benefit from this exemption. For example, so-called business fixtures (*Betriebsvorrichtung*) may not be rented along with a real estate without jeopardizing eligibility for the exemption. Under the preconditions that the specific requirements are observed, this exemption in practice should offer an investment being exempt from current trade tax. If the whole real estate of a trade taxpayer is sold by the end of the taxpayer's business year, it should also be possible to generally achieve that also trade tax on capital gains is not triggered.

Moreover, in general the sale of a partnership interest constitutes a termination of business and as such is not subject to trade tax. From the year 2002 onwards, gains realized and the disposal of a partnership interest have been treated differently. Capital gains realized by a corporate partner or by another partner, who is not an individual on the sale of a partnership interest or part of the partnership interest, have been subject to trade tax.

The extended trade tax reduction is also excluded in the following scenarios:

- a corporate taxpayer, generating capital gains;
- capital gains stemming from the disposal of real estate, which had been contributed on a tax neutral (roll over) basis to the company in question within the three preceding years,
- any income from real estate that serves the business establishment of a partner never qualifies.

3. Real Estate Transfer Tax (RETT)

Real Estate Transfer Tax (RETT) is an important cost factor not only in direct acquisitions of property but also in share deals or corporate reorganizations and restructurings. The subject of taxation for RETT purposes is the real property. So-called business fixtures (*Betriebsvorrichtungen*) are not viewed as real estate. On the contrary, hereditary building rights (*Erbbaurechte*) and buildings erected on land owned by a third party are deemed to be real property for real estate transfer tax purposes.

Within purchase agreements, the purchaser typically assumes the RETT burden, regardless of both parties being legally liable for the RETT. Generally, RETT exemptions exist in certain cases for transactions between related parties

or transfers by way of gift or inheritance. Other exemptions will rarely be of practical relevance.

RETT is levied on a number of transactions other than purchase agreements, such as on the highest bid at an auction. In addition, an agreement to transfer one of the claims to obtain ownership as well as a transfer of legal title of ownership without any underlying agreement is subject to RETT. Furthermore, where the aforementioned conditions are not met, but a party has de facto obtained the position similar to that of a legally entitled owner, RETT may be imposed. This is the case where the recipient is able to benefit from all substantial proceeds from the use or disposal of real estate. The conditions differ slightly from the economic ownership concept for income tax purposes. Whether this also applies to financial leasing under German tax law, depends on the individual circumstances.

Although in general the transfer of shares in a corporation or of an interest in a partnership is not taxable, there are some important exemptions. For example, all of the following transactions are subject to RETT under current law:

- Direct or indirect *unification* of 95% of the shares in a company or partnership that owns real estate in the hand of a person, a partnership or a corporation;
- *Transfer* of 95 % or more of the shares in such a company or partnership or
- Direct or indirect *change of the partners* in a partnership owning domestic real estate will also give rise to RETT, if the change is effected within a period of 5 years.

Practical Advice: Due to these complex rules RETT, may under certain circumstances be triggered twice or even more often in connection with the acquisition of one item of real estate (e.g. in a group structure). This has to be carefully considered.

A tax credit is possible, where one taxable transaction is connected to another, which was already subject to RETT. It should be noted that upon application, RETT will not be imposed in certain cases, e.g., if the transaction is reversed or the original transaction is rescinded within 2 years.

Moreover, the transfer of property through or by a partnership (transparent from a tax point of view) is privileged by a partial RETT exemption, if a partner participates in the transaction on both sides, either directly or through another partnership. The extent of the exemption depends on the proportion of interest in a partnership held by the respective partner. Although some legal restrictions apply in special cases (mainly a 5 years holding period in the transferring and the receiving partnership) and the anti-abuse case law has to be taken into account the privileges for partnerships should be kept in mind.

Proper RETT planning and partnership structures are required in conversion and reorganization structures. The mere change of the legal form of a corporation into a partnership and vice versa does basically not trigger RETT.

The applicable tax rate is usually 3.5 % of the agreed consideration.

Practical Advice: Care must be taken in case of a package deal, i.e., where land is sold with the obligation to enter into a construction agreement.

In most cases the agreed consideration is the purchase price. As a result of changes introduced by the Budget Accompanying Bill 2005 to the Value Added Tax Act, VAT is no longer part of the remuneration for RETT purposes. The reason is that due to the recent changes the buyer of real estate is solely liable for any VAT due on the real estate transaction.

A separate real estate value (*Grundbesitzwert*) for RETT purposes applies to a number of special transactions, in particular, where no consideration can be determined, such as certain group reorganizations, contributions in exchange for shares, unification of shares and other transactions basing on statutory agreements.

Where the tax is levied on a share transfer, i.e., where the consideration, if any, is not directly linked to the real estate, the basis of the assessment will be 12.5 x the rentable value of land and buildings. This rentable value is derived from the average rentals actually achieved over the past three years, if the site was rented out (from 2007 onwards rentable value will be derived from the rentals actually and currently agreed upon). In general, the value is reduced by 0.5%, maximum 25%, in order to take the age of the building into consideration. If not, the value is derived from estimates, prepared by the local valuation office, which is a branch of the local municipality, suitably adjusted to take account of factors, such as the age of the buildings or pollution of the soil. Where the site is undeveloped, recourse must be added to the figures from the local valuation office (there is a 20% lump sum deduction). Until 2006, the valuation has to be based on 1996 values. From 2007 onwards, the valuation need to be based on the actual situation when the taxable event was created.

A lower fair market value can be proven. However, this is almost never the case.

For the transfer of hereditary building rights, the tax base is the capitalized value of the ground rent. The regulations of RETT apply irrespective of whether or not the transaction itself is also subject to VAT.

A substantial reform of the RETT code was brought on the way by the Federalism Reform Act (*Förderalismusreformgesetz*) in summer 2006. As from 2007 onwards, the individual Federal States of Germany (no longer the Federal Republic of Germany itself) were allowed to create their own tax rates/tax computation system for RETT purposes. Today it can, however, not be foreseen how such a change in the system would be transformed into the RETT code. Rumors say, it might become similar to the trade tax system, having the municipalities introducing a local tax rate (*Hebesatz*). Berlin levies 1 % additional tax (=4,5 %).

4. Value Added Tax (VAT)

The basic concept of the German VAT regime, such as taxable persons, nature of the goods, delivery of goods and supply of services, has been brought into line with the 6th EC Directive. This means that the basic Germany regulations are comparable to those applicable in the other EU member states. A brief overview of the German VAT system:

- A taxable person (entrepreneur) under the German VAT Act is a person who independently carries out an economic activity, which under the German VAT Act, is rated as a supply of goods or services. The entrepreneur must not seek for profits subject to income tax.
- As a consequence, a company may be considered to be an entrepreneur for VAT purposes, even though it only performs tax exempt transactions. Tax exempt activities are in particular under further conditions public, education, health, insurance and banking services. Moreover, such a company will generally be not permitted to recover input VAT.
- The supply of goods means the transfer of the right to dispose of tangible property like an owner. Goods are notably tangible property and some rights "in rem", giving their holder the right of a user of the immovable property such as building rights etc. Land and buildings are viewed as goods for German VAT purposes and thus, their transfer can be taxable. A tax exemption exists for all transactions subject to RETT, particularly the sale of real estate. There is no tax on the transfer of shares.
- Supply of services means any transaction not constituting a supply of goods.

Services supplied in connection with real properties fall regularly within the scope of VAT. However, most of these transactions are exempt under German VAT law. This is for example generally the case, if real estates are merely rented or leased. This includes lease, financing activities in which the lessor could be the economic owner (for more details please refer to Chapter 12, III. 2.

Although transactions subject to RETT (hereditary building rights excluded), especially the sale of real estate, is VAT exempt, they may voluntarily be subjected to VAT. Following rather recent changes, such waiver of the VAT exemption can only be exercised at the time of and must be declared in the notarized sale and purchase agreement. In this case, the real estate transaction now subject to VAT, is taxed under the reverse charge procedure, meaning the buyer alone is liable for VAT. The reverse charge procedure also applies generally to construction work and other building related services such as repair and maintenance as well as the cleaning of buildings or part of the building.

The aforementioned applies in case a sale is effected to another enterprise for purposes of a lessor's business regardless of whether the purchaser is entitled to recover input VAT (VAT option or not). The vendor may under certain circumstances opt to subject the sale to VAT either wholly or in part.

Under certain circumstances, the VAT option applies to the letting of real estate, the transfer of hereditary building rights and other rights "in rem". If the VAT option is exercised, the purchaser or lessee may recover input VAT paid on the supplies and services and thus, reduce acquisition or construction cost considerably. When buildings are let partly for non-business purposes (i.e. letting for housing or to public entities) and partly for business purposes, the VAT option is only applicable as far as it is exclusively used for business purposes and the lessee has a 100 % right of deduction of input VAT (not the case for banks and insurance companies in their core business). In case the VAT option is exercised or indeed possible, only for that part of the sales from letting of the real estate, then the input VAT may only be recovered in part as well. In this context, the relevant ratio of the sales from letting of the real estate for business in relation to such for non-business purposes is to be determined with regard to the spaces let. Only if that is impossible, the ratio may be determined with regard to the proceeds generated.

If there are changes in the percentage rate of the use for which the lessor exercised the option or the lessor does opt or waive to charge VAT on the sale of the real estate within 10 years after the acquisition (or in the event of further acquisition or construction cost later correspondingly) the portion of any input VAT initially recovered will have to be corrected for the remaining time of the 10 years period.

Example: The lessor had erected the building in year 01 and rented it out plus VAT for 80 % of the building space. He could recover 80 % of the input tax. If he rents out since the beginning of year 6, only 70 % in a qualifying way, he has to return ½ of 10 % of the input VAT of the construction cost. If he sells in the end of year 8 plus VAT on the total building, he recovers 2/10 of 30 % of the input VAT of the construction cost. If he does not opt to VAT on the sale of the building, he has to repay 2/10 of 70 % of input VAT on the construction cost.

There exists an important general exception: The sale of the whole business or an independent part of the business (*Geschäftsveräußerung im Ganzen*) to an entrepreneur is in general not taxable; he steps in the remaining term of the still for him remaining 10 years period. Even the disposal of one piece of real estate can fall into this category. This would be the case, if it represents the main business asset. Consequently, the purchaser succeeds or substitutes the seller in his VAT position. In view of the latest judgment by the Federal Fiscal Court, this exception may not be applicable in connection with the sale of buildings by project developers, in particular in the developing phase.

The general VAT rate until 31st December 2006 was 16 %. Since 2007 it is 19 %.

Practical Advice: This makes the option on a sale of buildings that have been erected and where VAT (at 16 %) had been deducted at e.g. 80 %, less attractive. But it is even more attractive to opt in future in erection cases.

In order to bring invoicing in line with European Law, the minimum details required for invoices were amended in 2004, extending the VAT reverse charge principle. In order to apply this, the deferred tax exemption, which is applicable to transactions subject to RETT, must have been waived in the first place. As noted above, the VAT option must now be exercised at the time of and declared in the notarized sale and purchase agreement. Since August 2004, an entrepreneur providing work, supply or other services in connection with real estate, is obliged to issue an invoice, regardless of whether or not the recipient is an entrepreneur and he has to do so within 6 months. Entrepreneurs have already in the past been obliged to keep invoices issued or received for 10 years. The new rules provide that even non-entrepreneurial recipients of services and pertinent invoices, have an obligation which must be pointed out in the invoice to keep those invoices for at least 2 years. A violation of these rules may now trigger a fine.

5. Land Tax

Land Tax is a recurring annual tax, levied by the municipal authorities and payable under the provisions of the Land Tax Act (LTA – *Grundsteuergesetz, GrStG*). All domestic real estate is subject to land tax, unless a tax exemption applies. Exemptions are specifically granted in case the real estate is used by certain public institutions or for the public benefit. The status of the owner and the owner's individual income tax position are irrelevant for the computation of the land tax.

The tax base is the unitary tax value of the property (*Einheitswert*). The unitary value is an estimated fair market value determined as of 1st January 1964 in the territory of the former West Germany and on the basis of those values as of 1st January 1935 in the territory of the former East Germany. Roughly, the unitary value of real estate located in Germany should only amount to about 25 % of the actual fair market value. For newly erected buildings, the values of those days remain relevant. But the quality is today always at the highest end in comparison with 1935 or 1964, so that the values for newly erected buildings may reach 50 % of the fair market values.

Land Tax is assessed in a two-step procedure. In the first step, the tax authorities determine the base value (*Steuermessbetrag*) by multiplying the unitary value of the property with the applicable basic federal rate (*Steuermesszahl*), which is usually 3.5‰. In a second step, the municipal authorities apply their local tax rate (Hebesatz) to the assessed base value. The annual land tax burden actually varies between 0.1 % and 0.6 % of the fair market value (not the unitary value).

Land Tax relief is granted under certain conditions. Such relief is generally applicable to public parks or to real estate constituting an important cultural asset. Relief may also be granted to land that is used for business purposes in case the deemed gross earnings (*Rohertrag*) from the real estate are reduced by more than a certain percentage due to the exceptional circumstances.

The tax authorities attribute property to the tax payer when assessing the unitary value first time after erection or attribute the previously assessed value to the acquirer of the real estate. The acquiror can only claim that the original value was incorrect for future years. The owner of the property is generally the tax payer. But the holder of a hereditary building right or the beneficial owner may also become a tax payer. In case of the disposal of property, it is attributed to the new owner, a holder of a hereditary building right or a beneficial owner only from 1st January of the year following the transaction. Until this date, the property is attributed to the former owner, holder of a hereditary building right or beneficial owner. Thus, he may seek insofar a higher purchase price as refund in the purchase contract.

Land tax is a deductible expense for income or trade tax purposes. The economic burden of land tax is tried to be transferred to the tenants by including it in the incidental rental charges.

As an outlook, there are plans to substantially reform land tax:

- The above mentioned unitary values have proved as being rather difficult and sometimes inconvenient in handling and have been replaced as point of reference for a number of other acts and tax purposes already. It is proposed to do so for the land tax as well taking as new point of reference a combination of parameters most likely including factors, such as standard land value per square meter, building size and building type.
- The proponents maintain that the envisaged reform would be largely revenue neutral, meaning it should lead to more or less the same level of tax revenues. It remains still unclear to what extent the land tax burden on individual properties may change.
- Within the discussed enterprises income tax reform 2008 a special (higher) land tax for real estate for business use is discussed.

6. Investment Grants

Investments in the new federal states (Brandenburg, Mecklenburg-Western Pomeranian, Saxony, Saxony-Anhalt and Thuringia) as well as in former East and West Berlin have been promoted through German governmental incentives ever since German reunification.

The tax subsidies may only be applied for by the economic owner. This economic owner should be generally identical with the legal owner of the subsidies' assets.

Special depreciation rates were allowed in addition to straight line depreciation. The highest special depreciation rates resulted in some cases in full amortization of renovation and modernization cost within 10 years. These special depreciation rates could in principle only be applied to investments made before the

end of 1998. In practice an investor can still claim these rates under certain circumstances.

After subsidies in the form of attractive depreciation rates were determined, the parliament changed to direct subsidies. In principle, those payments are tax exempt (Special subsidies granted by the regional authorities under the EU subsidizing rules (*Investitionszuschüsse*) applied before the investment were deducted when calculating the investment cost,or shown as a separate correction item on he passive side of the balance sheet) and do not affect the level of depreciation and renovation cost for income tax purposes. For the acquisition or construction of movable new *business assets* and buildings for a new or a significant enlargement of an existing operating business office or *manufacturing site* in the territory of the new Federal States or East or West Berlin made by domestic and foreign investors after 24th March 2004 until 31st December 2006, the Investment Subsidies Act 2005 (*Investitionszulagegesetz 2005*) applies. Subsidies of 12.5 % or in certain cases of up to 15 % of the acquisition construction cost will be granted once. In order to avoid repayment of the subsidy, the assets must remain in the new Federal States or East or West Berlin for a minimum of 5 years as qualifying site; this applies also to hotels.

From 2007 onwards, the latest Investment Subsidies Act 2007 (*Investitionszulagengesetz 2007*) confirms the subsidies of 12.5 %/15 % for investments made after 20th July 2006 and before 31st December 2010. However, investments commenced before 21st July 2006 and completed after 31st December 2006 should not benefit anymore (investment gap).

Chapter 12 Taxation along the Life Cycle of an Investment

I. Investments in German Real Estate

Investors, wishing to acquire German real estate have various options in terms of the best way to structure their acquisitions or erections. There is a choice in particular between a direct acquisition of assets and an indirect acquisition, meaning through the establishment of a company and/or a partnership which is acquiring the targeted assets or the company or partnership holding it. Rather than actually participating in the management of real properties, some investors may also wish to obtain a return on real estate through pure financial investments. For these investors Germany provides a number of interesting instruments, such as open-end real estate investment funds. The investments in regulated funds can still benefit from the tax-exemption for capital gains after the 10 years holding period for private investments in real estate has elapsed.

Although close-end real estate investment funds in the form of partnerships are popular and attracting huge amounts of private equity for investments in German real estate, as the depreciation tax allowance typically leads in the early states to tax losses which can be offset usually by taxpayers with their positive domestic income, it is chosen typically by resident taxpayers. These days, also growth driven shares in companies listed at a stock exchange, and thus easy to sell, are en vogue. The G-REITs will in contrast allow domestic investors a one time taxation at a flat rate of 25 % upon dividend distribution and allow until 31.12.2009 further the domestic owners of real estate to sell real estate held for at least 10 years to the G-REIT corporation at half capital gain and exempt from RETT. However, as there is a recapture period of 4 years, the seller is subject to taxation at full rate, in case the REIT sells the real estate within this short period.

Practical Advice: Foreign tax residents may seek for a reduction in such a way that withholding tax according to the applicable Double Taxation Treaty (DTT) is applied (usually down to 15 % possible). The German understanding is that this resident tax should be credited on the local income tax of the foreign resident. But this will depend on the local laws, to which the foreign investor will be subject to.

For many German companies it may be judged as quite attractive to use these opportunities. In general it is more and more popular to restrict own resources to the core business (and thus not to real estate) and thus, many companies tend to lease out their immovable property, in order to have it off balance sheet.

The characteristics and consequences of these various alternatives or options are analyzed below together with the tax features regarding the construction of a new building.

1. Direct Acquisition or Construction of Real Estate in the Hands of the Investor

a) Income Tax (Individual and Corporate)

aa) Tax Accounting Methods

The determination of profits is either to be achieved by balance sheet/accrual accounting or cash basis accounting, depending on legal requirements mainly.

- Determination of profits by balance sheet/accrual accounting

  The method of balance sheet/accrual accounting in order to determine profit is applied where income is derived by *entrepreneurs*, agriculturists, self-employed persons as well as (individual) proprietors, who are either obliged to keep books of account or who keep books voluntarily.

  Profit is defined by law as the difference between the book values of the business assets at the end of the preceding business year, increased by withdrawals and reduced by contributions.

  In general, the balance sheet must include on the asset side fixed assets and current assets and on the liability side provisions and creditors. The difference is the equity. The law determines, which assets have to be included in the balance sheet in some detail. Mainly, the (German) GAAP have to be observed.

  Since business receipts and expenses have to be allocated to the business year, in which they belong to economically, the determination of profits is on an accruals basis.

  Assets are generally evaluated at acquisition and production costs, whereby in the case of limited-life assets the latter have to be reduced by the amount of regular depreciation and specific impairments.

  Equally, in order to evaluate real estate and buildings, acquisition or production costs have to be applied. Land and building are judged as different assets. A building, being one economic unit only, constitutes one asset. As for other limited-life assets, the acquisition costs of buildings have to be reduced by a regular depreciation amount.

- Determination of profits by cash basis accounting

  The legal method of cash basis accounting may only be used by persons, who are neither obliged to keep books nor do so voluntarily. This is the typical

method for the determination of rental or financial income or capital gains income

Profit in this regard is defined as the excess of business receipts over business expenses. Even though there is no general record keeping requirement, there can be an obligation to keep records such as an index of limited-life fixed assets, of withdrawals and contributions, or low-cost assets in certain cases.

The basic feature of this method is that business receipts or expenses are allocated on a cash basis i. e. they are allocated to the fiscal year in which they are received or incurred, rather than to the fiscal year they belong to economically.

Nevertheless, the method of cash basis accounting is amended in some aspects to conform to the method of balance sheet accounting:

The rules concerning the depreciation of assets are applicable. Furthermore, acquisition or production costs of assets with a business life of more than 1 year (such as real estate) are not deductible as business expenses before the disposition or withdrawal of the assets. In addition, the incoming cash from loans does not constitute a business receipt or expense, and therefore does not have any impact on the profit.

Recurring receipts which are received by the taxpayer shortly after or before the end of the fiscal year, in which they economically belong to, are deemed to be received in the fiscal year the economically belong to. Expenses are dealt with accordingly.

- Main differences

Main differences between the method of balance sheet accounting and the method of cash basis accounting are the following:
The method of cash basis accounting does not allow impairments and the use of deferred expenses/income. In addition, any increase or decrease of the market values of the current assets is not taken into account when the method of cash basis accounting is applied.

Irrespective of which method is applied in order to determine profits, the total amount of profit must be equal on a long term basis. The main difference can be said to be the point of time, in which profits are recognized.

bb) Acquisition and Construction Cost

For an asset with a limited useful life, the basis for depreciation is the historical cost. This is typically the acquisition price as referred to in the purchase deed plus incidental acquisition cost. The acquisition cost for the land and the additional costs relating thereto cannot be depreciated regularly. These cover in particular notarization and land registry fees for the purchase contract and the ownership change and RETT.

Practical Advice: Due to this, it may be recommendable to clearly specify in the purchase deed the portion of the acquisition price to be attributed to the land and to the buildings or to safe documents on the previous acquisition cost of the seller for the land portion.

cc) Depreciation Options

- Buildings belonging to a company's business assets, which are not let for housing purposes and which were erected after 31st March 1985 (date of completion)can generally be depreciated at an annual rate of 3 % over a period of 33 years (straight line method).
- For buildings, for which the application for the building permit was filed before 31st December 2000 or in case of an existing building where the purchase agreement was concluded before that date, the annual depreciation rate was 4 % (depreciation period of 25 years).
- In case one of these conditions is not fulfilled, the annual depreciation rate for buildings erected after 31st December 1924 is 2 % (depreciation period of 50 years).
- Buildings erected before that date are depreciated at an annual rate of 2.5 % over a period of 40 years.
- Higher depreciation rates can be applied for, if the tax payer can substantiate that the residual useful life of the building will be less than the other mentioned periods (e.g. warehouses).

Instead of applying the standard straight-line rates, buildings serving housing purposes may be depreciated on a declining balance basis (accelerated depreciation) in case the investor has erected these or acquired these in the year of completion. In these cases, the building permit must have been issued or the building has been acquired after 31st December 1995. For buildings serving housing purposes, the declining balance depreciation was abolished from 2006 onwards.

The applicable declining balance depreciation periods were as follows:

- A rate of 5 % for the year of completion and following 7 years
- a rate of 2.5 % for the following 6 years
- a rate of 1.25 % for the remaining 36 years.

New depreciation rates for buildings that serve housing purposes were established in late 2004. In case the building was acquired or the building permit issued after 31st December 2003 and before 1st January 2006, the applicable depreciation rates were as follows:

- A rate of 4 % for the year of completion and the following 9 years
- a rate of 2.5 % for the following 8 years
- a rate of 1.25 % for the remaining 32 years.

Supplementary acquisition or construction cost incurred at a later date increase the depreciation basis for the building. In addition to depreciation related cost e.g. maintenance cost, administration cost, land tax and financing cost, can be deducted immediately. Plant and machinery may be depreciated separately as movable assets, provided they are not an integral part of the real estate. Integral parts are those parts of the real estate that cannot be separated from the real estate without destroying or substantially altering either the real estate or its components.

Exceptions apply to "business fixtures" (*Betriebsvorrichtungen*) which are depreciated as movable assets regardless of whether they can be qualified as an integral part of the real estate under Civil Law. The depreciation terms generally follow the official depreciation tables.

b) Trade Tax

aa) No Permanent Establishment (PE) in Germany

In case the acquisition of property subsequently involves activities such as commercial real estate dealings or trading in real estate - in contrast to passive property management - this can be seen as a first step to establishing a liability to trade tax. In case of direct passive property management, trade tax should not be levied, if the investor has no permanent establishment in Germany.

The concept of a permanent establishment is used in the field of international taxation to determine the right of one country (e. g. Germany) to tax the profit of a person (individual or incorporated) who is tax resident in another country.

In addition, Germany has entered into treaties to avoid double taxation *(*DTT*)* with various other countries that provide additional rules for determining the existence of a German PE. Generally, the applicable tax treaty will set a higher threshold for the existence of a PE than as provided by German domestic tax law. Where the non-resident is entitled to benefits of a tax treaty with Germany, the rules prescribed by this tax treaty generally apply. On the other hand, German domestic tax law only applies in all cases, where no tax treaty is applicable.

In more detail: according to German domestic tax law, a PE is deemed to exist through a fixed place of business that serves the, business activities of a non-resident person. Several examples are enumerated in the General Tax Code (*Abgabenordnung/AO*) where a PE is deemed to exist in Germany, such as the location of the head office (the head office of the foreign company, being the general partner of a GmbH & Co. KG may be abroad, if there is no business activity in Germany), other office, factory or registered branch or a construction or engineering for a period of more than 6 months (the tax treaties often stipulate 12 months).

A fixed place of business requires that the business activities of the foreign taxpayer exceed the level of mere business relations in the other country and that the activities are carried out in a certain consolidated form. A place of business encompasses all the tangible and intangible assets used to carry out the business in the other country, which include not only office premises but also other forms

of assets. It must be a fixed place, meaning a link should exist between the place of business and a specific geographical point. It is not necessary that the place of business is physically connected to the land (e. g. permanent building) but a certain permanence is required (i. e. at least 6 months). In addition, the non-resident must have a certain not merely temporary power of disposition (*Verfügungsmacht*) over the place of business which cannot be taken away at any time. This disposition right needs not necessarily to be based on a legal contract such as a lease agreement. It can be granted by factual circumstances (e. g. the permanent acceptance to use a certain place, office etc. by the legal owner not based on a contract).

As a conclusion, in case of direct passive property management, trade tax should not be levied if the investor has not a permanent establishment in Germany.

bb) PE in Germany

If the investor is a company with limited tax liability and is engaged in passive property management but is subject to trade tax, since the investor maintains a permanent establishment in Germany, it may be possible to structure the activities in such a way that they qualify for the "extended trade tax deduction for passive real estate companies" as described above (Chapter 11, II. 2. b)). This could be an effective way to reduce the tax base for trade tax purposes significantly. However, this preferential treatment is expressively excluded for capital gains arising from the disposal of shares in a property managing partnership and is also not available for capital gains attributable to corporations. Insofar the investor should seek to structure the active business activities separately from the passive ones.

c) Real Estate Transfer Tax (RETT)

In contractual practice it is generally agreed that the cost that incurred during the transaction process such as RETT and notary and land registration fees are borne by the purchaser (though generally both parties are liable for these cost towards the tax authorities). The seller will, however, assume the cost for freeing the land from encumbrances. Real estate transfer tax is levied in most German Federal States at the rate of 3.5 % on the consideration as described above in Chapter 11 under II. 3. (e.g.Berlin: 4.5 %).

Based on the fiscal court decisions, the tax basis for the land alone may be increased in certain constellations, if at the time the vendor concludes the sales agreement for the land, other agreements are concluded in conjunction with (BFH, BStBl II, 1997, page 85; BFH, BStBl II, 2000, page 34).

Example: a construction contract has been concluded together with the agreement for the transfer of ownership of the land within a uniform set of agreements.

The consideration, which forms the tax basis for calculating the RETT payable consists of the cost for the sold land and the construction cost associated with the construction agreement for the building, even if the vendor of the property and

the building constructor are not identical (so-called unitary contractual framework issue).

d) VAT

The sale of real property should be exempt from VAT in principle. The seller may opt to subject the sale to VAT, in case it is effected to another entrepreneur for the latter's business purposes.

In the past, the tax authorities were of the opinion that the VAT option on the sale of real estate which served both, business and non-business purposes, could only be exercised uniformly for the entire plot. Recently, a European court decision provided for the possibility to restrict the exercise of the option to the part serving business purposes. The purchase price must be allocated accordingly (EuGH, BStBl II, 2004, page 378; BFH, BStBl II, 2004, page 371).

Moreover, an entrepreneur acquiring real estate has the choice to attribute real estate used for business and non-business purposes fully to the entrepreneurial sphere, even if the portion serving business purposes is rather small. The privately used portion is then treated as a withdrawal of benefits stemming from business property by the owner for non-business purposes which in general is taxable but exempt from VAT. Input VAT on cost relating to the private sphere is therefore not recoverable through a 10 years period at that point of time. Vice versa, in case a private real estate is used commercially within 10 years from the days of which usage commenced the non-recoverable portion of input VAT should be refunded by the tax authority proportionally for the time of commercial use within these 10 years.

If the vendor applied the VAT option, to be expressed in the purchase deed, and has recovered input VAT on construction/acquisition cost and subsequently sells the property within 10 years after the date of acquisition/construction without charging VAT, then part of the purchase VAT initially recovered will have to be paid back. For each remaining year the amount of VAT repayable is determined by the time frame to be adjusted (1/10 of the overall amount initially recovered is attributed to each year).

> **Practical Advice:** The application of the VAT option allows the vendor to recover input VAT charged to him in connection with the acquisition or construction of the property and thus to reduce these cost. As a result of this cost reduction, he may possibly be prepared to lower the net sales price. It is necessary to decide in each individual case whether the application of the VAT option might be useful or not.

An issue is that an option is not possible in case the real estate is judged as independent business. The borderlines are rather unclear. In such cases the purchaser carries legal risks and chances during the time until completion of the 10 years period, after the seller has completed the acquisition/erection of the building that the business use with option for input VAT deduction decreases or increases

(please refer also to Chapter 11, II. 4.). Of course the purchase deed can transfer these obligations to the seller but only among the parties internally and not with effect for the tax authorities.

It should be noted that if the purchaser acquires a business he may become liable for taxes due but unpaid by the vendor, such as trade tax and VAT for a certain period prior to the acquisition even if the purchase agreement contains a provision to the contrary. In such a case the purchaser remains liable towards the tax authorities but may seek indemnification from the seller.

2. Acquisition of a German Real Estate Owning Company or Partnership (Indirect Acquisition)

In the following, some typical circumstances are described and explained, in case such transactions occur.

a) Corporate Tax

aa) Resident Companies

If the real estate owning domestic company is acquired by another domestic company, the taxable income of that company is (again) derived from the statutory accounts drawn up in accordance with the provisions of the German Commercial Code. As regards the income determination, please refer to the specifications made above in Chapter 11, II. 1. a).

It may be an option to create a tax grouping (*Organschaft*) as of the first day of the target company's business year, leading to a tax consolidation.

If no tax consolidation is made, it is important to note that since 2002 income from dividends and capital gains on the sale of shares are tax exempted, regardless of the amount of the investment or the length of time for which the shares were held. This is applicable to both, German and foreign investments.

> **Note:** Precondition for trade tax exemption for dividend income is a 10% ownership at the beginning of the calendar year. As regards the exemption for capital gains on the sale of shares, this is only applicable, if a recapture of previously tax deductible impairments occur. Further, through a 7 year period tax free roll over of assets into the corporation may trigger claw backs. Exceptions are available for certain shares held by banks and insurance companies.

The non-deductible directly related cost of earning of this tax-free income is irrefutably presumed to be 5 % of the dividend received or capital gains realized. Expenses incurred in connection with such tax-free dividends are fully deductible. Capital losses cannot be deducted. It should not be possible to offset them against capital gains.

If the target company was founded before 2000, some old issues may still have to be taken care of: profits earned by German resident corporations up to 2000 were charged to Corporation Tax under a different system those days. This old system made the Corporation Tax payable by the company dependent on the distribution policy and also gave a credit against the resident shareholder's own income or Corporation Tax in the amount of the equivalent Corporation Tax previously borne by the company.

According to the system applicable now, the individual taxpayer has to tax half of the dividends and - potentially - the capital gains, (please refer to Chapter 11, II. 1. c) for more details).

Transitional provisions which were intended to remain in force until 2018 provide that German companies distributing dividends out of pre-2001 tax retained earnings of German source will in principle be able to claim a credit against their corporation tax currently now of 1/6 to the gross dividend. On the other hand, if the distribution relates to previously untaxed retained earnings of domestic source, an additional uplift of 3/7 of the gross dividends will be payable. Care is therefore indicated when planning dividends from German companies with undistributed income brought forward from 2000 onwards. Return of capital to the shareholders on the liquidation can have similar effects. Under a temporary measure dividends paid up to December 31st, 2005 will not rank for credit. Credit claimable in each year thereafter will not be more than an equal annual apportionment of the remaining credit potential over the remaining period up to 2018.

As the financial authorities rated this system as too complex it was decided to end this profit distributing depending change over system in 2007. The corporations having old tax credits are given a claim towards the tax authorities to receive a tenth of the total credited amount in 10 equal installments from 2008 through 2017. With such procedure, the tax credit is paid out completely and the results from the tax credit system under tax reform finished.

However, There is still in come cases not a refund potential but tax increase potential, in particular e.g. in case of tax free dividend income or tax free incentive income.

bb) Non-resident Companies

In case the German target corporation is purchased by a non-resident company no tax consolidation, i.e., the entering into a tax grouping, is possible under current law.

The tax treatment from holding the shares in the German resident company depends on German tax law and the applicable double taxation treaty concluded with the acquirer's home country, if any. The German resident company having unlimited tax liability is subject to corporate income tax and trade tax on its income. Under corporate income tax rate of 25 % (including 5.5 % solidarity surcharge: 26.375 %) this is applicable since 2001 irrespective of whether the earnings are retained or distributed to the shareholders.

Note: It is expected that from 2008 onwards, both trade and corporation tax will be reduced by about ¼.

According to the EC Parent Subsidiary Directive, which has been implemented into German Tax Law, no withholding tax applies if a German company distributes dividends to an EC corporate shareholder, provided that the latter has held directly 20 % (on reciprocity with some countries 10 %) of the shares in the German company for an uninterrupted period of 12 month. The EU Directive Implementation Bill provides for a gradual reduction to 10 % of the minimum holding requirement (1st January 2007 15 %, 1st January 2009 10 %). Furthermore, the EU Parent Subsidiary Directive is now also applicable in cases where an EC permanent establishment of a German or EC parent company receives dividends from a German subsidiary company. Moreover, the EC regulation or any other treaty application is only allowed after receipt of a certificate by the competent German *Bundeszentralamt für Steuern*. Otherwise the regular withholding tax rate may be payable at the amount of 20 % (since 2009: 25 %) plus 5.5 % Solidarity Surcharge thereon = 21.1 %. The recipient of the dividend may apply for a refund at the latter authority.

b) Individuals (Income Tax)

If shares in a German real estate owning company are held by individuals, the following has to be considered besides the dividends:

Capital gains realized on disposal of shares in a German or a foreign corporation by a resident individual or by a non-resident individual holding the shares as a private asset are only tax exempt under German Tax Law unless one the following applies:

- the sale occurs within one year of the date of acquisition. In this case the capital gain is taxable at standard rates but only in the hand of resident individuals. Capital losses on the other hand, realized by German resident individuals from the disposal of privately held shares may be offset against taxable income from capital gains realized in the same year. They can be carried back to compensate against last year's or carried forward to compensate against future years capital gains
- The seller (or the ancestors by gift or inheritance of the past 5 years) holds - directly or indirectly - a substantial interest in the company. In this case the capital gain is deemed to be taxable business income. Capital losses on the disposal of substantial interest are only recognized, if the shares were acquired by the taxpayer or his ancestors after gift or inheritance more than 5 years before the sale and in case in addition the shareholder has held a substantial shareholder throughout the 5 years' period or has created such a shareholding. Such capital loss can be offset against other income of the taxpayer. The threshold for the assumption of a substantial interest amounts to 1 %. To avoid capital gains taxation shareholdings are often split among family members to stay be-

low the threshold. The threshold of 1 % is given up for shares acquired after 1.1.2009.

Under most of Germany's tax treaties capital gains derived by a non-resident of Germany on the disposal of shares in a German corporation are exempt from taxation in Germany irrespective of the percentage of the shareholding. Moreover, certain tax treaties contain a subject-to-tax-clause according to which the right of taxation remains with the country of source of the capital gain if the gain is not subject to tax in the country of residence. In case the participation forms part of the business assets of a German permanent establishment of a foreign lender, Germany generally has the right of taxation.

Since 2001 only 50 % of capital gain realized by a German resident from the disposal of privately owned shares in a corporation and only 50 % of dividends received by non-corporate shareholders is taxable (*Halbeinkünfteverfahren*).

c) Partnerships

Partnerships cannot be subject to (corporate or individual) income taxes. Instead of the partnership itself, the taxable profit is to be determined at the level of the partner (i. e. individual or corporation).

In contrast, a partnership and its business activities can be subject to Trade Tax, RETT, VAT and so on. Insofar, the general rules as described above in Chapter 11, II. are applicable.

d) Real Estate Transfer Tax

The transfer of a shareholding in a corporation or an interest in a partnership as such is generally not subject to RETT.

RETT will, however, be levied where as a result of the transfer

- 95 % or more of the shares in a real property owning partnership are transferred within a 5 years' period or
- 95 % or more of the shares in a real property owning partnership or corporation are directly or indirectly assembled in the hands of one individual partnership or corporation.

The threshold for avoiding the imposition of RETT is 94.9 % or less. An indirect substantial change of partners in a partnership is also subject to RETT. This could arise e. g. where corporate entities are partners and there are changes in the shareholders of these corporate entities. By contrast the transformation of a company into a partnership by a change in legal form should not trigger RETT.

Practical Advice: It is very important to consider RETT implications when contemplating reorganizations within structures involving property owning entities. There have been repeated legislative pushes for a preferential RETT regime for intra-group reorganizations. So far, it remains uncertain whether that may change.

e) VAT

The transfer of shares is usually VAT-exempt but may be subject to VAT in case the sale is effected to another entrepreneur for purposes of his business (i.e., possibility to opt for VAT). This may be of interest in order to assure the deductibility of input VAT e.g. associated with advisory cost. In case of foreign sellers the reverse charge system applies

3. Hereditary Building Right and Usufruct

Rights in rem are quite common in the German real estate business. They usually confirm more stability than a mere rent and they usually guarantee revenues over a long period of time. Under certain aspects the acquisition of rights in rem can be considered as an alternative to a purchase of the land/building itself. Rights in rem are in fact usually concluded for a long period and give extended right to their holders.

- Hereditary Building Right

  A hereditary building right (*Erbbaurecht*) entitles its holder to erect and own or acquire buildings, works or plantations on land which remains in the legal ownership of the granter. For the duration of the holder's right the holder is the sole legal owner of such erected assets. The holder may use, enjoy or demolish them – as far as allowed under public law-, provided that the holder returns the land in the condition in which he obtained it. Such rights are typically offered by public law sellers.

  For tax purposes, the grant of a hereditary building right or usufruct is principally treated as a regular lease contract. The holder has to capitalize the expenses connected with the transfer of the hereditary building right such as notarial fees and RETT as acquisition cost of the hereditary building right. Such cost are depreciable over the term of the agreement. The land rent constitutes an immediately deductible business expense. The tax treatment of advance payments for a long-term transfer of use (hereditary building right) has been clarified by the EU Directive Implementation Bill. In the past there have been some uncertainties as to whether such payments were to be capitalized as ancillary acquisition cost or were rather immediately deductible as business expenses. It is now expressly stipulated that such advance payments are deductible as follows: In case the advance payment relates to a period of up to 5 years it is deductible immediately. If they relate to a longer period they are deductible only pro rata temporis for the term to which they relate. If the hereditary building right is granted for land with buildings, the buildings must be listed at acquisition cost that means the capitalized value of the land rent in the holder's account. If the holder erects a building it is to be stated at construction cost. The usual depreciation rate for buildings is applicable. For the grantor the land rate in principle constitutes immediately taxable income. In the case

of advance payments relating to a period of more than 5 years the granter may elect to spread the respective income over the period to which it relates.

- Usufruct

Usufruct rights are typically created in family succession situations.

Taxation mainly depends on usufructuary being classified as user of the property or as its economic owner. The contractual relationship in each individual case should be considered. If the grantor remains the economic owner of the property the usufruct is basically treated as a normal lease contract. For the grantor the payments received for granting the right is taxable income. He may deduct expenses relating thereto as well as depreciations on the building. The usufructuary on the other hand may depreciate the cost of the usufruct right over its lifetime. In case the usufructuary sub-lends the property to a third party he generates in general rental income. Expenses such as maintenance cost etc. are deductible.

The conditions for the attribution of the economic ownership to either the usufructuary or the grantor are regulated in a decree of the Federal Ministry of Finance and by case law (BMF, BStBl I, 1983, page 508; BMF, BStBl I, 1998, page 914; BStBl I, 2001, page 171). According to these ruling, the economic ownership is allocated to the usufructuary, if he has the control of the property over its useful life and bears all cost relating thereto. This means not only the public charges but also the cost for maintenance and repair. As a result, he is entitled to claim the depreciation on the real estate.

> **Practical Advice:** Usufruct agreements may be regarded as an alternative to long-term lease agreements and may serve as a flexible instrument to achieve the desired income tax position as purchaser or lessee and sublessor without being considered the legal owner of the property.

- Real Estate Transfer Tax

The transfer of a hereditary building right is subject to 3.5 % (in Berlin: 4.5 %) RETT. The tax basis is the capitalized value for ground rent to be calculated as outlined in the Valuation Act (*Bewertungsgesetz*). Roughly, from 2007 onwards, 80 % of the value is assigned to the building and 20 % to the land. But more detailed rules have to be considered as well. In contrast the grant of a usufruct is not subject to RETT.

- VAT

The grant and transfer of rights in rem in real estate is exempted from VAT. The grantor may opt to charge VAT in case the holder is an entrepreneur who will exclusively use the property for business purposes and is entitled to recover input VAT. Under certain conditions, depending in particular on the year of construction of a building, it may not be necessary that the entrepre-

neur is entitled to recover input VAT. The same rule should apply for the renting of property as outlined above under Chapter 11, II. 4.

4. Financial Investments in German Real Estate

a) Typical Silent Partnership

As a special mezzanine financing type, an investor may as a silent partner lend cash to a company investing in German real estate. In German Civil Law terms a typical silent partnership is an undisclosed partnership between the principal and the silent partner. The principal may e.g. be a company holding real estate. The contribution of the silent partner is recognised in Germany as a type of equity under certain conditions, in particular ranking behind the company's debtors. Shareholders may also be silent partners as well. The silent partner possesses only limited control rights. He has also a profit and loss sharing entitlement in the principal's business. Within liquidations, the silent partner does not participate in the liquidation proceeds.

Under German Tax Law the profit share of a silent partner is deductible for the principal (e. g. a corporation) in determining his income for corporate income tax purposes (as regards thin capitalization requirements, please refer to I. 4. c) below). For Trade Tax purposes the profit share is not deductible under current tax law. Foreign investors entering into a silent partnership may be treated as lendors or shareholders depending on the applicable tax treaty. Special attention must be given to how the arrangement is treated in the foreign investor's home country. The income of the silent partner is generally subject to withholding tax at a rate of 25 % (plus 5.5 % solidarity surcharge) which may be reduced under the relevant tax treaty.

b) Atypical Silent Partnership

An investor who lends capital under the above mentioned terms of a silent partnership agreement may also invest like a co-entrepreneur and then be treated as a so-called atypical silent partner in a company investing in German real estate. In comparison to a typical silent partnership, the silent partner in an atypical silent partnership generally has extended control rights. Moreover, he participates in liquidation proceeds and hence in the hidden reserve realized at the time of the sale.

Under German Tax Law and under a number of tax treaties such investors are treated as direct investors in the same way as partners under an ordinary partnership agreement. This means such partners will often be considered as having a permanent establishment in Germany (no withholding tax on repatriated proceeds). In case the atypical silent partner is a corporation, its profit share is taxed at a corporate tax rate of 25 % plus 5.5 % solidarity surcharge thereon = 26.375 %. (from 2008 onwards: 15 % + 0.825 % = 15.825 %). In principle the

tax treatment for partnerships applies. Again, the tax treatment in the foreign investor's home country needs to be carefully monitored.

c) Profit Participating Loans

Investments in real estate located in Germany can also be achieved by lending capital on the basis of a profit participating loan arrangement (*Partiarisches Darlehen*). This is similar to a traditional loan, except that the interest payments vary depending on the profits of the investor unit. As a result, the lendor may receive larger interest payments in profitable years. The interest rate of profit participating loans is normally lower than under a silent partnership agreement as there is no loss sharing provision.

Since 2004, in case of a shareholder or a shareholder related party as lender, all profit/profit participating interest agreements have lead to non-deductible interest for both corporate and trade tax purposes, since the amended thin capitalisation rules apply to non-resident as well as resident companies (regarding the detailed thin capitalisation rules, please refer to II. 1. c) below). Profit participating loans enjoy no safe haven and such interest payments will therefore be always qualified as hidden profit distributions/constructive dividends as they exceed the applicable exemption limit of EUR 250,000 per assessment period. This exemption limit applies at the level of the borrowing company rather than at the lendor/shareholder level. Since 2008 it is expected that the profit participating loans are deductible as any other financing.For trade tax interest should be deductible in general only at 50 % (since 2008 25 %).

d) Jouissance Rights

An investor may acquire jouissance rights (*Genussrechte*) in a German corporation, which invests in real estate. Jouissance rights are not defined by law although they are frequently used by corporations. These rights are contractual and can be documented by bearer or registered certificates that can be listed on a stock exchange. The holder of jouissance rights have no voting rights and cannot participate in shareholders or management meetings. The profit share expressed as a percentage of the amount of the investments is generally higher than the prevailing interest rate.

For tax purposes, income derived from jouissance rights is generally treated as unearned income (*Einkünfte aus Kapitalvermögen*).

> **Practical Advice:** It needs to be analysed carefully to which extent the percentage of profit share shall be higher, in case the investor and the corporation are related parties, in order to avoid the hidden profit distribution/constructive dividend under German Tax Law.

In case that jouissance rights do not allow for a participation in the hidden reserves and the liquidation proceeds the payments are fully deductible by the German entity for corporate tax and 50 % (as of 2008: 25 %) deductible for trade tax

purposes. Regarding the thin capitalization requirements, the above under 1.4.3 said applies. Otherwise the treatment is similar of that of a shareholder. In some cases traditional debt arrangements may provide a better after tax result in case the interest is not subject to withholding taxes under the relevant tax treaty. However, there might be cases in which jouissance rights are actually treated as an atypical silent partnership with the consequence that the income is categorized not as unearned income but as business income.

II. Financing the Acquisition of German Real Estate

1. Deductibility of Interest Payments

From a German tax point of view, the conditions of all borrowings to and from related parties must be at arms' length in Germany at a first step. They must be governed by an agreement concluded in advance which must outline in detail the conditions agreed upon, in particular as to amount, repayment term, currency and interest rate. Failure to conclude a clear agreement in advance leads to the consequence that the interest expense may be disallowable for a German borrower. Furthermore, it may give the tax office an opportunity of imputing its own concept of fair market rate of interest to the income of the German lender. Given the remuneration is still at arm's length there should generally not be a requirement for a related party loan to be secured.

> **Practical Advice:** It is clearly recommendable to have a written agreement in this regard.

The arms' length interest rate is of course dependent on the agreed currency of the loan. The currency chosen should be reasonable and plausible under the given circumstances but the choice is not otherwise limited by any hard and fixed rules. As the legislator issued a draft on a tax reform, the transfer pricing rules are expected to be put on a firmer legal basis.

a) General

Moreover, interest paid under a loan agreement contracted for the acquisition of real estate is fully deductible for corporate and income tax purposes, provided that the investor can prove that the financing relates to the acquisition of a property. This is usually the case if the loan is secured by a mortgage or land charge on the real estate. The fees paid in order to secure loans such as notary and court fees are also deductible. If the borrower generates business income a discount (disagio) on the loan is not immediately deductible but must be capitalized and written off over the period of the loan agreement. In certain cases the deductibility of interest payments may be restricted or denied as German thin capitalization

rules must be taken into account. When computing the tax base for trade tax purposes only 50 % of the interest on long-term loans is deductible. Long-term loans mean generally those with a term of more than one year. Related party interest will, however, not be deductible in arriving at the taxable income. The consideration of restrictions may also apply for rental income cases, if the disagio is unreasonable.

b) Interest Payments by a Partnership

Due to special regulations for the taxation of partnerships, interest payments to a partner by a German partnership are treated as appropriations of profit and are not deductible in determining the taxable income basis of the partnership. On the other hand, (interest) expenses incurred by a partner (in his home country) and attributable to his investment in the partnership can - in general - be deducted.

c) Thin Capitalization Rules

Thin capitalization rules are enforced to restrict the amount of related party interest on long-term debt as defined long standing for trade tax purposes (see Chapter 11, II. 2. above), thus referring in particular to the 1 year rule, that can be deducted as an expense. A German company may deduct related party interest on finance not exceeding 1.5 x times its shareholders' equity as shown in its German statutory financial statements at the end of the last year. A loss of the year can be added back, if recovered by profits or equity injections in the following three years. This equity is reduced by the book value of any financial investments held by an operating company but a holding company is free from this requirement. On the other hand the German subsidiaries of the holding company do generally not enjoy an own 1.5 to 1 safe haven except as regards borrowings from the holding directly. According to the German Ministry of Finance a holding company is one which owns two substantial (20 % shareholding or more) domestic or foreign financial investments (shareholdings) and whose main *activity* is holding and financing its investments *or* whose financial *investments* are more than 75 % of its gross assets. According to the wording of the law, borrowings from outside parties rank as related party borrowings if the lendor has recourse to a related party. However, an implementing decree (BMF, BStBl I, 2004, page 593) makes an exception to this rule in favor of (confirmed) borrowing from banks other than through a back-to-back loan. The exception was decreed in recognition of the standard practice of banks not to lend without a guarantee or at least a comfort letter from the parent.

The 1.5:1 debt to equity ratio can be exceeded, if a German subsidiary can show that it could have taken out the same finance on the same terms from a third party. In most circumstances this proof is literally impossible.

Interest based on profits, turnover or on any factor apart from the principal outstanding is disallowed altogether. The thin capitalization rules apply to companies in both domestic and foreign ownership. However, it applies to neither,

where the total related party interest expense for the year does not exceed EUR 250,000. This exception is relevant to all aspects of the rule including the prohibition on results based interest.

The statute also provides that any interest paid on related party loans taken up to finance the acquisition of shares from the same or other related parties is a hidden distribution by definition. There are no exceptions whether by amount or ratio or by reference to any kind of arms' length comparison.

The legislator intends to replace the present thin capital rules by an "interest limit" as of 2008. The interest limit means that the excess of interest paid over that received will be disallowed to the extent it exceeds 30 % of the profit before interest. However, there is no interest limit if the net interest cost is less than EUR 1 million, if the business is not part of a group, or if it is part of a group but has a better capital ratio (equity to balance sheet total) than that shown in the group´s audited consolidated balance sheet. However, these "self-financing" exemptions from the interest limit only apply, in case the subsidiary does not pay more than 10 % of its net interest cost to any shareholder with a holding of 25 % or more, provided such debt is shown as debt in the group financial statements, if any. Disallowed interest can be carried forward for offset in future years where the limit is not reached.

2. Withholding Taxes on Interest

Withholding taxes on interest payments is only levied within the bank sector. It will therefore e. g. not be imposed on interest payments for loans granted by a foreign company to its German subsidiary. Taxpayers with limited tax liability receiving interest or loans secured directly or indirectly by mortgage registered on German real estate are in principle subject to tax by assessment (for more details please refer to Chapter 11, II. 1. b) and II. 1. d)). However, most tax treaties provide for an exemption of all interest income from German tax. This is taxed in the home country exclusively.

3. Interest Received

Interest income is included in a German company's taxable profit and will as such be subject to corporate tax at the normal rate. Under most of Germany's tax treaties interest income received by a non-resident lendor is only taxable in the latter's country of residence.

III. Managing German Real Estate

1. Letting

a) Income Tax

Income derived from the letting of property is generally deemed to be rental income. However, resident companies are deemed to generate business income from their letting activities only due to their legal form. Related expenses such as depreciation (please refer to II., in particular II. 1. c) above for more details), maintenance and financing cost (please refer to I. 1. a), cc) above) can be deducted in the amount actually incurred. It should be noted that income from the letting of real estate is deemed to be business income, if the investor provides certain additional services to the lessees besides the letting and administration, e. g. cleaning of the office space, or if the property is let under short-term contracts with high tenant turnover. Thus, e. g. the operation of a hotel and the letting of exhibition space and stands, parking sites or the short-term letting of convention halls are each considered as business activity.

b) VAT

As a general rule, the letting of immovable property is VAT exempt with the following exceptions:

- Letting of accommodation for short periods by an entrepreneur,
- Letting of vehicle parking space,
- Letting of camping areas for short periods,
- Letting of machinery and so-called business fixtures (*Betriebsvorrichtungen*).

The exemption from VAT can generally be waived by the lessor in case a building is let to an entrepreneur for business purposes, regardless of whether or not he is entitled to recover input VAT and if the following conditions are met:

- If a building is destined to serve housing purposes, its erection must have been commenced before 1st June 1984 and completed before 1st April 1985,
- If a building is destined to serve non-business purposes its erection must have been commenced before 1st June 1984 and completed before 1st January 1986,
- If a building is destined to serve business purposes and the ultimate user is not entitled to recover input VAT its erection must have been commenced before 11th November 1993 and completed before 1st January 1998.

For buildings not meeting the above mentioned requirement, the application of the VAT option additionally requires that the lessee is an entrepreneur who will use the property exclusively for business purposes entitling him to fully recover input VAT. This anti-avoidance rule is to prevent the lessor from interposing a commercial lessee who then lets the building for residential purposes. In this respect it should be noted that e. g. the services of banks, insurance companies,

municipalities and hospitals are VAT exempt and that as lessees they are no entrepreneurs who are entitled to fully recover input VAT.

If buildings are let partly for business and partly for housing purposes the VAT option can only be applied to the commercially used space. In case the lessee carries out both VAT liable and VAT exempt services the lessor may only charge VAT on that portion of the rent which can be attributed to the VAT liable turnover. If the VAT exempt services do not exceed 5 % of the total turnover the lesser may, however, charge VAT on the full amount. Though the VAT option can only be exercised by the lessor he will usually be prepared to negotiate with the lessee on its application in order to optimize recoverable input VAT for the lessor and avoid non-recoverable VAT for the lessee resulting in lower acceptable rentals. In case the VAT option is exercised or indeed possible only for parts of the letting turnovers then the input VAT may also be recovered in part only. In this connection the relevant ratio of letting turnovers for business in relation for such for non-business purposes is to be determined with regard to the spaces let. Only if this is impossible the ratio may be determined with regard to the proceeds generated.

2. Real Estate Financial Leasing

Real estate financial leasing may offer considerable cost and tax advantages in addition to the benefits of off balance sheet financing of the lessee in case the leasing agreements are carefully drafted. In particular subsidiaries of German banks have special expertise with these financial instruments.

Under a real estate financing leasing agreement, the landlord leases for a certain long-term period real estate to the tenant for a consideration in form of a rent. The lessor finances the erection of a building on a plot of land for the use of the tenant. Contrary to a normal lease contract, the tenant is generally liable for maintenance cost and liabilities in connection with the destruction of or damage to the property. When concluding the agreement, he is usually granted a purchase option for the property up on termination of the lease agreement.

Note: The financial leasing may thus be considered an alternative to a normal lease or the acquisition of real estate. Contracts on real estate leases are concluded in written form. If a purchase option in favour of the lessee is agreed upon, the agreement requires notarial form. The purchase option is entered in the land register as a priority notice.

Practical Advice: Financial leasing may be an advantage for the lessee under certain conditions. To achieve these advantages, the lease agreement should be drafted in such a way that it can be recognised by the tax authority with the lessor as the economic owner of the land and building for tax purposes. Economic owner is a person who is able to and usually does exclude the legal owner from the use of the asset for the remainder of its assumed useful life, this means for a period long enough to reduce the value of a property to appoint whether legal title is economically insignificant. A decree issued by the Federal Ministry of Finance (BMF, BStBl I, 1972, page 188) sets out standardized procedures for the attribution of economic ownership for leased immovable property to the lessee or the lessor respectively. In such leases the economic ownership position must be determined separately for land and building with the ownership for the land following the decision on economic ownership for the buildings. Economic ownership is vital for the decision on who is to carry the leased asset in his balance sheet and depreciated whereas the legal owner is normally considered the economic owner of the building the decree contains a number of provisions according to which economic ownership is attributed to the lessee. The allocation of the real estate to either the lessee or the lessor depends mainly on the duration of the agreement in relation to the normal useful life of the building and the material (cost and charges) assumed by the lessee under their agreement. As these rules are rather strict and therefore largely indisputable it should enable the parties to stipulate contractual terms that may lead to an optimal arrangement.

If the lessor is considered the economic owner of the land and buildings, leasing agreements are treated as normal lease contracts for tax purposes.

The lessor has to capitalize the leased property at acquisition/construction cost in its balance sheet and must depreciate it over the property's useful life. Rentals received are taxable income. Interest payments on loans taken up to finance real property is deductible as is depreciation on building and other expenses incurred in connection with the lease agreement (for more details please refer to above II. 1. c) and I. 1. a), cc). The lessee does not need to capitalize the leased assets in his balance sheet and correspondingly must not show a debt which could be an issue under the thin capitalization rules and be subject to the 50 % add back for trade tax purposes; under the altered rules possibly to be enacted as of 2008, there is still no inclusion in general thin capitalization rules but an add back of (25 %) of the interest portion (75 %) for trade tax purposes. He must disclose the leasing obligation in the notes to the account. Rent paid is immediately deductible. If the lessor is not exempt from trade tax on earnings his taxable income is increased under the old law by 50 % (from 2008 onwards by 25 % of any) of the interest on long-term borrowings for purposes of trade tax and earnings. On the other hand 1.2 % of the unitary tax value of property belonging to the assets of the business can be deducted. If the lessor establishes a real estate company he

can make use of the extended trade tax reduction if the condition of its application are met (please refer to Chapter 11, II. 2. a) and II. 2. b) above for more details). From a VAT perspective, the lease is treated as renting with every single rent being subject to VAT (please refer to Chapter 11, II. 4. for more details).

In case the lessee is considered to be the economic owner of the property, leasing agreements for tax purposes are considered as a sale of real estate or instalment. A capital gain derived by a resident lessor from the "sale" of the real estate is generally taxable at standard rates, if classified as business income or as income from capital gain (please refer to II. 1. a) and II. 1. c) above for more details). In addition, a capital gain derived by non-residents on the sale of German real estate should also be subject to individual or corporate income tax in Germany (please refer to Chapter 11, II. 1. b) and II. 1. d) for more details).

From a tax accounting point of view the lessor must record the minimum lease payments in his balance sheet as a receivable. The annual lease payments shall be broken down into a capital and an interest component, whereas the capital component reduces the receivable, the interest component is taxable income. The lessee must disclose the "purchase" asset in his balance sheet and is entitled to depreciate the capitalized building cost. On the other hand, the corresponding liability for the future instalment payments to the lessor must be reported in the balance sheet. The interest portion contained in the instalment payment is a deductible business expense whereas the capital portion will amortize the liability. Tax and interest will only be levied if a mortgage or land charge is provided security for the non-resident lessor. In such a case tax is assessed at the normal corporate income tax rate imposed on non-resident enterprises unless the applicable tax treaty provides for an exemption.

The economic ownership concept for income tax purposes should not be applicable for real estate transfer tax purposes, meaning the change in the economic ownership from an income tax viewpoint does not automatically trigger RETT. The RETT Act provides, however, for taxation of a transfer if the recipient has de facto reached the position similar to the entitle legal owner. In case this recipient is in such a position, he is able to benefit from all substantial proceeds from the use or the disposal of the real property. Whether or not a lease agreement on real estate triggers RETT therefore depends on the individual contractual terms, in particular on the rights and obligations assumed by the lessee under the agreement.

If the lease is considered as a sale for income tax purposes it will also be viewed as a taxable supply of goods for VAT purposes but recognized as exempted from VAT. The exemption may be waived under certain circumstances as described above. In this case the accumulated instalment payments without interest plus the price for the purchase option form the tax base.

IV. Selling German Real Estate

1. Capital Gains

Capital gains - in principle, this is the difference between tax book values and (regularly) fair market value - derived from the sale of real estate are generally taxable at standard rates and they are classified as business income of the German company or as capital gain income.

Thus a capital gain is taxable where it is realized by any of the following:

- A person, individual also through a transparent partnership or corporation, whether resident or non-resident, who is subject to unlimited tax liability on German source business income (capital gains generally included),
- a person, whether resident or non-resident, receiving income from a sales transaction, i. e. short-term gains within 10 years of the date of acquisition,
- non-resident business companies or business partnerships within the meaning of German law which receive capital gain income as deemed business income. This is irrespective of whether a permanent establishment or a permanent representative is maintained in Germany and further, irrespective of the ownership period. It applies in particular to non-resident investors with a corporate structure similar to that of German companies which have a limited liability (limited tax liability).

a) Income tax

aa) Three-Objects-Rule as Indicator

Under certain conditions, rental activities may be classified as trading in real estate and therefore as business activity. This is considered in cases of a developer or a partnership or shares in a partnership, where the real estate is part of the current assets and in case the real estate is part of the fixed assets. Under German case law, business income is basically as well given if, e.g., more than three items of real estate, including the sale of items of real estate located outside Germany, are sold within a period of 5 years (BFH, BStBl II, 2002, page 291), or, e.g., only one object is sold, but the seller had from the beginning the intention to sell the object (BFH, BFH-NV, 2005, page 417). Furthermore, the risk of qualifying as traders in real property even for investments including only one property is considerably higher for individuals, professionally involved in the real estate industry (such as architects, developers and agents) than for other individuals. A capital gain derived by a non-resident on the sale of German real estate, which does fulfil the above mentioned conditions, has in most cases also been subject to individual or corporate income tax in Germany. As a consequence, the rental activity will be qualified as business income and therefore will be not only subject to corporate or individual income tax but also to trade tax, if there is a permanent

establishment and the extended trade tax deduction does not apply (please refer to Chapter 11, II. 4. for more details).

Therefore, for non-resident business entities and individuals, a tax-free capital gain is basically only achievable in certain limited cases. The taxable amount is the sale price less book value of the property, whereas the book value is the acquisition cost at the time of purchase diminished by depreciation allowances.

bb) Rollover Relief on Capital Gains

Capital gains from the sale of land and buildings held at least for 6 years in a German permanent establishment need not to be taken to income immediately but may be deducted from the cost of purchasing replacement premises in the same or in the previous year. Alternatively, the gain may be carried forward and be deducted from the purchase price of land and buildings acquired during the following 4 years or from the construction cost of a building erected during the following 6 years. This reserve may be released back to taxable income at any time but the release triggers additional taxable income of 6 % of the amount released for each year for which the reserve was carried. The release and uplift to taxable income are compulsory at the end of the fourth year unless construction of a new building has already started. The effect of this rollover relief provision is to defer the taxation of a gain on sale by deducting it from the acquisition cost of replacement assets and thereby reducing their amortization basis. The reserve is often referred to as "§ 6b reserve" after the section and the Income Tax Act governing this provision.

b) Trade Tax

Capital gains will only result in a trade tax burden if a permanent establishment is maintained in Germany and the investment fails to qualify for trade tax exemptions (please refer to Chapter 11, II. 4. for more details), which also apply to passive real estate investments. The sale of an interest in a partnership is treated for tax purposes as a proportionate asset sale. Contrary to the situation of the sale of the property by the partnership, gain realized on the disposal of the partners' interest is generally not subject to trade tax as such a sale does not reflect a commercial activity by the partnership. However, the sale of parts of a part of partnership interest is treated as current business income and is subject to trade tax. Furthermore, the sale of a partnership interest by a corporation or by another partner who is not an individual is generally subject to trade tax.

The extended trade tax deduction is explicitly excluded for any capital gains realized on the sale of a partnership interest in a property owning entity as well as for capital gains stemming from the disposal of a property, which had been contributed on a tax neutral basis to the company in question within the three preceding years.

2. Real Estate Transfer Tax / VAT

From a real estate transfer tax and VAT perspective at the time of the sale of real estate in Germany, the same rules should be applicable as outlined above for direct investments in German real estate (please refer to Chapter 11, II. 3. and II. 4. for more details).

V. Structuring German Real Estate Investments

As any investment, the optimal real estate investment structure depends on special objectives and needs of the investor and the target. Long-term investments aimed at generating a considerable rental yield and a future increase in value resulting in capital gains should be carefully structured, taking into consideration the home country situation of the investor's financing, the specialities of the target and possible exit scenarios. Soon foreseeable changes in the structure of the real estate investment should be considered and the structure should be open/flexible in particular for any demands of potential acquirers. German reorganization, commercial, and tax laws provide a number of instruments. It is necessary to plan the income stream due to the minimum taxation rules on a long-term (i.e.restricted use of tax loss carry forwards).

> **Note:** A split of the target will be very difficult to manage on a book value or rollover relief basis. Hence, it should be done when there is not yet an increase in value. A de-merger leads to a partial loss of tax loss carry forwards.

As the German thin capitalization rules were extended to corporations and partnerships either held by resident or non-resident shareholders and to loans from resident or non-resident corporations, any envisaged structure requires a sound analysis under those rules as they are rather complex and controversial on a number of specific issues. They are expected to be changed substantially from 2008 onwards.

The German income determination rules generally allow reasonable depreciation rates and a deductibility of incurred costs. Thus, proper structuring should most likely lead to the tax burden on rental income being relatively low. As of 2008, a reduction in corporate tax rates of ¼ can be expected. Institutional investors aiming at investments of considerable size should carefully consider the use of investment funds. Short-term investments aimed at the realisation of capital gains by trading and real estate or developing real estate should be structured carefully as well.

Particularly all other activities of the investor in Germany and of course the home country tax situation have to be taken into account from a tax perspective.

Chapter 13 Open-End and Closed-End Funds and Real Estate Investment Trusts

I. Introduction

In addition to the direct acquisition of real estate, there are also various forms of indirect investment. Open-end and closed-end funds as well as the real estate investment trusts (REITs), which are currently passing through the legislative procedure, deserve particular mention and will be dealt with in detail in the following. Indirect participation models are interesting to foreign investors for two different reasons. Firstly, it is possible to invest in companies that already exist. Such investments not only reduce the administration expense, in particular the cost of setting up one's own staff organisation, but also create the appropriate spread of risk from the very outset. From this aspect, investment in open-end or closed-end funds holding several properties or in a stock corporation which is formed as a real estate investment trust may be of interest.

On the other hand, the formation and establishment of such structures may be the correct approach to pool and refinance one's own real estate activities in the Federal Republic of Germany. The one aspect that all structures have in common is that a special legal structure is created by a professionally managed company with the aid of which one or more properties are acquired, managed and, when necessary, resold.

These vehicles are all funded by the capital market, either by the regulated capital market (real estate investment trusts, open-end funds) or by the so-called free capital market (closed-end funds).

II. Open-end Real Estate Investment Funds

Open-end real estate investment funds perform so-called banking transactions and therefore require permission from the Federal Financial Supervisory Authority (*BaFin*). The open-end investment funds which are created by investment trusts or investment companies, are regulated by the Investment Act. The aim of this Act is enable a large group of investors to have the same advantages when purchasing real estate and securities as only people with large funds to invest would otherwise have. The investment business therefore traditionally focuses on pooling the money of small investors. To do this, the investment companies set up funds. The

purpose of these funds is to invest the small investors' money; the range of admissible transactions is limited but investment in real estate is permitted. To this extent the investment company performs the tasks of a professional asset manager.

The investment business run by the German investment companies has a basic legal structure which differs greatly from the concept that is practised in Anglo-Saxon countries in particular. This applies above all to the legal organisation of the administration of the fund. The following therefore deals in more detail with the general framework conditions for investment companies.

1. Definition

The term "investment" has a broad meaning in Anglo-Saxon countries. It designates the investment of capital in general. German law is based on a much narrower definition. According to this definition, investment is a risk-reduced form of assets management which addresses a relatively large group of investors and, as far as the joint investment is concerned, does not have its own corporate objective (Baur in Assmann/Schütze, Handbuch des Kapitalanlagerechts, page 705).

2. Corporate Structure

There are statutory requirements governing the legal structure of investment companies. Investment companies must be organised in the legal form of a German stock corporation (*Aktiengesellschaft*) or limited liability company (*Gesellschaft mit beschränkter Haftung*) and, if they manage real estate, they must have a registered or share capital of at least € 2.5 million which must be fully paid in. Other capital requirements apply if the assets managed exceed € 3 billion. Moreover, the companies must be domiciled and have their head office in Germany.

The legal organisation of the fund management itself is either in the basic form of the company type or the contract type. German law provides for both forms.

With the contract type, the investors do not become shareholders of the investment company. The relationships with the investment company are based on a contract under the law of obligations (non-gratuitous business management contract).

With the company type (investment stock corporations), the relationship between the investors and the investment company is a relationship under company law. The investors therefore become shareholders of the investment company, which must automatically be run in the legal form of a stock corporation (*Aktiengesellschaft*). This type is comparable with the American investment companies in the legal form of diversified closed-end companies, non-diversified closed-end companies and unit investment trusts.

The investment company uses the investors' money to buy, manage and sell real estate (or securities) in its own name and for its own account. Here, the

company does not act for the joint account of the investors, as is the case with the contract type.

In contrast to the contract type, the investors in an investment stock corporation must sell their shares on the stock exchange. In the case of the separate fund created by the investment companies (i.e. with the contract type), the investor can demand that the investment company takes back his shares. In times of falling prices, cash is therefore frequently withdrawn from the investment fund with the contract type as the investors make greater use of their right of return in such times. On the other hand, the investment stock corporation has the advantage that in times of falling prices, it can invest its free cash assets.

German law only created the possibility of setting up an investment stock corporation a few years ago. For various reasons this form has not yet established itself in practice.

3. Permission

As investment companies are credit institutes in accordance with the provisions of banking supervisory regulations (see Section 1, para. 1 No. 6 KWG), they require written permission from the Federal Financial Supervisory Authority (*BaFin*) to operate their business. However, this permission may only be refused if the company does not have enough equity, the organisational requirements for running the investment business are not fulfilled and the people appointed to manage the institute are unreliable or do not have suitable professional qualifications. The managing directors or Board members are deemed to be suitable for running the investment business if they have theoretical and practical knowledge of banking transactions as well as managerial experience. Professional suitability is assumed if a person can be proved to have held a leading position with an investment company for three years (Section 22, para. 2 KWG).

If an investment company already approved by its home country in the European Economic Area also wants to pursue investment business activities in the Federal Republic of Germany, it also requires permission from the BaFin, which must interview the office responsible in the original country beforehand.

There is a so-called "European passport" for investment companies in accordance with the EU directive 85/611. This means that investment companies which are registered in their home country do not require permission from the BaFin. However, one requirement is that the company is a separate fund in compliance with the directive which is also to be managed in another state. Real estate separate funds do not comply with the directive and therefore the EU directive will not be dealt with further here.

Foreign companies which do not want to attract any capital from investors in Germany but only want to invest their capital acquired abroad in Germany do not need any permission to make their investments. The legal situation is different if capital is also to be obtained from investors in Germany through the foreign investment company. In this case, it is also irrelevant whether the investments are to be made in Germany or abroad.

4. Separate Funds

With the contract type, the money invested with the investment company and the real estate acquired with it form a separate fund and have to be kept separate from the investment company's own assets. The separate funds are identical to the investment funds. The separate fund has no legal personality.

In the preparation of the contractual conditions for the respective fund the law has left it to the discretion of the investment company whether the real estate belonging to the fund assets is held in trust by the investment company (trust solution) or whether the investors should have joint ownership of the fund assets (joint ownership constellation). In practice, the co-ownership constellation is used virtually exclusively. With this solution the investment company holds the fund assets in its own name on the basis of an authorisation expressly granted to it by law. Accordingly, the investment company is entitled to dispose of the real estate belonging to the separate fund in its own name and to exercise all rights arising from the real estate.

5. Open-End Principle

Investment funds of investment companies run in accordance with the German Investment Act are set up according to the open-end principle. They therefore always remain open to new contributions from investors. Accordingly, new investment shares can constantly be issued.

Every investor can, in turn, demand that his share in the separate fund be paid out to him against return of the share certificate. The return of share certificates and the issuing of new certificates take place regularly on the basis of the prices established on the stock exchange every day. The idea behind the open-end principle of the German investment fund is to guarantee the investor mobility of the money invested.

6. Public Funds and Special Funds

A difference is made between public funds and special funds depending on the group of people involved in the fund. **Public funds** are funds where the share certificates can be bought by anyone. Here, the investors frequently remain anonymous to the investment company. The investment companies receive the money to be invested by selling the fund certificates through the depository banks acting as intermediaries.

Special funds are funds where the share certificates are reserved for a specific group of buyers. To this extent this is a separate fund where the share certificates are held, on the basis of written agreements with the investment company, by not more than 10 shareholders who must not be natural persons. In this way the German investment companies are given the opportunity to make their special know-how available as a service to major domestic and foreign investors, in

particular institutional investors. As the special fund is a subtype of the public investment fund, the same statutory regulations apply to both types of fund. With special funds, there is merely no statutory obligation to publish a sales prospectus or to publish issue and redemption prices.

7. Distribution and Prospectus Liability

When investment shares are being sold, the investor must be provided with a simplified sales prospectus and the detailed sales prospectus. The investment company must prepare a simplified and a detailed sales prospectus for every separate fund it manages. The reason why two prospectuses have to be published is that the detailed and sometimes difficult-to-understand sales prospectuses are seldom read by private investors. The idea behind the simplified sales prospectus is to inform the investors in an easily understandable manner about the main aspects of the investment. To this extent, the simplified sales prospectus has to contain information on five subjects:

- Brief description of the separate fund
- Investment information with an explanation of the investment objectives and investment strategy
- Economic information
- Purchase and sale of the shares,
- Additional information with references to the detailed sales prospectus and the supervisory authority responsible.

The simplified sales prospectus must not contain more information than that mentioned above.

Section 42, para. 1 of the Investment Act gives a detailed and extensive 28-point explanation of what information the detailed sales prospectus must contain. It must also include the contract terms and conditions, which require written approval by the BaFin.

Special statutory provisions apply to the case where information in the detailed or simplified sales prospectus which is of material importance for assessing the shares is incorrect or incomplete. In this case, the investor may demand that the investment company and the person who sold these shares in his own name take the shares back and reimburse the amount the investor paid.

It must be stressed that only the person who acquired the investment shares on the basis of the sales prospectus and was at least influenced in his investment decision by this prospectus has this right to claim under prospectus liability. The onus is on the investor to provide proof although a refutable assumption speaks for causation if the sales prospectus does actually contain mistakes.

Another requirement for the prospectus liability claim is that the incorrect information was the reason why the investor decided to purchase the shares.

Prospectus liability is fault liability; however, the investment company must prove that it did not know about the incorrectness or incompleteness of the prospectus and this lack of knowledge was not due to gross negligence on its part.

8. Special Aspects of Real Estate Separate Funds

The legislator has introduced various regulations for separate funds which invest the money deposited with them in real estate in accordance with the contract terms (real estate separate funds). Risk diversification of the investment is prescribed by law for open-end real estate funds. Apart from in the first four years of the fund's existence, i.e. the founding phase, a real estate must not make up more than 15% of the total value of the separate fund at the time of its purchase. Furthermore, the total value of all real estate whose individual value is more than 10% of the value of the separate fund must not exceed 50% of the total value of the separate fund. This regulation creates appropriate risk diversification of the real estate fund.

The assets of the open-end real estate fund comprise the land assets and other assets. Only certain items may be acquired as land assets. This primarily includes land for rented accommodation, business land and mixed-use land as well as undeveloped land and land already being developed provided that the value of this land does not exceed 20% of the value of the separate fund. Moreover, shareholdings in real estate companies may be acquired; in this case a so-called majority which changes the articles of association (as a rule 75% of the company shares) must be acquired. Minority shareholdings in real estate companies may only be purchased provided that such shareholdings do not account for more than 20% of the value of the real estate separate fund.

The remaining assets of the real estate fund serve to provide liquidity. Liquidity is necessary in order to be able to pay out the shares in the fund assets when investors demand the return of their investment. To this extent, the law requires the investment company to ensure that an amount corresponding to at least 5% of the value of the separate fund is available on a daily basis.

III. Closed-end Real Estate Investment Funds

1. Definition

In contrast to open-end real estate investment funds, closed-end investment funds are characterised by the following features:

- limited number of properties,
- relatively low liquidity requirement,
- either no sale of shares or max. once,
- as a rule no organised certificate trading,
- no obligation to take back the shareholding,
- property-related, limited term of the fund,
- form of investment in accordance with commercial law,
- voluntary (limited) obligation to publish and report,
- no qualifications for the management regulated by public law,
- investment not evidenced by securities.

Closed-end funds must also take a large number of different interests into account. The investor is - in addition to possible tax advantages – only interested in as high a return on his investment as possible. As a rule, the initiator of the closed-end fund generates earnings from the structuring of the closed-end fund and the successful attraction of equity and borrowed capital. Banks – where they are not initiators either themselves or through subsidiaries – finance the acquisition or construction of the real estate by lending the necessary capital and are therefore, just like the investors, interested in real estate which will generate sustained good earnings.

2. Corporate Structure

a) Legal Forms of Investment Funds

The term "funds" does not describe a legal form under company law but is used in the area of closed-end funds as the generic term for companies in which a large number of investors participate.

In the past, tax considerations were the driving force behind the selection of a particular company form. German law makes a fundamental difference between limited liability companies (*Gesellschaft mit beschränkter Haftung,* GmbH), stock corporations (*Aktiengesellschaft*, AG) and commercial partnerships limited by shares (*Kommanditgesellschaft auf Aktien*, KGaA) on the one hand (corporations), and companies constituted under civil law (*Gesellschaft bürgerlichen Rechtes*, GbR), general commercial partnerships (*offene Handelsgesellschatf,* OHG) and limited commercial partnerships (*Kommanditgesellschaft,* KG) on the other (partnerships). Whereas corporations are based on the ideal model of the separation of capital and work (the shareholders are not necessarily managing directors at the same time), the basic concept of a partnership is that the partner also runs the business at the same time. In terms of taxation, the consequence is that the income generated by partnerships (profits and losses) result directly in the taxation of the partners whereas the income of corporations is initially only taxed at the level of the company itself.

In the case of real estate investment funds, the investor should pay tax directly on the income generated by the fund. Initial losses, which are frequently incurred as a result of the marketing and concept costs for the fund, can then be allocated directly to the investor. The investor can offset such losses against earnings from other types of income (e.g. income from work) and therefore reduce his tax burden.

However, in recent years the legislator has introduced various regulations which substantially restrict the setoff of losses from the participation in investment models against income from other sources. Today, losses from investment models can no longer be set off against other income if the planned losses of the company exceed more than 10% of the equity employed. If the above-mentioned limit is observed, it is still advisable for tax reasons to form a partnership. It is only a partnership which guarantees that losses can also be directly allocated to the

investors. Losses which can be offset against other income reduce the tax burden and thus increase the investor's return.

Irrespective of tax considerations, another advantage of the partnership is the possible flexible legal structure of the partner relationships in combination with only limited liability of the investors and the possibility of separating investors and management under company law. The procedures for forming a partnership and increasing the capital by accepting other partners are considerably easier to manage with partnerships than with corporations.

The limited commercial partnership has become the most popular partnership. Companies constituted under civil law also exist but are less frequent.

aa) Limited commercial partnership

The limited commercial partnership, which is regulated in Section 105 et seq. HGB, differentiates between two types of partners. On the one hand, there are the limited partners whose liability to the company creditors is basically limited to the capital contribution which they make and which is entered in the commercial register. On the other hand, there are the general partners whose liability for the company's debts cannot be limited.

In order to achieve limited liability for the general partner as well, a limited liability company (GmbH) is frequently used as the general partner. Its share capital frequently only amounts to the minimum capital of € 25,000 required by law. In this case only the GmbH is liable with its company assets for the liabilities of the limited commercial partnership.

As a rule, investment companies are structured so that the initiators assume the position of the general partner through a limited liability company (GmbH) which they have founded whereas the investors become limited partners, directly or indirectly, of the limited commercial partnership. This set-up creates additional benefits for the initiators in the management and representation of the limited commercial partnership. The general partner is therefore also entitled to assume managerial authority over the limited partners. This means that, with a majority resolution of the general partner, the limited partners cannot issue instructions in the normal course of business. The initiators are therefore largely free to take decisions and are merely subject to a liability risk in the event of incorrect management decisions.

The limited partners only have the authority to participate in the area of so-called extraordinary business transactions. These are transactions which are of extremely great importance for the company and are exceptions by their nature. The general partner may not enter into such transactions without the limited partners' consent.

> **Practical advice:** The limited partners' powers of consent to extraordinary business transactions may also be limited to one core area.

Under the heading "public limited partnership" court rulings have created a special right for closed-end funds in the legal form of the limited commercial partnership; this right must be observed when a public fund is being set up. The

term "public limited partnership" means a limited commercial partnership created for numerous investors to join. Typical characteristics of such a company are in particular:

- the differentiation between the founding partners, on the one hand, and the investors who subsequently join, on the other,
- the resultant lack of any possibility of the investors who join later to exert any influence on the structure of the partnership agreement,
- the process of publicly attracting the investors,
- the strong focus on the element of capital and, at the same time, the disregarding of the personnel element through the authorisation of a founding partner to increase the capital up to a defined amount.

According to court rulings, these aspects and the fact that a large number of limited partners participate with their capital but have no personal or any other relationship with each other and therefore have no influence on the company's partners permit principles applicable to corporations to be also applied to a limited commercial partnership.

This special right has taken on a special form through the objective interpretation and monitoring of the contents of the partnership agreements of this type of company. The objective interpretation of the partnership agreement means that it does not depend on subjective expectations of the investors or founding partners, which are not reflected in the partnership agreement. Given the fact that one of the typical features of the public limited commercial partnership is a pre-formulated partnership agreement, the contents of the agreement are monitored by applying the provisions pertaining to standard business terms (Section 305 et seq. BGB).

Practical advice: The preparation of the partnership agreement of a real estate investment company not only requires the greatest diligence but also a knowledge of the extensive court rulings on the special aspects of a public limited partnership.

bb) Company Constituted under Civil Law

As an investment company, a company constituted under civil law is an alternative to the limited commercial partnership. Statutory provisions on a company constituted under civil law can be found in Section 705 et seq. BGB. A company constituted under civil law differs essentially from the limited commercial partnership in that a statutory provision on its (partial) legal capacity does not exist. Whereas the limited commercial partnership is an independent legal entity, the designation "company constituted under civil law" means, according to the statutory definition, the contractual association of several people to pursue a joint purpose. This has material importance initially for the ownership entries in the land register. Whereas in the case of real estate belonging to a limited commercial partnership, the latter is entered as the owner, all partners of a company constituted under civil law must be entered in the land register.

The differentiation with regard to the partners' liability has particular practical significance. The partners of a company constituted under civil law are always liable for the company's debts. In principle, an exclusion of liability or a limitation of liability to the contribution made, such as applies to limited partners of a limited commercial partnership, does not exist for the rights of a company constituted under civil law. Therefore, the question is how liability can nevertheless be limited.

Basically, according to court rulings, it is not sufficient for the contracting party to be informed in a manner which he can understand that liability is limited to the company assets or that personal liability of the partners is excluded. A different principle applies to closed-end real estate funds with the legal form of a company constituted under civil law. If the partnership agreement contains a limitation of liability and the intention to limit liability was at least recognisable to the contracting party, the partners of such a company may invoke this limitation of liability.

> **Practice advice:** The partnership agreement of a real estate fund operated in the legal form of a company constituted under civil law must always contain the provision that the liability of the partners is limited to the company assets.

As far as partnership agreements for real estate funds are concerned, the provisions of the partnership agreement of a company constituted under civil law correspond to those in a partnership agreement of a limited commercial partnership. They are therefore explained together in the following.

b) Main Provisions in Partnership Agreements of Investment Companies

aa) Requirements on the Form of Partnership Agreements

Companies are frequently formed by the conclusion of a partnership agreement. The agreement may be concluded expressly or implicitly. At least two partners must undertake to promote a common purpose by making a contribution or promoting it in another way. Partnership agreements may also be informal, i.e. verbal. The partnership agreement of real estate investment company whose purpose is to buy and sell properties does not, in principle, require any particular form.

However, the situation is different when the partnership agreement contains the obligation to buy or sell a particular property. This is often the case with closed-end investment funds because they are generally formed for certain properties. However, there is no requirement on the form of the partnership agreement if a real estate company to which initially only the initiators of the funds belong first acquires the property for itself and only then are the applications for membership of the investors as well as collateral agreements and powers of attorney signed.

Practical advice: Where a real estate investment company is concerned, the question of the need for a formal partnership agreement requires thorough examination.

bb) Membership of the Capital Investors

The formulation most frequently used in practice of investor "membership" of an investment company means, in legal terms, that this involves the conclusion of an agreement between all the existing partners of the limited commercial partnership and the new partner. However, given the large number of partners in an investment company, it would be impractical for all the partners to meet in order to conclude a new partnership agreement with every "new member". Therefore, the general partner is frequently authorised in a provision in the partnership agreement to act on behalf of all the member partners and to adopt an appropriate resolution accepting the new partner's application for membership.

Practical advice: The new membership is to be recorded in a separate document and should contain once again the key aspects of the investor's participation.

It must also be noted that the investor is entitled, in accordance with Sections 312 and 355 BGB, to revoke his membership of the investment company within two weeks provided that he became a member in a so-called "doorstep situation". This is often the case when somebody has talked to the investor at his workplace or private residence and induced him to join an investment company. To ensure that the two-week period of revocation commences, it is necessary for the investor to be informed about the right of revocation.

Practical advice: The fact that the investor has been informed of his right of revocation must be recorded in a separate document.

cc) Participation in Assets and Profits

The key criterion for the investor's participation in the assets and profits is always the partner's share in the capital of the company. This capital share is only an operand. The statutory provision for limited commercial partnerships is based on a so-called variable capital share. The capital share refers to the contribution made. Shares in profits and any additional contributions made are credited, shares in losses and withdrawals are deducted.

This statutory system of variable capital shares, which is supposed to be the basis for participation in assets and profits, has proved to be particularly impractical for investment companies. The partnership agreements of investment companies therefore provide for at least two accounts which are kept for each partner by the company's accounts department. The agreed compulsory contribution is booked to the one account (often termed the so-called "fixed capital account" or capital account I). This fixed account is decisive for the

investor's participation in the assets and results. All profits and losses as well as withdrawals are booked to another account (variable capital account or capital account II).

In principle, the partners participate in the result of the investment company proportionate to their contributions. The profit distribution agreement under company law is also used as a basis for determining the results for tax purposes.

dd) Taking Decisions and Adopting Resolutions

Apart from a general provision, German law does not contain any statutory regulations on taking decisions and adopting resolutions in partnerships and at partners' meetings. For an investment company it is therefore of key importance for organisational rules on these aspects to be laid down in the partnership agreement. The partnership agreements of such companies therefore normally contain provisions based on the stipulations of limited liability company law on the convening of partners' meetings and the adoption of partners' resolutions.

In a partnership, the partners' meeting is usually convened by the limited liability company as the general partner or, in the case of a company constituted under civil law, by the managing partner. If there are good grounds, a limited partner may also convene a partners' meeting. Regardless of any provision in the partnership agreement, it is sufficient if five percent of the limited partners demand that an extraordinary partners' meeting be held.

The partnership agreements must also contain provisions on what constitutes a quorum of the partners' meeting. There are no reservations in law about a provision according to which a partners' meeting constitutes a quorum regardless of the number of partners attending. The partnership agreement of an investment company may, however, also establish that the meeting only constitutes a quorum when a certain percentage of the company's capital is present or represented.

The partners of an investment company may send a representative to attend the partners' meetings and cast votes on their behalf. Any exclusion of this possibility in the partnership agreement is ineffective. Moreover, any clause in the partnership agreement which authorises the general partner to cast a vote on behalf of partners who are not present or not represented is also ineffective.

Partners' resolutions must be adopted unanimously in typical commercial partnerships. Appropriate regulations in the partnership agreement permit deviations from this and majority resolutions can be agreed. Contrary to the provisions which place additional demands on the partnership agreement provisions relating to majority resolutions in commercial partnerships with a manageable number of partners, this is not necessary for investment companies. To this extent, a list of the subjects of resolutions which may be passed by a majority of partners can be dispensed with in the partnership agreement.

ee) Information Rights

In investment companies, the influence of the limited partners is frequently restricted to information rights which cannot be excluded. They include the right to demand a copy of the annual financial statements and to check their correctness by examining the books and documents. Moreover, on the application of a limited

partner, a court may, if there are good grounds, order the disclosure of a balance sheet and annual financial statements or other explanatory documents as well as the presentation of the books and documents at any time.

The investors have no possibility of influencing the management. In particular, they cannot demand that the management refrain from taking action which, if taken, would constitute an infringement of the managing directors' obligations. However, special provisions apply to investment companies as regards the possibilities of terminating a managing director's authority and the right to represent. According to the statutory provisions, a court ruling is required to terminate the managing director's authority and the right to represent; this ruling requires an appropriate application by all the partners. With an investment company, a resolution passed with a simple majority at a partners' meeting is sufficient. Any other provision in the partnership agreement demanding, in particular, a qualified majority for such a resolution is ineffective.

ff) Duration and End of Membership and the Partnership

The statutory provisions differentiate between partnerships which are entered into for an indefinite period and those entered into for a definite period. Both constellations are feasible in the field of closed-end real estate investment funds.

In the case of partnerships which are entered into for a definite period, termination prior to the final date stipulated in the partnership agreement is generally only possible for good cause. Premature withdrawal of the investors from such partnerships by serving due notice of termination is therefore not possible.

In the case of partnerships entered into for an indefinite period, the partners have, according to the statutory provisions, a right to serve six months' notice of termination at the end of the financial year. This right cannot be permanently excluded. However, it is possible to exclude the possibility of termination for a certain period, which may well be 20 years or possibly even longer. With such a constellation the investors, in turn, only have the possibility of terminating their membership for good cause.

> **Practical advice:** The termination possibilities must be clearly stipulated in the partnership agreement.

A partner's membership of the partnership is terminated when he withdraws from the partnership. The withdrawing partner has a right to payment of the amount which he would have received if the partnership had been dissolved at the time of his withdrawal. However, this regulation is dispositive. In order not to jeopardise the continuation of the investment company, provisions should be made in the partnership agreement permitting a settlement which has as small an impact on liquidity as possible. Points to consider here are the amount and the date when payment to the withdrawing partner is due.

gg) Liability and Duty to Make Subsequent Contributions

The investors are obliged to make their contributions in accordance with the provisions of the partnership agreement. In practice, there are various ways of doing so, in particular the immediate payment of the full amount of the contribution or payment in several instalments. To this extent, the provisions in the partnership agreement depend on the business necessities.

According to the statutory provisions, a limited partner is directly liable to the creditors of the partnership up to the amount of his contribution. Liability is excluded once the contribution has been paid. It arises again if and insofar as the contribution is paid back to him. The same applies if a limited partner withdraws shares in the profits although a loss has reduced his capital share to below the amount of the contribution made. The last constellation frequently occurs with investment companies. In the case of real estate investment funds, it is part of the economic concept that cash from rental income received is distributed to the limited partners regardless of whether the investment company records a profit in the balance sheet or whether it is still making a loss. An example is a real estate investment fund where the capital in the balance sheet is completely used up through depreciation but the rental income exceeds current liabilities (interest on loans and capital repayments etc.) and so the partnership can distribute the excess money to its partners.

The liability of the investing limited partner which arises under law in this case can be avoided: The amount entered in the commercial register by which the limited partner is liable to the company's external creditors is not his compulsory contribution agreed internally but a considerably lower so-called liability sum. Therefore, in practice a liability sum of € 100.00, for example, is often entered in the commercial register for every limited partner, regardless of the contribution he actually paid. The limited partner is then only liable up to the amount of this liability sum if his contribution has been paid back to him or he has withdrawn profits although the company has posted losses in the balance sheet.

> **Practical advice:** In order to reduce the risk of the investors' liability to third parties, only an amount of, for example, € 100.00 should be entered as the liability sum in the commercial register for each investor.

In view of the fact that limited partners and partners of a company constituted under civil law are not obliged to make subsequent contributions, any arrangement which obliges the investors to provide money in addition to their established contribution, for example, depending on the company's possible need for cash, requires an explicit provision in the partnership agreement.

Voluntary participation in a capital increase is a different case. As the partners' voting, profit and asset rights are normally linked to their percentage share of the fixed capital, failure to participate in a capital increase might result in a shift in these percentages. Therefore, it must be ensured that the limited partners are allowed to participate in any capital increase. In a company, a resolution on a capital increase can be passed by majority vote. On the other hand, it must also be ensured that the limited partners are not obliged to participate in a capital increase.

c) Forms of Investor Participation

In the structuring of a real estate investment fund there are basically two possibilities for the investors to participate in the company. Firstly, the investors can become involved directly as shareholders in the investment company, for example as a limited partner. Secondly, indirect participation is possible, preferably in the form of a trust or dormant partnership. The disadvantage of direct participation in a GmbH & Co. KG (combination of a limited liability company with a limited commercial partnership) is that every limited partner is entered in the commercial register as a shareholder. This not only creates corresponding public owing to the publicity in the commercial register but it also takes considerable time. The entry in the commercial register can only be made on the basis of notarised declarations which have to be submitted by each shareholder. As this makes the process for accepting the investor into the investment company much more difficult, indirect participation has proved to be more popular in practice, above all in the form of a trust or dormant partnership.

aa) Direct Participation

In the case of direct participation, the investor directly becomes a shareholder of the investment company. Here, the investor also has the participation rights under company law arising from his participation under company law. However, this does not mean that the legal position of the investor with a direct participation is stronger than that of an investor who is merely involved in the investment company through the mediation of a trustee. To this extent it all depends on the respective contracts, i.e. the partnership agreement and the trust contract. And in the case of indirect participation through a trustee limited partner it is also not unusual to directly grant the trustor, i.e. the investor, voting, monitoring and information rights.

In practice, investors are frequently offered both direct membership and indirect participation through a trustee limited partner. However, in view of the difficulties already mentioned above (notarisation of the commercial register application for entry as a limited partner in the commercial register) and the related costs, although only minimal, there are only a few investors who participate directly in investment companies.

> **Practical advice:** According to court rulings, every investor who participates indirectly must have the right to be able to convert his participation into direct participation. A corresponding provision must be provided in the partnership agreement.

bb) Indirect Participation

In the case of indirect participation, the participation of the investor is negotiated through a trustee limited partner selected by the initiators. The structure looks like this:

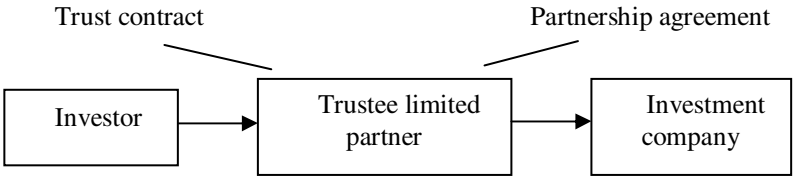


Figure 1. Participation of Investors in the case of indirect participations

The investors do not therefore join the investment company but conclude a trust contract with the trustee limited partner on the basis of which the trustee limited partner increases his limited partner's share in the investment company by the corresponding participation amount subscribed to by the individual investor. The trustee limited partner can have a large number of trustors, which is why, as a rule, he holds the participation of all investors together. Externally, only the trustee limited partner is regarded as a shareholder of the investment company.

The rights and obligations arising from the partnership agreement initially only affect the trustee limited partner. He is obliged under the law of obligations and on the basis of the trust contract to hold the limited partnership share in the interest of the trustor and accordingly exercise the associated membership rights. In order to assign the limited partnership participation to the investor under tax law, it is necessary for extensive authority to issue instructions regarding the participation to be granted to the trustor in the trust contract.

This leads to problems under company law if the trustee limited partner is given different instructions by the investors as regards voting on individual motions at the shareholders' meeting of the investment company. The splitting of votes is only possible if the partnership agreement permits this. Alternatively, the problem can be solved by permitting the investors to exercise their voting rights directly at the shareholders' meeting themselves.

The question as to whether the trustors have the right to attend the shareholders' meeting or whether they have further-reaching information rights, in particular the right to examine the books and documents of the company, is of the same nature. To be on the safe side (the higher courts have yet to rule on this aspect), the partnership agreement should contain appropriate provisions on this point and it is recommended to grant the investors corresponding rights directly in the partnership agreement.

cc) Dormant Partnership

The dormant partnership is also a possibility of collecting capital. In the case of the dormant partnership, a partnership agreement is concluded between the proprietor of a trading company, i.e. the investment company, and the dormant partner, i.e. the investor, by means of which the dormant partner makes a contribution to the investment company. The dormant partner at least participates in the profit of the investment company, but frequently also in the loss. A constellation whereby he receives a minimum rate of return regardless of the profit is also possible.

The dormant partnership agreement also contains extensive provisions on the legal relationship between the dormant partner and the investment company. As the name already indicates, the relationship between the investor and the investment company is concealed and is therefore not entered in the commercial register.

Fragmentary legal provisions for the dormant partnership relations can be found in Section 230 et seq. HGB. The differentiation between typical and atypical dormant participation not regulated in the law is material for its treatment, above all under tax law. In the case of an atypical dormant participation, the dormant partner also participates in the assets of the investment company. Moreover, the dormant partner has at least the rights which are also due to a limited partner by virtue of the statutory regulations.

3. Legal Foundation: German Securities Sales Prospectus Act

a) Introduction

Statutory regulations on closed-end funds (*geschlossene Fonds*) came into force for the first time in Germany on 1 July 2005. In view of the almost € 13 billion which was invested in closed-end funds by more than 370,000 private investors in Germany in 2005, the regulations for the so-called "grey capital market" also have major economic significance. Investments in this market are sold through freelance investment consultants and the banks. Prospectuses describing the investment in detail are used to inform the investors. These prospectuses are of key importance, which is also the reason for statutory regulation.

The Securities Sales Prospectus Act (*Verkaufsprospektgesetz*) is therefore also important for the initiators of closed-end real estate funds. In addition to this law, the Ordinance on Prospectuses for Securities Offered for Sale issued on the basis of this Act on 16 December 2004 also deserves special mention; it primarily regulates the contents and structure of prospectuses. The provisions correspond to the regulations known from other capital market laws on the content and form of prospectuses on investments offered publicly.

Three areas are now regulated with legally binding effect:

- the obligation to publish a prospectus,
- registration of the prospectus to sell after a formal examination by the Federal Financial Supervisory Authority (BaFin) and
- prospectus liability.

The aim is to provide greater protection for the investor, facilitate the creation of a uniform European capital market and to bring the regulations on investments in securities (Stock Exchange Act, Investment Act, Securities Prospectus Act) into line with those for company shareholdings not evidenced by securities.

The obligation to publish a prospectus affects the issuer. The issuer is the body which launches the investment on the market for the first time or offers it publicly

for purchase either itself or through third parties. In the case of shareholdings in a limited partnership (KG), the limited partnership is therefore the issuer.

b) Overview of the statutory regulations

The regulations can be broken down into four sections: the scope of application (see Section 1.), the duty to deposit and publish (see Section 2.), the requirements on the contents of the prospectus (see Section 3.) and prospectus liability (see Section 4.).

aa) Scope of application

The issuer must publish a prospectus if it

- is publicly offering shares not evidenced by securities which grant a participation in the results of a company or
- is offering shares in assets which the issuer or a third party holds or manages in its own name and for its own account or
- is offering shares in other closed-end funds.

The law is therefore creating quite a broad scope of application. Shares as defined by the regulation include shareholdings in partnerships, private limited company shares, shares in companies formed under the German Civil Code, co-operative shares as well as dormant equity holdings in the above companies or in certain assets as well as shareholdings in foreign companies with other legal forms. However, the scope of application does not cover shareholdings in stock corporations (*Aktiengesellschaften*) as these are evidenced by shares.

> **Practical advice:** Today in Germany the preparation of a prospectus is always a statutory requirement for a public offering regardless of the legal form of the company in which a shareholding is being offered.

Investments not evidenced by securities must be offered publicly. The term is not defined by law. It is mainly used to make a distinction between publicly offered investments and so-called private placements. Thus, offers are public when they are addressed to an undefined group of people.

Certain offers and investments are exempt from the prospectus obligation. The following cases are of practical importance:

- if no more than 20 shares of the same investment are offered or
- the selling price of the shares offered in a period of 12 months does not exceed € 100,000 or
- where the price of each share offered is at least € 200,000 per investor.

The aim of the exemptions is to protect the market against overregulation.

bb) Duty to deposit and publish

The essential amendment to the law is that the prospectus has to be submitted to and deposited with the Federal Financial Supervisory Authority (*BaFin*) prior to

its publication (and therefore also prior to the start of sale). This Authority keeps the prospectuses deposited with it for 10 years.

> **Practical advice:** The BaFin informs the offerer in writing of the date of receipt of the prospectus.

The prospectus may not be published until the BaFin gives permission for publication. The BaFin must give its decision on permission within 20 working days (including Saturday but not Sunday) from receipt of the prospectus; this period only starts to run when the offerer has submitted the documentation in full.

If the prospectus does not contain the minimum details required by the law and the ordinance, the BaFin forbids the sale. The fund initiator can appeal against this decision by filing an objection and an action to set aside the decision. However, the appeal does not suspend the effect of the decision and so no sale is possible until the decision is reversed.

However, the BaFin only performs a limited, i.e. merely formal, examination of the prospectuses. A check is only made to determine whether the prospectus contains all the factual and legal details required by law. Consequently, the prospectus is examined for *completeness* and to ensure that a certain structure has been observed. No examination of the correctness of the contents is performed.

> **Practical advice:** The granting of permission can take up to 24 week days. If public holidays fall in this period, it is extended accordingly.

After the BaFin has given its approval, the prospectus must be published before sales may commence. This means that either the prospectus or the paying agents where the prospectus can be obtained free of charge must be published in a supra-regional newspaper authorised by the German stock exchanges.

As the prospectus will in practice not be published alone because of its length, the limited partnership itself or the trustee (if appointed) is frequently mentioned as the paying agent.

> **Practical advice:** Supra-regional newspapers authorised by the German stock exchanges are, for example, Frankfurter Allgemeine Zeitung, Süddeutsche Zeitung, Financial Times Deutschland or Handelsblatt. A full list is given on the website of the BaFin (www.bafin.de) under "Links“ and there under "Ad hoc announcements“.

cc) Prospectus contents

According to the statutory provisions, the prospectus must contain all the factual and legal details necessary to enable the investor to make an appropriate assessment of the issuer and the investment. The details on this are regulated in an ordinance which requires that detailed information on the issuer, the investment, the assets and liabilities, financial position and profits and losses as well as the business prospects be given.

Special importance is attached to presentation of the factual and legal risks of a shareholding. They are to be explained in a separate section only containing this information. In the opinion of the BaFin, this section must appear in the first third of the prospectus.

> **Practical advice:** An incorrect or incomplete presentation of the risks connected with an investment means substantial liability risks for the offerer. Every offerer should therefore obtain professional advice.

The prospectus is to contain the necessary minimum details in the sequence stipulated in the ordinance. As this is a directory provision, the prospectus publisher may deviate from this sequence but must also then submit the "Crossover Checklist" (*Überkreuz-Checkliste*) to the BaFin. This checklist must indicate at what point in the prospectus the required minimum details are to be found. As the sequence required by law does not make it easier for investors to understand the investment on offer, a different sequence is always selected in practice.

> **Practical advice:** Observe the requirements of the extensive "Crossover Checklist" from the outset. The list can be downloaded from the website of the BaFin (www.bafin.de) under "Für Anbieter“ and there under "Prospekte for Vermögensanlagen" (not yet available in English).

dd) Prospectus Liability

The liability for prospectuses marketing participation in investment companies has now also been regulated in law. Section 13 VerkProspG refers to the relevant provisions in the Stock Exchange Act (*Börsengesetz*) and therefore differs fundamentally from the prospectus liability under investment law applying to open-end funds (see above under 2.2.5). Even before the new statutory regulations of prospectus liability came into force on 1 July 2005, any provider who had either not issued a prospectus or had issued a prospectus with mistakes in it ran the risk of being liable to pay damages to the investors according to the principles of prospectus liability developed by the court rulings. On the basis of the statutory regulations already in place regarding the publication of incorrect prospectuses in connection with the admission of a company to the stock exchange, the legislator has now also made the attraction of capital for shares in unlisted companies subject to statutory prospectus liability (Section 13 para. 1 No. 3, Section 13a VerkProspG). The provision refers to Sections 44 to 47 BörsG.

The starting point for liability is that material information is incorrect or incomplete in the prospectus. Material information includes the circumstances which, viewed objectively, are the value-forming factors of an investment and which any average, prudent investor would consider when making an investment decision. Information on actual circumstances is incorrect if the real circumstances at the time of the publication of the prospectus were different. Forecasts and value

assessments are incorrect if they do not have a proper factual basis or are not economically justifiable.

A prospectus is incomplete if it does not contain all material information. It must firstly be noted here that the examination of the formal completeness of the prospectus by the BaFin does provide a certain degree of monitoring. However, it must be remembered that a prospectus is not regarded as complete merely because it has been approved by the BaFin. The BaFin merely checks to determine whether the information required by law is contained in the prospectus. However, according to court rulings, a prospectus must, for example, also contain information on tax effectiveness risks if it is to be regarded as complete. This is not required by the German Securities Sales Prospectus Act.

Practical advice: In spite of approval by the BaFin, a prospectus may be incomplete in terms of prospectus liability. It is therefore always necessary to have a separate examination conducted by an expert consultant to determine whether the prospectus also contains all the information required by court rulings.

The investors claim against those who have assumed responsibility for the prospectus and those who initiated the publication of the prospectus. Those responsible for the prospectus are frequently both the investment company, as the issuer of the shares offered, and the initiator behind the investment company who acts on the market as the provider of the closed-end fund. The people who initiated the prospectus include those who do not appear publicly and who are the actual initiators of the prospectus.

These people are only liable if they are guilty of wilful intent or gross negligence as regards the incorrect or incomplete information in the prospectus. However guilt is assumed, which means that the people affected have to prove that they did not know about the incorrectness or incompleteness of the information in the prospectus and their lack of knowledge was not due to gross negligence on their part.

In addition to prospectus liability in the narrower sense regulated by law, the principles of prospectus liability in the broader sense developed by court rulings in the past also apply. Prospectus liability in the broader sense carries on from the contractual negotiations on the acquisition of shares in a closed-end fund. One major difference to prospectus liability in the narrower sense is therefore that claims can also be brought against people who only participate in the contractual negotiations on the acquisition of shares in an investment company. In this sense the investment brokers, investment consultants or guarantors (chartered accountants, lawyers, tax consultants) involved in the conclusion of the agreement can also be considered as being liable. However, in this case it is necessary for the defendant to have assumed a special personal guarantee for the soundness and due performance of the agreement. This may mainly be considered when the negotiating party provides guarantees for the correctness of he prospectus or make promises above and beyond the prospectus contents.

c) Prospectus Expertise by Chartered Accountants

It is now standard practice for an expertise on the assessment of the sales prospectus to be prepared by an independent chartered accountant and made available to the investors on request. The purpose of the chartered accountant's expertise is to draw a conclusion on whether the information material to an investment decision in the sales prospectus is complete and correct and whether this information is presented in a clear manner. The details of the assessment of prospectuses by chartered accountants are stipulated in so-called standards of the German Institute of Chartered Accountants (IDW). The so-called IDWS4 "Principles of the Proper Assessment of Sale Prospectuses on Investments Offered to the Public" dated 18 May 2006 (see www.idw.de under "Verlautbarungen“) are crucial in this connection.

The promulgation of the IDW represents, at the same time, working instructions for the preparation of a prospectus because the observance of the standards published by the IDW also satisfies the requirements of the German Securities Sales Prospectus Act.

Practical advice: It is recommended to commission a chartered accountant's expertise. The chartered accountant should be chosen and commissioned at an early stage and involved in the preparation of the prospectus.

IV. Real Estate Investment Trusts

1. Introduction

The introduction of real estate investment trusts (REITs) in Germany is imminent. The German cabinet voted on a relevant bill on 2 November 2006 which passed through the Bundestag (lower house) on 23 March 2007. The law would come into force after the end of the legislative procedure, which is expected on April 2007.

Real estate investment trusts are not a German invention. There have been REITs in the rest of Europe (France, Belgium, Luxembourg and the Netherlands) for years. Structures similar to REITs have been introduced in Spain and Italy and Great Britain is about to launch REITs. The concept was developed in the United States in the 1960s. REITs achieved the decisive breakthrough in the USA in 1992. Since then the previous owners of the real estate no longer have to immediately tax undisclosed reserves of the real estate which they transfer to the REITs. Thanks to this incentive, the volume of real estate offered for REITs has grown sharply in the USA. The transparent REIT status has resulted in a mobilisation of investment capital. Taken together, both aspects have increased and professionalised the organised market for real estate investments tremendously.

Similar expectations are also placed on the introduction of REITs in Germany. Here, about 73% of companies own their own real estate, a high figure compared

with the USA with 25% and England with 54%. The 65 largest listed companies in Germany alone have real estate reserves amounting to some € 80 billion. This ties up a lot of equity which could be put to better use for investments in the company's core business and therefore for improving the international competitiveness of German companies.

2. Key Points of the law

Real estate investment trusts are not a new form of company. These companies are listed stock corporations which are subject to different income tax regulations. The taxes are not levied on the company itself but on its investors. To this end REITs must fulfil two conditions: Firstly, a high percentage of the profit must be distributed to the investors. Secondly, the company's activity must be limited to real estate transactions.

The law mainly contains the following elements:

- The German REIT is formed as a stock corporation with its registered office in Germany and must definitely be listed on the stock exchange. The free float is to be secured by a permanent quota of at least 15%.
- The REIT stock corporation is exempt from corporation and trade tax provided the main activity of the company is the acquisition, management and sale of real estate. The investors are taxed directly on the income generated by the REIT after the distribution of profits.
- Each shareholder may only have a direct participation of less than 10% in a REIT stock corporation. Through this regulation, the legislator aims to establish the REIT as a stock corporation with a broad group of investors. Indirect participation of the investors which may also result in a higher participation than 10% is possible - and in practice will certainly be found in many cases in the future.
- The REIT stock corporation is obliged to distribute to the shareholders at least 90% of the distributable profits posted in the annual financial statements.
- A so-called exit tax is also planned. Companies which transfer their real estate into a REIT stock corporation or convert into such a corporation need only carry half the value of the real estate for tax purposes provided the process takes place by 31 December 2009. With this regulation German companies are to be given the appropriate incentive to actually put their stocks of real estate on the market.

The important aspect is that residential real estate built prior to 1 January 2007 is explicitly excluded from the scope of application of the REITs. Here, rented residential real estate means real estate where the useful space is used predominantly, i.e. more than 50%, for accommodation. Germany would therefore adopt a different strategy to other countries. However, in view of the minor significance of REITs for residential real estate (e.g. in the USA only 18% of the REITs specialise in residential real estate), this only minimally reduces the

attractiveness of the REIT stock corporation. Anyway, it remains to be seen whether this limitation is lifted again in the future.

All in all, it must be noted that the introduction of REITs in Germany will create an attractive tax possibility which should be of particular interest to foreign investors. It is expected that attractive commercial real estate will be offered on the market in the years to come, exploiting the exit tax possibility so that REITs with an attractive real estate portfolio can be set up in the short term.

Appendix I: Verordnung über Grundsätze für Ermittlung der Verkehrswerte von Grundstücken (Wertermittlungsverordnung – WertV)

Verordnung über Grundsätze für die Ermittlung der Verkehrswerte von Grundstücken (Wertermittlungsverordnung – WertV) vom 6.12.1988 (BGBl. I 1988, S. 2209)

zuletzt geändert durch Art. 3 des Gesetzes zur Änderung des Baugesetzbuchs und zur Neuregelung des Rechts der Raumordnung (Bau- und Raumordnungsgesetz 1998 - BauROG) vom 18. August 1997 (BGBl. I 1997, S. 2081

Erster Teil Anwendungsbereich, allgemeine Verfahrensgrundsätze und Begriffsbestimmungen

§ 1 Anwendungsbereich
(1) Bei der Ermittlung der Verkehrswerte von Grundstücken und bei der Ableitung der für die Wertermittlung erforderlichen Daten sind die Vorschriften dieser Verordnung anzuwenden.
(2) Absatz 1 ist auf die Wertermittlung von grundstücksgleichen Rechten, Rechten an diesen und Rechten an Grundstücken entsprechend anzuwenden.

§ 2 Gegenstand der Wertermittlung
Gegenstand der Wertermittlung kann das Grundstück oder ein Grundstücksteil einschließlich seiner Bestandteile wie Gebäude, Außenanlagen und sonstigen Anlagen sowie des Zubehörs sein. Die Wertermittlung kann sich auch auf einzelne der in Satz 1 bezeichneten Gegenstände beziehen.

§ 3 Zustand des Grundstücks und allgemeine Wertverhältnisse
(1) Zur Ermittlung des Verkehrswerts eines Grundstücks sind die allgemeinen Wertverhältnisse auf dem Grundstücksmarkt in dem Zeitpunkt zugrunde zu legen, auf den sich die Wertermittlung bezieht (Wertermittlungsstichtag). Dies gilt auch für den Zustand des Grundstücks, es sei denn, dass aus rechtlichen oder sonstigen Gründen ein anderer Zustand des Grundstücks maßgebend ist.

(2) Der Zustand eines Grundstücks bestimmt sich nach der Gesamtheit der verkehrswertbeeinflussenden rechtlichen Gegebenheiten und tatsächlichen Eigenschaften, der sonstigen Beschaffenheit und der Lage des Grundstücks. Hierzu gehören insbesondere der Entwicklungszustand (§ 4), die Art und das Maß der baulichen Nutzung (§ 5 Abs. 1), die wertbeeinflussenden Rechte und Belastungen (§ 5 Abs. 2), der beitrags- und abgabenrechtliche Zustand (§ 5 Abs. 3), die Wartezeit bis zu einer baulichen oder sonstigen Nutzung (§ 5 Abs. 4), die Beschaffenheit und Eigenschaft des Grundstücks (§ 5 Abs. 5) und die Lagemerkmale (§ 5 Abs. 6).
(3) Die allgemeinen Wertverhältnisse auf dem Grundstücksmarkt bestimmen sich nach der Gesamtheit der am Wertermittlungsstichtag für die Preisbildung von Grundstücken im gewöhnlichen Geschäftsverkehr für Angebot und Nachfrage maßgebenden Umstände wie die allgemeine Wirtschaftssituation, der Kapitalmarkt und die Entwicklungen am Ort. Dabei bleiben ungewöhnliche oder persönliche Verhältnisse (§ 6) außer Betracht.

§ 4 Zustand und Entwicklung von Grund und Boden
(1) Flächen der Land- und Forstwirtschaft sind entsprechend genutzte oder nutzbare Flächen,

1. von denen anzunehmen ist, dass sie nach ihren Eigenschaften, der sonstigen Beschaffenheit und Lage, nach ihren Verwertungsmöglichkeiten oder den sonstigen Umständen in absehbarer Zeit nur land- und forstwirtschaftlichen Zwecken dienen werden,

2. die sich, insbesondere durch ihre landschaftliche oder verkehrliche Lage, durch ihre Funktion oder durch ihre Nähe zu Siedlungsgebieten geprägt, auch für außerlandwirtschaftliche oder außerforstwirtschaftliche Nutzungen eignen, sofern im gewöhnlichen Geschäftsverkehr eine dahingehende Nachfrage besteht und auf absehbare Zeit keine Entwicklung zu einer Bauerwartung bevorsteht.

(2) Bauerwartungsland sind Flächen, die nach ihrer Eigenschaft, ihrer sonstigen Beschaffenheit und ihrer Lage eine bauliche Nutzung in absehbarer Zeit tatsächlich erwarten lassen. Diese Erwartung kann sich insbesondere auf eine entsprechende Darstellung dieser Flächen im Flächennutzungsplan, auf ein entsprechendes Verhalten der Gemeinde oder auf die allgemeine städtebauliche Entwicklung des Gemeindegebiets gründen.
(3) Rohbauland sind Flächen, die nach den §§ 30, 33 und 34 des Baugesetzbuchs für eine bauliche Nutzung bestimmt sind, deren Erschließung aber noch nicht gesichert ist oder die nach Lage, Form oder Größe für eine bauliche Nutzung unzureichend gestaltet sind.
(4) Baureifes Land sind Flächen, die nach öffentlich-rechtlichen Vorschriften baulich nutzbar sind.

§ 5 Weitere Zustandsmerkmale

(1) Art und Maß der baulichen Nutzung ergeben sich in der Regel aus den für die städtebauliche Zulässigkeit von Vorhaben maßgeblichen §§ 30, 33 und 34 des Baugesetzbuchs unter Berücksichtigung der sonstigen öffentlich-rechtlichen und privatrechtlichen Vorschriften, die Art und Maß der baulichen Nutzung mitbestimmen. Wird vom Maß der zulässigen Nutzung am Wertermittlungsstichtag in der Umgebung regelmäßig nach oben abgewichen oder wird die zulässige Nutzung nicht voll ausgeschöpft, ist die Nutzung maßgebend, die im gewöhnlichen Geschäftsverkehr zugrunde gelegt wird.

(2) Als wertbeeinflussende Rechte und Belastungen kommen solche privatrechtlicher und öf-fentlich-rechtlicher Art wie Dienstbarkeiten, Nutzungsrechte, Baulasten und sonstige dingliche Rechte und Lasten in Betracht.

(3) Für den beitrags-und abgaberechtlichen Zustand des Grundstücks ist die Pflicht zur Entrichtung von öffentlich-rechtlichen Beiträgen und nicht steuerlichen Abgaben maßgebend.

(4) Die Wartezeit bis zu einer bauliche oder sonstigen Nutzung eines Grundstücks richtet sich nach der voraussichtlichen Dauer bis zum Eintritt der rechtlichen und tatsächlichen Voraussetzungen, die für die Zulässigkeit der baulichen Nutzung erforderlich sind.

(5) Die Beschaffenheit und die tatsächlichen Eigenschaften des Grundstücks werden insbesondere durch die Grundstücksgröße und Grundstücksgestalt, die Bodenbeschaffenheit (z.B. Bodengüte, Eignung als Baugrund, Belastung mit Ablagerungen), die Umwelteinflüsse, die tatsächliche Nutzung und Nutzbarkeit bestimmt. Bei bebauten Grundstücken wird die Beschaffenheit vor allem auch durch den Zustand der baulichen Anlagen hinsichtlich der Gebäudeart, des Baujahrs, der Bauweise und Baugestaltung, der Größe und Ausstattung, des baulichen Zustands und der Erträge bestimmt.

(6) Lagemerkmale von Grundstücken sind insbesondere die Verkehrsanbindung, die Nachbarschaft, die Wohn- und Geschäftslage sowie die Umwelteinflüsse.

§ 6 Ungewöhnliche oder persönliche Verhältnisse

(1) Zur Wertermittlung und zur Ableitung erforderlicher Daten für die Wertermittlung sind Kaufpreise und andere Daten wie Mieten und Bewirtschaftungskosten heranzuziehen, bei denen anzunehmen ist, dass sie nicht durch ungewöhnliche oder persönliche Verhältnisse beeinflusst worden sind. Die Kaufpreise und die anderen Daten, die durch ungewöhnliche oder persönliche Verhältnisse beeinflusst worden sind, dürfen nur herangezogen werden, wenn deren Auswirkungen auf die Kaufpreise und die anderen Daten sicher erfasst werden können.

(2) Kaufpreise und andere Daten können durch ungewöhnliche oder persönliche Verhältnisse beeinflusst werden, wenn

1. sie erheblich von den Kaufpreisen in vergleichbaren Fällen abweichen,
2. ein außergewöhnliches Interesse des Veräußerers oder des Erwerbers an dem Verkauf oder dem Erwerb des Grundstücks bestanden hat,
3. besondere Bindungen verwandtschaftlicher, wirtschaftlicher oder sonstiger Art zwischen den Vertragsparteien bestanden haben oder

4. Erträge, Bewirtschaftungs- und Herstellungskosten erheblich von denen in vergleichbaren Fällen abweichen.

(3) Eine Beeinflussung der Kaufpreise und der anderen Daten kann auch vorliegen, wenn diese durch Aufwendungen mitbestimmt worden sind, die aus Anlass des Erwerbs und der Veräußerung entstehen, wenn diese nicht zu den üblicherweise vertraglich vereinbarten Entgelten gehören, namentlich besondere Zahlungsbedingungen sowie die Kosten der bisherigen Vorhaltung, Abstandzahlungen, Ersatzleistungen, Zinsen, Steuern und Gebühren.

§ 7 Ermittlung des Verkehrswerts

(1) Zur Ermittlung des Verkehrswerts sind das Vergleichswertverfahren (§§ 13 und 14), das Ertragswertverfahren (§§ 15 bis 20), das Sachwertverfahren (§§ 21 bis 25) oder mehrere dieser Verfahren heranzuziehen. Der Verkehrswert ist aus dem Ergebnis des herangezogenen Verfahrens unter Berücksichtigung der Lage auf dem Grundstücksmarkt (§ 3 Abs. 3) zu bemessen. Sind mehrere Verfahren herangezogen worden, ist der Verkehrswert aus den Ergebnissen der angewandten Verfahren unter Würdigung ihrer Aussagefähigkeit zu bemessen.

(2) Die Verfahren sind nach der Art des Gegenstands der Wertermittlung (§ 2) unter Berücksichtigung der im gewöhnlichen Geschäftsverkehr bestehenden Gepflogenheiten und den sonstigen Umständen des Einzelfalls zu wählen; die Wahl ist zu begründen.

Zweiter Teil Ableitung erforderlicher Daten

§ 8 Erforderliche Daten

Die für die Wertermittlung erforderlichen Daten sind aus der Kaufpreissammlung (§ 193 Abs. 3 des Baugesetzbuchs) unter Berücksichtigung der jeweiligen Lage auf dem Grundstücksmarkt abzuleiten. Hierzu gehören insbesondere Indexreihen (§ 9), Umrechnungskoeffizienten (§ 10), Liegenschaftszinssätze (§ 11) und Vergleichsfaktoren für bebaute Grundstücke (§ 12).

§ 9 Indexreihen

(1) Änderungen der allgemeinen Wertverhältnisse auf dem Grundstücksmarkt sollen mit Indexreihen erfasst werden.

(2) Bodenpreisindexreihen bestehen aus Indexzahlen, die sich aus dem durchschnittlichen Verhältnis der Bodenpreise eines Erhebungszeitraums zu den Bodenpreisen eines Basiszeitraums mit der Indexzahl 100 ergeben. Die Bodenpreisindexzahlen können auch auf bestimmte Zeitpunkte des Erhebungs- und Basiszeitraums bezogen werden.

(3) Die Indexzahlen der Bodenpreisindexreihen werden für Grundstücke mit vergleichbaren La-ge-und Nutzungsverhältnissen aus den geeigneten und ausgewerteten Kaufpreisen für unbebaute Grundstücke des Erhebungszeitraums abgeleitet. Kaufpreise solcher Grundstücke, die in ihren wertbeeinflussenden Merkmalen voneinander abweichen, sind nach Satz 1 zur Ableitung der Bodenpreisindexzahlen nur geeignet, wenn die Abweichungen

1. in ihren Auswirkungen auf die Preise sich ausgleichen,
2. durch Zu- oder Abschläge oder
3. durch andere geeignete Verfahren berücksichtigt werden können.

Das Ergebnis eines Erhebungszeitraums kann in geeigneten Fällen durch Vergleich mit den Indexreihen anderer Bereiche und vorausgegangener Erhebungszeiträume überprüft werden.
(4) Bei Ableitung anderer Indexreihen, wie für Preise von Eigentumswohnungen, sind die Absätze 2 und 3 entsprechend anzuwenden.

§ 10 Umrechnungskoeffizienten
(1) Wertunterschiede von Grundstücken, die sich aus Abweichungen bestimmter wertbeeinflussender Merkmale sonst gleichartiger Grundstücke ergeben, insbesondere aus dem unterschiedlichen Maß der baulichen Nutzung, sollen mit Hilfe von Umrechungskoeffizienten erfasst werden.
(2) Umrechnungskoeffizienten werden auf der Grundlage einer ausreichenden Zahl geeigneter und ausgewerteter Kaufpreise für bestimmte Merkmale der Abweichungen abgeleitet. Kaufpreise von Grundstücken, die in mehreren wertbeeinflussenden Merkmalen voneinander abweichen oder von den allgemeinen Wertverhältnissen auf dem Grundstücksmarkt unterschiedlich beeinflusst worden sind, sind geeignet, wenn diese Einflüsse jeweils durch Zu- oder Abschläge oder durch andere geeignete Verfahren berücksichtigt werden können.

§ 11 Liegenschaftszins
(1) Der Liegenschaftszins ist der Zinssatz, mit dem der Verkehrswert von Liegenschaften im Durchschnitt marktüblich verzinst wird.
(2) Der Liegenschaftszinssatz ist auf der Grundlage geeigneter Kaupreise und der ihnen entsprechenden Reinerträge für gleichartig bebaute und genutzte Grundstücke unter Berücksichtigung der Restnutzungsdauer der Gebäude nach den Grundsätzen des Ertragswertverfahrens (§§ 15 bis 20) zu ermitteln.

§ 12 Vergleichsfaktoren für bebaute Grundstücke
(1) Zur Ermittlung von Vergleichsfaktoren für bebaute Grundstücke sind die Kaufpreise gleichartiger Grundstücke heranzuziehen. Gleichartige Grundstücke sind solche, die insbesondere nach Lage und Art und Maß der baulichen Nutzung sowie Größe und Alter der baulichen Anlagen vergleichbar sind.
(2) Die Kaufpreise nach Absatz 1 sind auf den nachhaltig erzielbaren jährlichen Ertrag (Ertragsfaktor) oder auf eine sonstige geeignete Bezugseinheit, insbesondere auf eine Raum- oder Flächeneinheit der baulichen Anlage (Gebäudefaktor), zu beziehen.
(3) Soll bei der Ermittlung des Verkehrswerts bebauter Grundstücke nach dem Vergleichswertverfahren der Wert der Gebäude getrennt von dem Bodenwert ermittelt werden, können nach Maßgabe des Absatzes 2 auch die auf das jeweilige Gebäude entfallenden Anteile der Kaufpreise gleichartig bebauter und genutzter

Grundstücke auf den nachhaltig erzielbaren jährlichen Ertrag oder auf eine der sonstigen geeigneten Bezugseinheiten bezogen werden.

Dritter Teil Wertermittlungsverfahren

Erster Abschnitt Vergleichswertverfahren

§ 13 Ermittlungsgrundlagen

(1) Bei Anwendung des Vergleichswertverfahrens sind Kaufpreise solcher Grundstücke heranzuziehen, die hinsichtlich der ihren Wert beeinflussenden Merkmale (§§ 4 und 5) mit dem zu bewertenden Grundstück hinreichend übereinstimmen (Vergleichsgrundstücke). Finden sich in dem Gebiet, in dem das Grundstück gelegen ist, nicht genügend Kaufpreise, können auch Vergleichsgrundstücke aus vergleichbaren Gebieten herangezogen werden.

(2) Zur Ermittlung des Bodenwerts können neben oder anstelle von Preisen für Vergleichsgrundstücke auch geeignete Bodenrichtwerte herangezogen werden. Bodenrichtwerte sind geeignet, wenn sie entsprechend den örtlichen Verhältnissen unter Berücksichtigung von Lage und Entwicklungszustand gegliedert und nach Art und Maß der baulichen Nutzung, Erschließungszustand und jeweils vorherrschender Grundstücksgestalt hinreichend bestimmt sind.

(3) Bei bebauten Grundstücken können neben oder anstelle von Preisen für Vergleichsgrundstücke insbesondere die nach Maßgabe des § 12 ermittelten Vergleichsfaktoren herangezogen werden. Der Vergleichswert ergibt sich durch Vervielfachung des jährlichen Ertrags oder der sonstigen Bezugseinheit des zu bewertenden Grundstücks mit dem nach § 12 ermittelten Vergleichsfaktor; Zu- oder Abschläge nach § 14 sind dabei zu berücksichtigen. Bei Verwendung von Vergleichsfaktoren, die sich nur auf das Gebäude beziehen (§ 12 Abs. 3), ist der getrennt vom Gebäudewert zu ermittelnde Bodenwert gesondert zu berücksichtigen.

§ 14 Berücksichtigung von Abweichungen

Weichen die wertbeeinflussenden Merkmale der Vergleichsgrundstücke oder der Grundstücke, für die Bodenrichtwerte oder Vergleichsfaktoren bebauter Grundstücke abgeleitet worden sind, vom Zustand des zu bewertenden Grundstücks ab, so ist dies durch Zu-oder Abschläge oder in anderer geeigneter Weise zu berücksichtigen. Dies gilt auch, soweit die den Preisen von Vergleichsgrundstücken und den Bodenrichtwerten zugrunde liegenden allgemeinen Wertverhältnisse von denjenigen am Wertermittlungsstichtag abweichen. Dabei sollen vorhandene Indexreihen (§ 9) und Umrechnungskoeffizienten (§ 10) herangezogen werden.

Zweiter Abschnitt Ertragswertverfahren

§ 15 Ermittlungsgrundlagen

(1) Bei Anwendung des Ertragswertverfahrens ist der Wert der baulichen Anlagen, insbesondere der Gebäude, getrennt von dem Bodenwert auf der Grundlage des Ertrags nach den §§ 16 bis 19 zu ermitteln.

(2) Der Bodenwert ist in der Regel im Vergleichswertverfahren (§§ 13 und 14) zu ermitteln.

(3) Bodenwert und Wert der baulichen Anlagen ergeben den Ertragswert des Grundstücks, soweit dieser nicht nach § 20 zu ermitteln ist.

§ 16 Ermittlung des Ertragswerts der baulichen Anlage

(1) Bei der Ermittlung des Ertragswerts der baulichen Anlagen ist von dem nachhaltig erzielbaren jährlichen Reinertrag des Grundstücks auszugehen. Der Reinertrag ergibt sich aus dem Rohertrag (§ 17) abzüglich der Bewirtschaftungskosten (§ 18).

(2) Der Reinertrag ist um den Betrag zu vermindern, der sich durch angemessene Verzinsung des Bodenwerts ergibt. Der Verzinsung ist in der Regel der für die Kapitalisierung nach Absatz 3 maßgebende Liegenschaftszinssatz (§ 11) zugrunde zu legen. Ist das Grundstück wesentlich größer als es einer den baulichen Anlagen angemessenen Nutzung entspricht und ist eine zusätzliche Nutzung oder Verwertung einer Teilfläche zulässig und möglich, ist bei der Berechung des Verzinsungsbetrags der Bodenwert dieser Teilfläche nicht anzusetzen.

(3) Der um den Verzinsungsbetrag des Bodenwerts verminderte Reinertrag ist mit dem sich aus Anlage 1 zu dieser Verordnung ergebenden Vervielfältiger zu kapitalisieren. Maßgebend ist derjenige Vervielfältiger, der sich nach dem Liegenschaftszinssatz und der Restnutzungsdauer der baulichen Anlagen ergibt.

(4) Als Restnutzungsdauer ist die Anzahl der Jahre anzusehen, in denen die baulichen Anlagen bei ordnungsgemäßer Unterhaltung und Bewirtschaftung voraussichtlich noch wirtschaftlich genutzt werden können; durchgeführte Instandsetzungen oder Modernisierungen oder unterlassene Instandhaltung oder andere Gegebenheiten können die Restnutzungsdauer verlängern oder verkürzen. Entsprechen die baulichen Anlagen nicht den allgemeinen Anforderungen an gesunde Wohn-und Arbeitsverhältnisse oder an die Sicherheit der auf dem betroffenen Grundstück wohnenden oder arbeitenden Menschen, ist dies bei der Ermittlung der Restnutzungsdauer besonders zu berücksichtigen.

§ 17 Rohertrag

(1) Der Rohertrag umfasst alle bei ordnungsgemäßer Bewirtschaftung und zulässiger Nutzung nachhaltig erzielbaren Einnahmen aus dem Grundstück, insbesondere Mieten und Pachten einschließlich Vergütungen. Umlagen, die zur Deckung von Betriebskosten gezahlt werden, sind nicht zu berücksichtigen.

(2) Werden für die Nutzung von Grundstücken oder Teilen eines Grundstücks keine oder vom Üblichen abweichende Entgelte erzielt, sind die bei einer Vermietung oder Verpachtung nachhaltig erzielbaren Einnahmen zugrunde zu legen.

§ 18 Bewirtschaftungskosten

(1) Bewirtschaftungskosten sind die Abschreibung, die bei gewöhnlicher Bewirtschaftung nachhaltig entstehenden Verwaltungskosten (Absatz 2), Betriebskosten (Absatz 3), Instandhaltungskosten (Absatz 4) und das Mietausfallwagnis (Absatz 5); durch Umlagen gedeckte Betriebskosten bleiben unberücksichtigt. Die Abschreibung ist durch Einrechung in den Vervielfältiger nach § 16 Abs. 3 berücksichtigt.

(2) Verwaltungskosten sind

1. die Kosten der zur Verwaltung des Grundstücks erforderlichen Arbeitskräfte und Einrichtungen,
2. die Kosten der Aufsicht sowie
3. die Kosten für die gesetzlichen oder freiwilligen Prüfungen des Jahresabschlusses und der Geschäftsführung.

(3) Betriebskosten sind Kosten, die durch das Eigentum am Grundstück oder durch den bestimmungsgemäßen Gebrauch des Grundstücks sowie seiner baulichen und sonstigen Anlagen laufend entstehen.

(4) Instandhaltungskosten sind Kosten, die infolge Abnutzung, Alterung und Witterung zur Erhaltung des bestimmungsgemäßen Gebrauchs der baulichen Anlagen während ihrer Nutzungsdauer aufgewendet werden müssen.

(5) Mietausfallwagnis ist das Wagnis einer Ertragsminderung (§ 17), die durch uneinbringliche Mietrückstände oder Leerstehen von Raum, der zur Vermietung bestimmt ist, entsteht. Es dient auch zur Deckung der Kosten einer Rechtsverfolgung auf Zahlung, Aufhebung eines Mietverhältnisses oder Räumung.

(6) Die Verwaltungskosten, die Instandhaltungskosten und das Mietausfallwagnis sind nach Erfahrungssätzen anzusetzen, die unter Berücksichtigung der Restnutzungsdauer den Grundsätzen einer ordnungsgemäßen Bewirtschaftung entsprechen. Die Betriebskosten sind unter Berücksichtigung der Grundsätze einer ordnungsgemäßen Bewirtschaftung im üblichen Rahmen nach ihrer tatsächlichen Höhe unter Einbeziehung der vom Eigentümer selbst erbrachten Sach- und Arbeitsleistung zu ermitteln. Soweit sie sich nicht ermitteln lassen, ist von Erfahrungssätzen auszugehen.

§ 19 Berücksichtigung sonstiger wertbeeinflussender Umstände

Sonstige den Verkehrswert beeinflussende Umstände, die bei der Ermittlung nach den §§ 16 bis 18 noch nicht erfasst sind, sind durch Zu- oder Abschläge oder in anderer geeigneter Weise zur berücksichtigen. Insbesondere sind die Nutzung des Grundstücks für Werbezwecke oder wohnungs- und mietrechtliche Bindungen sowie Abweichungen vom normalen baulichen Zustand zu beachten, soweit sie nicht bereits durch den Ansatz des Ertrags oder durch eine entsprechend geänderte Restnutzungsdauer berücksichtigt sind.

§ 20 Ermittlung des Ertragswerts in besonderen Fällen

(1) Verbleibt bei der Minderung des Reinertrags um den Verzinsungsbetrag des Bodenwerts nach § 16 Abs. 2 kein Anteil für die Ermittlung des Ertragswerts der baulichen Anlagen, so ist als Ertragswert des Grundstücks nur der Bodenwert anzusetzen. Der Bodenwert ist in diesem Fall um die gewöhnlichen Kosten zu

mindern, insbesondere Abbruchkosten, die aufzuwenden wären, damit das Grundstück vergleichbaren unbebauten Grundstücken entspricht, soweit diese im gewöhnlichen Geschäftsverkehr berücksichtigt werden.
(2) Wenn das Grundstück aus rechtlichen oder sonstigen Gründen alsbald nicht freigelegt und deshalb eine dem Bodenwert angemessene Verzinsung nicht erzielt werden kann, ist dies bei dem nach Absatz 1 Satz 2 verminderten Bodenwert für die Dauer der Nutzungsbeschränkung zusätzlich angemessen zu berücksichtigen. Der so ermittelte Bodenwert zuzüglich des kapitalisierten, aus der Nutzung des Grundstücks nachhaltig erzielbaren Reinertrags ergeben den Ertragswert. Der für die Kapitalisierung des nachhaltig erzielbaren Reinertrags maßgebende Vervielfältiger bestimmt sich nach der Dauer der Nutzungsbeschränkung und dem der Grundstücksart entsprechenden Liegenschaftszinssatz.
(3) Stehen dem Abriss der Gebäude längerfristig rechtliche oder andere Gründe entgegen und wird den Gebäuden nach den Verhältnissen des örtlichen Grundstücksmarkts noch ein Wert beigemessen, kann der Ertragswert nach den §§ 15 bis 19 mit einem Bodenwert ermittelt werden, der von dem Wert nach § 15 Abs. 2 abweicht. Bei der Bemessung dieses Bodenwerts ist die eingeschränkte Ertragsfähigkeit des Grundstücks sowohl der Dauer als auch der Höhe nach angemessen zu berücksichtigen.

Dritter Abschnitt Sachwertverfahren

§ 21 Ermittlungsgrundlagen
(1) Bei Anwendung des Sachwertverfahrens ist der Wert der baulichen Anlagen, wie Gebäude, Außenanlagen und besondere Betriebseinrichtungen, und der Wert der sonstigen Anlagen, getrennt vom Bodenwert, nach Herstellungswerten zu ermitteln.
(2) Der Bodenwert ist in der Regel im Vergleichswertverfahren (§§ 13 und 14) zu ermitteln.
(3) Der Herstellungswert von Gebäuden ist unter Berücksichtigung ihres Alters (§ 23) und von Baumängeln und Bauschäden (§ 24) sowie sonstiger wertbeeinflussender Umstände (§ 25) nach § 22 zu ermitteln. Für die Ermittlung des Herstellungswerts der besonderen Betriebseinrichtungen gelten die §§ 22 bis 25 entsprechend.
(4) Der Herstellungswert von Außenanlagen und sonstigen Anlagen wird, soweit sie nicht vom Bodenwert miterfasst werden, nach Erfahrungssätzen oder nach den gewöhnlichen Herstellungskosten ermittelt. Die §§ 22 bis 25 finden entsprechende Anwendung.
(5) Bodenwert und Wert der baulichen Anlagen und der sonstigen Anlagen ergeben den Sachwert des Grundstücks.

§ 22 Ermittlung des Herstellungswerts
(1) Zur Ermittlung des Herstellungswerts der Gebäude sind die gewöhnlichen Herstellungskosten je Raum- oder Flächeneinheit (Normalherstellungskosten) mit der Anzahl der entsprechenden Raum-, Flächen-oder sonstigen Bezugseinheiten

der Gebäude zu vervielfachen. Einzelne Bauteile, Einrichtungen oder sonstige Vorrichtungen, die insoweit nicht erfasst werden, sind durch Zu- oder Abschläge zu berücksichtigen.
(2) Zu den Normalherstellungskosten gehören auch die üblicherweise entstehenden Baunebenkosten, insbesondere Kosten für Planung, Baudurchführung, behördliche Prüfungen und Genehmigungen sowie für die in unmittelbarem Zusammenhang mit der Herstellung erforderliche Finanzierung.
(3) Die Normalherstellungskosten sind nach Erfahrungssätzen anzusetzen. Sie sind erforderlichenfalls mit Hilfe geeigneter Baupreisindexreihen auf die Preisverhältnisse am Wertermittlungsstichtag umzurechnen.
(4) Ausnahmsweise kann der Herstellungswert der Gebäude ganz oder teilweise nach den gewöhnlichen Herstellungskosten einzelner Bauleistungen (Einzelkosten) ermittelt werden.
(5) Zur Ermittlung des Herstellungswerts der Gebäude kann von den tatsächlich entstandenen Herstellungskosten ausgegangen werden, wenn sie den gewöhnlichen Herstellungskosten entsprechen.

§ 23 Wertminderung wegen Alters
(1) Die Wertminderung wegen Alters bestimmt sich nach dem Verhältnis der Restnutzungsdauer zur Gesamtnutzungsdauer der baulichen Anlagen; sie ist in einem Vomhundertsatz des Herstellungswerts auszudrücken. Bei der Bestimmung der Wertminderung kann je nach Art und Nutzung der baulichen Anlagen von einer gleichmäßigen oder von einer mit zunehmendem Alter sich verändernden Wertminderung ausgegangen werden.
(2) Ist die bei ordnungsgemäßem Gebrauch übliche Gesamtnutzungsdauer der baulichen Anlagen durch Instandsetzungen oder Modernisierungen verlängert worden oder haben unterlassene Instandhaltung oder andere Gegebenheiten zu einer Verkürzung der Restnutzungsdauer geführt, soll der Bestimmung der Wertminderung wegen Alters die geänderte Restnutzungsdauer und die für die baulichen Anlagen übliche Gesamtnutzungsdauer zugrunde gelegt werden.

§ 24 Wertminderung wegen Baumängeln und Bauschäden
Die Wertminderung wegen Baumängeln und Bauschäden ist nach Erfahrungssätzen oder auf der Grundlage der für ihre Beseitigung am Wertermittlungsstichtag erforderlichen Kosten zu bestimmen, soweit sie nicht nach den §§ 22 und 23 bereits berücksichtigt wurde.

§ 25 Berücksichtigung sonstiger wertbeeinflussender Umstände
Sonstige nach den §§ 22 bis 24 bisher noch nicht erfasste, den Wert beeinflussende Umstände, insbesondere eine wirtschaftliche Überalterung, ein überdurchschnittlicher Erhaltungszustand und ein erhebliches Abweichen der tatsächlichen von der nach § 5 Abs. 1 maßgeblichen Nutzung, sind durch Zu- oder Abschläge oder in anderer geeigneter Weise zur berücksichtigen.

Vierter Teil Ergänzende Vorschriften

§ 26 Wertermittlung nach § 153 Abs. 1, § 169 Abs. 1 Nr. 6 und Abs. 4 des Baugesetzbuches

(1) Zur Wertermittlung nach § 153 Abs. 1 des Baugesetzbuchs sind Vergleichsgrundstücke und Ertragsverhältnisse möglichst aus Gebieten heranzuziehen, die neben den allgemeinen wertbeeinflussenden Umständen (§§ 4 und 5) auch hinsichtlich ihrer städtebaulichen Missstände mit dem förmlich festgelegten Sanierungsgebiet vergleichbar sind, für die jedoch in absehbarer Zeit eine Sanierung nicht erwartet wird. Aus dem förmlich festgelegten Sanierungsgebiet oder aus Gebieten mit Aussicht auf Sanierung dürfen Vergleichsgrundstücke und Ertragsverhältnisse nur herangezogen werden, wenn die entsprechenden Kaufpreise oder Ertragsverhältnisse nicht von sanierungsbedingten Umständen beeinflusst sind oder ihr Einfluss erfasst werden kann.

(2) Absatz 1 ist entsprechend auf städtebauliche Entwicklungsbereiche anzuwenden. In Gebieten, in denen sich kein vom Verkehrswert für Flächen im Sinne von § 4 Abs. 1 Nr. 1 abweichender Verkehrswert gebildet hat, ist der Verkehrswert aus Gebieten maßgebend, die insbesondere hinsichtlich der Siedlungs-und Landschaftsstruktur sowie der Landschaft und der Verkehrslage mit dem städtebaulichen Entwicklungsbereich vergleichbar sind, in denen jedoch keine Entwicklungsmaßnahmen vorgesehen sind.

§ 27 Wertermittlung nach § 153 Abs. 4 und § 169 Abs. 8 des Baugesetzbuchs

(1) Zur Ermittlung des Verkehrswerts nach § 153 Abs. 4 und § 169 Abs. 8 des Baugesetzbuchs ist der Zustand des Gebiets nach Abschluss der Sanierungs-oder Entwicklungsmaßnahme zugrunde zu legen.

(2) Soweit die nach den § 153 Abs. 4 und § 169 Abs. 8 des Baugesetzbuchs zu berücksichtigende rechtliche und tatsächliche Neuordnung noch nicht abgeschlossen ist, ist die Wartezeit bis zum Abschluss der vorgesehenen Maßnahmen zu berücksichtigen.

§ 28 Wertermittlung für die Bemessung der Ausgleichbeträge nach § 154 Abs. 1 und § 166 Abs. 3 des Baugesetzbuchs

(1) Für die zur Bemessung der Ausgleichsbeträge nach § 154 Abs. 1 und § 166 Abs. 3 Satz 4 des Baugesetzbuchs zu ermittelnden Anfangs- und Endwerte sind die §§ 26 und 27 entsprechend anzuwenden.

(2) Die nach Absatz 1 maßgebenden Anfangs- und Endwerte des Grundstücks sind auf denselben Zeitpunkt zu ermitteln. In den Fällen des § 162 des Baugesetzbuchs ist der Zeitpunkt des In-Kraft-Tretens der Satzung , mit der die Sanierungssatzung aufgehoben wird, in den Fällen des § 169 Abs. 1 Nr. 8 in Verbindung mit § 162 des Baugesetzbuchs ist der Zeitpunkt des In-Kraft-Tretens der Satzung, mit der die Entwicklungssatzung aufgehoben wird, und in den Fällen des § 163 Absätze 1 und 2 sowie des § 169 Abs. 1 Nr. 8 in Verbindung mit § 163 Abs. 1 und 2 des Baugesetzbuchs ist der Zeitpunkt der Abschlusserklärung maßgebend.

(3) Bei der Ermittlung des Anfangs- und Endwerts ist der Wert des Bodens ohne Bebauung durch Vergleich mit dem Wert vergleichbarer unbebauter Grundstücke

zu ermitteln. Beeinträchtigungen der zulässigen Nutzbarkeit, die sich aus einer bestehen bleibenden Bebauung auf dem Grundstück ergeben, sind zu berücksichtigen, wenn es bei wirtschaftlicher Betrachtungsweise oder aus sonstigen Gründen geboten erscheint, das Grundstück in der bisherigen Weise zu nutzen.

§ 29 Berücksichtigung sonstiger Vermögensnachteile bei der Wertermittlung
Wird bei einer Enteignung, im Falle von Übernahmeansprüchen oder bei Nutzungsbeschränkungen aufgrund gesetzlicher Vorschriften oder bei freihändigem Erwerb zur Vermeidung einer Enteignung neben dem Rechtsverlust (§ 95 des Baugesetzbuchs) auch die Höhe der Entschädigung für andere Vermögensnachteile (§ 96 des Baugesetzbuchs) ermittelt, sollen beide voneinander abgegrenzt werden. Vermögensvorteile sind zu berücksichtigen.

Fünfter Teil Schlussvorschriften

§ 30 In-Kraft-Treten und abgelöste Vorschriften
Diese Verordnung tritt im einzelnen Bundesland zugleich mit dessen nach § 199 Abs. 2 des Baugesetzbuchs erlassener Verordnung, spätestens jedoch am 1. Januar 1990 in Kraft. Gleichzeitig tritt dort jeweils die Verordnung über Grundsätze für die Ermittlung des Verkehrswerts von Grundstücken (Wertermittlungsverordnung - WertV) in der Fassung der Bekanntmachung vom 15. August 1972 (BGBl. I S. 1416) außer Kraft.

Appendix II: Vergabe- und Vertragsordnung für Bauleistungen (VOB) Teil B

Vergabe- und Vertragsordnung für Bauleistungen (VOB) Teil B: Allgemeine Vertragsbedingungen für die Ausführung von Bauleistungen

Inhaltsübersicht

§ 1 Art und Umfang der Leistung

1. Die auszuführende Leistung wird nach Art und Umfang durch den Vertrag bestimmt. Als Bestandteil des Vertrags gelten auch die Allgemeinen Technischen Vertragsbedingungen für Bauleistungen.
2. Bei Widersprüchen im Vertrag gelten nacheinander:
   a) die Leistungsbeschreibung,
   b) die Besonderen Vertragsbedingungen,

c) etwaige Zusätzliche Vertragsbedingungen,
d) etwaige Zusätzliche Technische Vertragsbedingungen,
e) die Allgemeinen Technischen Vertragsbedingungen für Bauleistungen,
f) die Allgemeinen Vertragsbedingungen für die Ausführung von Bauleistungen.

3. Änderungen des Bauentwurfs anzuordnen, bleibt dem Auftraggeber vorbehalten.
4. Nicht vereinbarte Leistungen, die zur Ausführung der vertraglichen Leistung erforderlich werden, hat der Auftragnehmer auf Verlangen des Auftraggebers mit auszuführen, außer wenn sein Betrieb auf derartige Leistungen nicht eingerichtet ist. Andere Leistungen können dem Auftragnehmer nur mit seiner Zustimmung übertragen werden.

§ 2 Vergütung

1. Durch die vereinbarten Preise werden alle Leistungen abgegolten, die nach der Leistungsbeschreibung, den Besonderen Vertragsbedingungen, den Zusätzlichen Vertragsbedingungen, den Zusätzlichen Technischen Vertragsbedingungen, den Allgemeinen Technischen Vertragsbedingungen für Bauleistungen und der gewerblichen Verkehrssitte zur vertraglichen Leistung gehören.
2. Die Vergütung wird nach den vertraglichen Einheitspreisen und den tatsächlich ausgeführten Leistungen berechnet, wenn keine andere Berechnungsart (z. B. durch Pauschalsumme, nach Stundenlohnsätzen, nach Selbstkosten) vereinbart ist.
3. (1) Weicht die ausgeführte Menge der unter einem Einheitspreis erfassten Leistung oder Teilleistung um nicht mehr als 10 v. H. von dem im Vertrag vorgesehenen Umfang ab, so gilt der vertragliche Einheitspreis.
(2) Für die über 10 v. H. hinausgehende Überschreitung des Mengenansatzes ist auf Verlangen ein neuer Preis unter Berücksichtigung der Mehr- oder Minderkosten zu vereinbaren.
(3) Bei einer über 10 v. H. hinausgehenden Unterschreitung des Mengenansatzes ist auf Verlangen der Einheitspreis für die tatsächlich ausgeführte Menge der Leistung oder Teilleistung zu erhöhen, soweit der Auftragnehmer nicht durch Erhöhung der Mengen bei anderen Ordnungszahlen (Positionen) oder in anderer Weise einen Ausgleich erhält. Die Erhöhung des Einheitspreises soll im Wesentlichen dem Mehrbetrag entsprechen, der sich durch Verteilung der Baustelleneinrichtungs- und Baustellengemeinkosten und der Allgemeinen Geschäftskosten auf die verringerte Menge ergibt. Die Umsatzsteuer wird entsprechend dem neuen Preis vergütet.
(4) Sind von der unter einem Einheitspreis erfassten Leistung oder Teilleistung andere Leistungen abhängig, für die eine Pauschalsumme vereinbart ist, so kann mit der Änderung des Einheitspreises auch eine angemessene Änderung der Pauschalsumme gefordert werden.

4. Werden im Vertrag ausbedungene Leistungen des Auftragnehmers vom Auftraggeber selbst übernommen (z. B. Lieferung von Bau-, Bauhilfs- und Betriebsstoffen), so gilt, wenn nichts anderes vereinbart wird, § 8 Nr. 1 Abs. 2 entsprechend.
5. Werden durch Änderung des Bauentwurfs oder andere Anordnungen des Auftraggebers die Grundlagen des Preises für eine im Vertrag vorgesehene Leistung geändert, so ist ein neuer Preis unter Berücksichtigung der Mehr- oder Minderkosten zu vereinbaren. Die Vereinbarung soll vor der Ausführung getroffen werden.
6. (1) Wird eine im Vertrag nicht vorgesehene Leistung gefordert, so hat der Auftragnehmer Anspruch auf besondere Vergütung. Er muss jedoch den Anspruch dem Auftraggeber ankündigen, bevor er mit der Ausführung der Leistung beginnt.
   (2) Die Vergütung bestimmt sich nach den Grundlagen der Preisermittlung für die vertragliche Leistung und den besonderen Kosten der geforderten Leistung. Sie ist möglichst vor Beginn der Ausführung zu vereinbaren.
7. (1) Ist als Vergütung der Leistung eine Pauschalsumme vereinbart, so bleibt die Vergütung unverändert. Weicht jedoch die ausgeführte Leistung von der vertraglich vorgesehenen Leistung so erheblich ab, dass ein Festhalten an der Pauschalsumme nicht zumutbar ist (§ 242 BGB), so ist auf Verlangen ein Ausgleich unter Berücksichtigung der Mehr- oder Minderkosten zu gewähren. Für die Bemessung des Ausgleichs ist von den Grundlagen der Preisermittlung auszugehen. Die Nummern 4, 5 und 6 bleiben unberührt.
   (2) Wenn nichts anderes vereinbart ist, gilt Absatz 1 auch für Pauschalsummen, die für Teile der Leistung vereinbart sind; Nummer 3 Abs. 4 bleibt unberührt.
8. (1) Leistungen, die der Auftragnehmer ohne Auftrag oder unter eigenmächtiger Abweichung vom Auftrag ausführt, werden nicht vergütet. Der Auftragnehmer hat sie auf Verlangen innerhalb einer angemessenen Frist zu beseitigen; sonst kann es auf seine Kosten geschehen. Er haftet außerdem für andere Schäden, die dem Auftraggeber hieraus entstehen.
   (2) Eine Vergütung steht dem Auftragnehmer jedoch zu, wenn der Auftraggeber solche Leistungen nachträglich anerkennt. Eine Vergütung steht ihm auch zu, wenn die Leistungen für die Erfüllung des Vertrags notwendig waren, dem mutmaßlichen Willen des Auftraggebers entsprachen und ihm unverzüglich angezeigt wurden. Soweit dem Auftragnehmer eine Vergütung zusteht, gelten die Berechnungsgrundlagen für geänderte oder zusätzliche Leistungen der Nummer 5 oder 6 entsprechend.
   (3) Die Vorschriften des BGB über die Geschäftsführung ohne Auftrag (§§ 677 ff. BGB) bleiben unberührt.
9. (1) Verlangt der Auftraggeber Zeichnungen, Berechnungen oder andere Unterlagen, die der Auftragnehmer nach dem Vertrag, besonders den Technischen Vertragsbedingungen oder der gewerblichen Verkehrssitte, nicht zu beschaffen hat, so hat er sie zu vergüten.

(2) Lässt er vom Auftragnehmer nicht aufgestellte technische Berechnungen durch den Auftragnehmer nachprüfen, so hat er die Kosten zu tragen.

10. Stundenlohnarbeiten werden nur vergütet, wenn sie als solche vor ihrem Beginn ausdrücklich vereinbart worden sind (§ 15).

§ 3 Ausführungsunterlagen

1. Die für die Ausführung nötigen Unterlagen sind dem Auftragnehmer unentgeltlich und rechtzeitig zu übergeben.
2. Das Abstecken der Hauptachsen der baulichen Anlagen, ebenso der Grenzen des Geländes, das dem Auftragnehmer zur Verfügung gestellt wird, und das Schaffen der notwendigen Höhenfestpunkte in unmittelbarer Nähe der baulichen Anlagen sind Sache des Auftraggebers.
3. Die vom Auftraggeber zur Verfügung gestellten Geländeaufnahmen und Absteckungen und die übrigen für die Ausführung übergebenen Unterlagen sind für den Auftragnehmer maßgebend. Jedoch hat er sie, soweit es zur ordnungsgemäßen Vertragserfüllung gehört, auf etwaige Unstimmigkeiten zu überprüfen und den Auftraggeber auf entdeckte oder vermutete Mängel hinzuweisen.
4. Vor Beginn der Arbeiten ist, soweit notwendig, der Zustand der Straßen und Geländeoberfläche, der Vorfluter und Vorflutleitungen, ferner der baulichen Anlagen im Baubereich in einer Niederschrift festzuhalten, die vom Auftraggeber und Auftragnehmer anzuerkennen ist.
5. Zeichnungen, Berechnungen, Nachprüfungen von Berechnungen oder andere Unterlagen, die der Auftragnehmer nach dem Vertrag, besonders den Technischen Vertragsbedingungen, oder der gewerblichen Verkehrssitte oder auf besonderes Verlangen des Auftraggebers (§ 2 Nr. 9) zu beschaffen hat, sind dem Auftraggeber nach Aufforderung rechtzeitig vorzulegen.
6. (1) Die in Nummer 5 genannten Unterlagen dürfen ohne Genehmigung ihres Urhebers nicht veröffentlicht, vervielfältigt, geändert oder für einen anderen als den vereinbarten Zweck benutzt werden.
   (2) An DV-Programmen hat der Auftraggeber das Recht zur Nutzung mit den vereinbarten Leistungsmerkmalen in unveränderter Form auf den festgelegten Geräten. Der Auftraggeber darf zum Zwecke der Datensicherung zwei Kopien herstellen. Diese müssen alle Identifikationsmerkmale enthalten. Der Verbleib der Kopien ist auf Verlangen nachzuweisen.
   (3) Der Auftragnehmer bleibt unbeschadet des Nutzungsrechts des Auftraggebers zur Nutzung der Unterlagen und der DV-Programme berechtigt.

§ 4 Ausführung

1. (1) Der Auftraggeber hat für die Aufrechterhaltung der allgemeinen Ordnung auf der Baustelle zu sorgen und das Zusammenwirken der verschiedenen Unternehmer zu regeln. Er hat die erforderlichen öffentlich-

rechtlichen Genehmigungen und Erlaubnisse – z. B. nach dem Baurecht, dem Straßenverkehrsrecht, dem Wasserrecht, dem Gewerberecht – herbeizuführen.

(2) Der Auftraggeber hat das Recht, die vertragsgemäße Ausführung der Leistung zu überwachen. Hierzu hat er Zutritt zu den Arbeitsplätzen, Werkstätten und Lagerräumen, wo die vertragliche Leistung oder Teile von ihr hergestellt oder die hierfür bestimmten Stoffe und Bauteile gelagert werden. Auf Verlangen sind ihm die Werkzeichnungen oder andere Ausführungsunterlagen sowie die Ergebnisse von Güteprüfungen zur Einsicht vorzulegen und die erforderlichen Auskünfte zu erteilen, wenn hierdurch keine Geschäftsgeheimnisse preisgegeben werden. Als Geschäftsgeheimnis bezeichnete Auskünfte und Unterlagen hat er vertraulich zu behandeln.

(3) Der Auftraggeber ist befugt, unter Wahrung der dem Auftragnehmer zustehenden Leitung (Nummer 2) Anordnungen zu treffen, die zur vertragsgemäßen Ausführung der Leistung notwendig sind. Die Anordnungen sind grundsätzlich nur dem Auftragnehmer oder seinem für die Leitung der Ausführung bestellten Vertreter zu erteilen, außer wenn Gefahr im Verzug ist. Dem Auftraggeber ist mitzuteilen, wer jeweils als Vertreter des Auftragnehmers für die Leitung der Ausführung bestellt ist.

(4) Hält der Auftragnehmer die Anordnungen des Auftraggebers für unberechtigt oder unzweckmäßig, so hat er seine Bedenken geltend zu machen, die Anordnungen jedoch auf Verlangen auszuführen, wenn nicht gesetzliche oder behördliche Bestimmungen entgegenstehen. Wenn dadurch eine ungerechtfertigte Erschwerung verursacht wird, hat der Auftraggeber die Mehrkosten zu tragen.

2. (1) Der Auftragnehmer hat die Leistung unter eigener Verantwortung nach dem Vertrag auszuführen. Dabei hat er die anerkannten Regeln der Technik und die gesetzlichen und behördlichen Bestimmungen zu beachten. Es ist seine Sache, die Ausführung seiner vertraglichen Leistung zu leiten und für Ordnung auf seiner Arbeitsstelle zu sorgen.

(2) Er ist für die Erfüllung der gesetzlichen, behördlichen und berufsgenossenschaftlichen Verpflichtungen gegenüber seinen Arbeitnehmern allein verantwortlich. Es ist ausschließlich seine Aufgabe, die Vereinbarungen und Maßnahmen zu treffen, die sein Verhältnis zu den Arbeitnehmern regeln.

3. Hat der Auftragnehmer Bedenken gegen die vorgesehene Art der Ausführung (auch wegen der Sicherung gegen Unfallgefahren), gegen die Güte der vom Auftraggeber gelieferten Stoffe oder Bauteile oder gegen die Leistungen anderer Unternehmer, so hat er sie dem Auftraggeber unverzüglich – möglichst schon vor Beginn der Arbeiten – schriftlich mitzuteilen; der Auftraggeber bleibt jedoch für seine Angaben, Anordnungen oder Lieferungen verantwortlich.

4. Der Auftraggeber hat, wenn nichts anderes vereinbart ist, dem Auftragnehmer unentgeltlich zur Benutzung oder Mitbenutzung zu überlassen:
   a) die notwendigen Lager- und Arbeitsplätze auf der Baustelle,
   b) vorhandene Zufahrtswege und Anschlussgleise,

c) vorhandene Anschlüsse für Wasser und Energie. Die Kosten für den Verbrauch und den Messer oder Zähler trägt der Auftragnehmer, mehrere Auftragnehmer tragen sie anteilig.

5. Der Auftragnehmer hat die von ihm ausgeführten Leistungen und die ihm für die Ausführung übergebenen Gegenstände bis zur Abnahme vor Beschädigung und Diebstahl zu schützen. Auf Verlangen des Auftraggebers hat er sie vor Winterschäden und Grundwasser zu schützen, ferner Schnee und Eis zu beseitigen. Obliegt ihm die Verpflichtung nach Satz 2 nicht schon nach dem Vertrag, so regelt sich die Vergütung nach § 2 Nr. 6.

6. Stoffe oder Bauteile, die dem Vertrag oder den Proben nicht entsprechen, sind auf Anordnung des Auftraggebers innerhalb einer von ihm bestimmten Frist von der Baustelle zu entfernen. Geschieht es nicht, so können sie auf Kosten des Auftragnehmers entfernt oder für seine Rechnung veräußert werden.

7. Leistungen, die schon während der Ausführung als mangelhaft oder vertragswidrig erkannt werden, hat der Auftragnehmer auf eigene Kosten durch mangelfreie zu ersetzen. Hat der Auftragnehmer den Mangel oder die Vertragswidrigkeit zu vertreten, so hat er auch den daraus entstehenden Schaden zu ersetzen. Kommt der Auftragnehmer der Pflicht zur Beseitigung des Mangels nicht nach, so kann ihm der Auftraggeber eine angemessene Frist zur Beseitigung des Mangels setzen und erklären, dass er ihm nach fruchtlosem Ablauf der Frist den Auftrag entziehe (§ 8 Nr. 3).

8. (1) Der Auftragnehmer hat die Leistung im eigenen Betrieb auszuführen. Mit schriftlicher Zustimmung des Auftraggebers darf er sie an Nachunternehmer übertragen. Die Zustimmung ist nicht notwendig bei Leistungen, auf die der Betrieb des Auftragnehmers nicht eingerichtet ist. Erbringt der Auftragnehmer ohne schriftliche Zustimmung des Auftraggebers Leistungen nicht im eigenen Betrieb, obwohl sein Betrieb darauf eingerichtet ist, kann der Auftraggeber ihm eine angemessene Frist zur Aufnahme der Leistung im eigenen Betrieb setzen und erklären, dass er ihm nach fruchtlosem Ablauf der Frist den Auftrag entziehe (§ 8 Nr. 3).
(2) Der Auftragnehmer hat bei der Weitervergabe von Bauleistungen an Nachunternehmer die Vergabe- und Vertragsordnung für Bauleistungen zugrunde zu legen.
(3) Der Auftragnehmer hat die Nachunternehmer dem Auftraggeber auf Verlangen bekannt zu geben.

9. Werden bei Ausführung der Leistung auf einem Grundstück Gegenstände von Altertums-, Kunst- oder wissenschaftlichem Wert entdeckt, so hat der Auftragnehmer vor jedem weiteren Aufdecken oder Ändern dem Auftraggeber den Fund anzuzeigen und ihm die Gegenstände nach näherer Weisung abzuliefern. Die Vergütung etwaiger Mehrkosten regelt sich nach § 2 Nr. 6. Die Rechte des Entdeckers (§ 984 BGB) hat der Auftraggeber.

10. Der Zustand von Teilen der Leistung ist auf Verlangen gemeinsam von Auftraggeber und Auftragnehmer festzustellen, wenn diese Teile der Leistung durch die weitere Ausführung der Prüfung und Feststellung entzogen werden. Das Ergebnis ist schriftlich niederzulegen.

§ 5 Ausführungsfristen

1. Die Ausführung ist nach den verbindlichen Fristen (Vertragsfristen) zu beginnen, angemessen zu fördern und zu vollenden. In einem Bauzeitenplan enthaltene Einzelfristen gelten nur dann als Vertragsfristen, wenn dies im Vertrag ausdrücklich vereinbart ist.
2. Ist für den Beginn der Ausführung keine Frist vereinbart, so hat der Auftraggeber dem Auftragnehmer auf Verlangen Auskunft über den voraussichtlichen Beginn zu erteilen. Der Auftragnehmer hat innerhalb von 12 Werktagen nach Aufforderung zu beginnen. Der Beginn der Ausführung ist dem Auftraggeber anzuzeigen.
3. Wenn Arbeitskräfte, Geräte, Gerüste, Stoffe oder Bauteile so unzureichend sind, dass die Ausführungsfristen offenbar nicht eingehalten werden können, muss der Auftragnehmer auf Verlangen unverzüglich Abhilfe schaffen.
4. Verzögert der Auftragnehmer den Beginn der Ausführung, gerät er mit der Vollendung in Verzug, oder kommt er der in Nummer 3 erwähnten Verpflichtung nicht nach, so kann der Auftraggeber bei Aufrechterhaltung des Vertrages Schadensersatz nach § 6 Nr. 6 verlangen oder dem Auftragnehmer eine angemessene Frist zur Vertragserfüllung setzen und erklären, dass er ihm nach fruchtlosem Ablauf der Frist den Auftrag entziehe (§ 8 Nr. 3).

§ 6 Behinderung und Unterbrechung der Ausführung

1. Glaubt sich der Auftragnehmer in der ordnungsgemäßen Ausführung der Leistung behindert, so hat er es dem Auftraggeber unverzüglich schriftlich anzuzeigen. Unterlässt er die Anzeige, so hat er nur dann Anspruch auf Berücksichtigung der hindernden Umstände, wenn dem Auftraggeber offenkundig die Tatsache und deren hindernde Wirkung bekannt waren.
2. (1) Ausführungsfristen werden verlängert, soweit die Behinderung verursacht ist:
   a) durch einen Umstand aus dem Risikobereich des Auftraggebers,
   b) durch Streik oder eine von der Berufsvertretung der Arbeitgeber angeordnete Aussperrung im Betrieb des Auftragnehmers oder in einem unmittelbar für ihn arbeitenden Betrieb,
   c) durch höhere Gewalt oder andere für den Auftragnehmer unabwendbare Umstände.

   (2) Witterungseinflüsse während der Ausführungszeit, mit denen bei Abgabe des Angebots normalerweise gerechnet werden musste, gelten nicht als Behinderung.
3. Der Auftragnehmer hat alles zu tun, was ihm billigerweise zugemutet werden kann, um die Weiterführung der Arbeiten zu ermöglichen. Sobald die hindernden Umstände wegfallen, hat er ohne weiteres und unverzüglich die Arbeiten wieder aufzunehmen und den Auftraggeber davon zu benachrichtigen.

4. Die Fristverlängerung wird berechnet nach der Dauer der Behinderung mit einem Zuschlag für die Wiederaufnahme der Arbeiten und die etwaige Verschiebung in eine ungünstigere Jahreszeit.
5. Wird die Ausführung für voraussichtlich längere Dauer unterbrochen, ohne dass die Leistung dauernd unmöglich wird, so sind die ausgeführten Leistungen nach den Vertragspreisen abzurechnen und außerdem die Kosten zu vergüten, die dem Auftragnehmer bereits entstanden und in den Vertragspreisen des nicht ausgeführten Teils der Leistung enthalten sind.
6. Sind die hindernden Umstände von einem Vertragsteil zu vertreten, so hat der andere Teil Anspruch auf Ersatz des nachweislich entstandenen Schadens, des entgangenen Gewinns aber nur bei Vorsatz oder grober Fahrlässigkeit.
7. Dauert eine Unterbrechung länger als 3 Monate, so kann jeder Teil nach Ablauf dieser Zeit den Vertrag schriftlich kündigen. Die Abrechnung regelt sich nach den Nummern 5 und 6; wenn der Auftragnehmer die Unterbrechung nicht zu vertreten hat, sind auch die Kosten der Baustellenräumung zu vergüten, soweit sie nicht in der Vergütung für die bereits ausgeführten Leistungen enthalten sind.

§ 7 Verteilung der Gefahr

1. Wird die ganz oder teilweise ausgeführte Leistung vor der Abnahme durch höhere Gewalt, Krieg, Aufruhr oder andere objektiv unabwendbare vom Auftragnehmer nicht zu vertretende Umstände beschädigt oder zerstört, so hat dieser für die ausgeführten Teile der Leistung die Ansprüche nach § 6 Nr. 5; für andere Schäden besteht keine gegenseitige Ersatzpflicht.
2. Zu der ganz oder teilweise ausgeführten Leistung gehören alle mit der baulichen Anlage unmittelbar verbundenen, in ihre Substanz eingegangenen Leistungen, unabhängig von deren Fertigstellungsgrad.
3. Zu der ganz oder teilweise ausgeführten Leistung gehören nicht die noch nicht eingebauten Stoffe und Bauteile sowie die Baustelleneinrichtung und Absteckungen. Zu der ganz oder teilweise ausgeführten Leistung gehören ebenfalls nicht Baubehelfe, z. B. Gerüste, auch wenn diese als Besondere Leistung oder selbständig vergeben sind.

§ 8 Kündigung durch den Auftraggeber

1. (1) Der Auftraggeber kann bis zur Vollendung der Leistung jederzeit den Vertrag kündigen.
   (2) Dem Auftragnehmer steht die vereinbarte Vergütung zu. Er muss sich jedoch anrechnen lassen, was er infolge der Aufhebung des Vertrags an Kosten erspart oder durch anderweitige Verwendung seiner Arbeitskraft und seines Betriebs erwirbt oder zu erwerben böswillig unterlässt (§ 649 BGB).

2. (1) Der Auftraggeber kann den Vertrag kündigen, wenn der Auftragnehmer seine Zahlungen einstellt oder das Insolvenzverfahren beziehungsweise ein vergleichbares gesetzliches Verfahren beantragt oder ein solches Verfahren eröffnet wird oder dessen Eröffnung mangels Masse abgelehnt wird.
(2) Die ausgeführten Leistungen sind nach § 6 Nr. 5 abzurechnen. Der Auftraggeber kann Schadensersatz wegen Nichterfüllung des Restes verlangen.
3. (1) Der Auftraggeber kann den Vertrag kündigen, wenn in den Fällen des § 4 Nr. 7 und 8 Abs. 1 und des § 5 Nr. 4 die gesetzte Frist fruchtlos abgelaufen ist (Entziehung des Auftrags). Die Entziehung des Auftrags kann auf einen in sich abgeschlossenen Teil der vertraglichen Leistung beschränkt werden.
(2) Nach der Entziehung des Auftrags ist der Auftraggeber berechtigt, den noch nicht vollendeten Teil der Leistung zu Lasten des Auftragnehmers durch einen Dritten ausführen zu lassen, doch bleiben seine Ansprüche auf Ersatz des etwa entstehenden weiteren Schadens bestehen. Er ist auch berechtigt, auf die weitere Ausführung zu verzichten und Schadensersatz wegen Nichterfüllung zu verlangen, wenn die Ausführung aus den Gründen, die zur Entziehung des Auftrags geführt haben, für ihn kein Interesse mehr hat.
(3) Für die Weiterführung der Arbeiten kann der Auftraggeber Geräte, Gerüste, auf der Baustelle vorhandene andere Einrichtungen und angelieferte Stoffe und Bauteile gegen angemessene Vergütung in Anspruch nehmen.
(4) Der Auftraggeber hat dem Auftragnehmer eine Aufstellung über die entstandenen Mehrkosten und über seine anderen Ansprüche spätestens binnen 12 Werktagen nach Abrechnung mit dem Dritten zuzusenden.
4. Der Auftraggeber kann den Auftrag entziehen, wenn der Auftragnehmer aus Anlass der Vergabe eine Abrede getroffen hatte, die eine unzulässige Wettbewerbsbeschränkung darstellt. Die Kündigung ist innerhalb von 12 Werktagen nach Bekanntwerden des Kündigungsgrundes auszusprechen. Nummer 3 gilt entsprechend.
5. Die Kündigung ist schriftlich zu erklären.
6. Der Auftragnehmer kann Aufmaß und Abnahme der von ihm ausgeführten Leistungen alsbald nach der Kündigung verlangen; er hat unverzüglich eine prüfbare Rechnung über die ausgeführten Leistungen vorzulegen.
7. Eine wegen Verzugs verwirkte, nach Zeit bemessene Vertragsstrafe kann nur für die Zeit bis zum Tag der Kündigung des Vertrags gefordert werden.

§ 9 Kündigung durch den Auftragnehmer

1. Der Auftragnehmer kann den Vertrag kündigen:
   a) wenn der Auftraggeber eine ihm obliegende Handlung unterlässt und dadurch den Auftragnehmer außerstande setzt, die Leistung auszuführen (Annahmeverzug nach §§ 293 ff. BGB),
   b) wenn der Auftraggeber eine fällige Zahlung nicht leistet oder sonst in Schuldnerverzug gerät.

2. Die Kündigung ist schriftlich zu erklären. Sie ist erst zulässig, wenn der Auftragnehmer dem Auftraggeber ohne Erfolg eine angemessene Frist zur Vertragserfüllung gesetzt und erklärt hat, dass er nach fruchtlosem Ablauf der Frist den Vertrag kündigen werde.
3. Die bisherigen Leistungen sind nach den Vertragspreisen abzurechnen. Außerdem hat der Auftragnehmer Anspruch auf angemessene Entschädigung nach § 642 BGB; etwaige weitergehende Ansprüche des Auftragnehmers bleiben unberührt.

§ 10 Haftung der Vertragsparteien

1. Die Vertragsparteien haften einander für eigenes Verschulden sowie für das Verschulden ihrer gesetzlichen Vertreter und der Personen, deren sie sich zur Erfüllung ihrer Verbindlichkeiten bedienen (§§ 276, 278 BGB).
2. (1) Entsteht einem Dritten im Zusammenhang mit der Leistung ein Schaden, für den auf Grund gesetzlicher Haftpflichtbestimmungen beide Vertragsparteien haften, so gelten für den Ausgleich zwischen den Vertragsparteien die allgemeinen gesetzlichen Bestimmungen, soweit im Einzelfall nichts anderes vereinbart ist. Soweit der Schaden des Dritten nur die Folge einer Maßnahme ist, die der Auftraggeber in dieser Form angeordnet hat, trägt er den Schaden allein, wenn ihn der Auftragnehmer auf die mit der angeordneten Ausführung verbundene Gefahr nach § 4 Nr. 3 hingewiesen hat.
   (2) Der Auftragnehmer trägt den Schaden allein, soweit er ihn durch Versicherung seiner gesetzlichen Haftpflicht gedeckt hat oder durch eine solche zu tarifmäßigen, nicht auf außergewöhnliche Verhältnisse abgestellten Prämien und Prämienzuschlägen bei einem im Inland zum Geschäftsbetrieb zugelassenen Versicherer hätte decken können.
3. Ist der Auftragnehmer einem Dritten nach den §§ 823 ff. BGB zu Schadensersatz verpflichtet wegen unbefugten Betretens oder Beschädigung angrenzender Grundstücke, wegen Entnahme oder Auflagerung von Boden oder anderen Gegenständen außerhalb der vom Auftraggeber dazu angewiesenen Flächen oder wegen der Folgen eigenmächtiger Versperrung von Wegen oder Wasserläufen, so trägt er im Verhältnis zum Auftraggeber den Schaden allein.
4. Für die Verletzung gewerblicher Schutzrechte haftet im Verhältnis der Vertragsparteien zueinander der Auftragnehmer allein, wenn er selbst das geschützte Verfahren oder die Verwendung geschützter Gegenstände angeboten oder wenn der Auftraggeber die Verwendung vorgeschrieben und auf das Schutzrecht hingewiesen hat.
5. Ist eine Vertragspartei gegenüber der anderen nach den Nummern 2, 3 oder 4 von der Ausgleichspflicht befreit, so gilt diese Befreiung auch zugunsten ihrer gesetzlichen Vertreter und Erfüllungsgehilfen, wenn sie nicht vorsätzlich oder grob fahrlässig gehandelt haben.

6. Soweit eine Vertragspartei von dem Dritten für einen Schaden in Anspruch genommen wird, den nach den Nummern 2, 3 oder 4 die andere Vertragspartei zu tragen hat, kann sie verlangen, dass ihre Vertragspartei sie von der Verbindlichkeit gegenüber dem Dritten befreit. Sie darf den Anspruch des Dritten nicht anerkennen oder befriedigen, ohne der anderen Vertragspartei vorher Gelegenheit zur Äußerung gegeben zu haben.

§ 11 Vertragsstrafe

1. Wenn Vertragsstrafen vereinbart sind, gelten die §§ 339 bis 345 BGB.
2. Ist die Vertragsstrafe für den Fall vereinbart, dass der Auftragnehmer nicht in der vorgesehenen Frist erfüllt, so wird sie fällig, wenn der Auftragnehmer in Verzug gerät.
3. Ist die Vertragsstrafe nach Tagen bemessen, so zählen nur Werktage; ist sie nach Wochen bemessen, so wird jeder Werktag angefangener Wochen als 1/6 Woche gerechnet.
4. Hat der Auftraggeber die Leistung abgenommen, so kann er die Strafe nur verlangen, wenn er dies bei der Abnahme vorbehalten hat.

§ 12 Abnahme

1. Verlangt der Auftragnehmer nach der Fertigstellung – gegebenenfalls auch vor Ablauf der vereinbarten Ausführungsfrist – die Abnahme der Leistung, so hat sie der Auftraggeber binnen 12 Werktagen durchzuführen; eine andere Frist kann vereinbart werden.
2. Auf Verlangen sind in sich abgeschlossene Teile der Leistung besonders abzunehmen.
3. Wegen wesentlicher Mängel kann die Abnahme bis zur Beseitigung verweigert werden.
4. (1) Eine förmliche Abnahme hat stattzufinden, wenn eine Vertragspartei es verlangt. Jede Partei kann auf ihre Kosten einen Sachverständigen zuziehen. Der Befund ist in gemeinsamer Verhandlung schriftlich niederzulegen. In die Niederschrift sind etwaige Vorbehalte wegen bekannter Mängel und wegen Vertragsstrafen aufzunehmen, ebenso etwaige Einwendungen des Auftragnehmers. Jede Partei erhält eine Ausfertigung.
   (2) Die förmliche Abnahme kann in Abwesenheit des Auftragnehmers stattfinden, wenn der Termin vereinbart war oder der Auftraggeber mit genügender Frist dazu eingeladen hatte. Das Ergebnis der Abnahme ist dem Auftragnehmer alsbald mitzuteilen.
5. (1) Wird keine Abnahme verlangt, so gilt die Leistung als abgenommen mit Ablauf von 12 Werktagen nach schriftlicher Mitteilung über die Fertigstellung der Leistung.
   (2) Wird keine Abnahme verlangt und hat der Auftraggeber die Leistung oder einen Teil der Leistung in Benutzung genommen, so gilt die Abnahme

nach Ablauf von 6 Werktagen nach Beginn der Benutzung als erfolgt, wenn nichts anderes vereinbart ist. Die Benutzung von Teilen einer baulichen Anlage zur Weiterführung der Arbeiten gilt nicht als Abnahme.
(3) Vorbehalte wegen bekannter Mängel oder wegen Vertragsstrafen hat der Auftraggeber spätestens zu den in den Absätzen 1 und 2 bezeichneten Zeitpunkten geltend zu machen.

6. Mit der Abnahme geht die Gefahr auf den Auftraggeber über, soweit er sie nicht schon nach § 7 trägt.

§ 13 Mängelansprüche

1. Der Auftragnehmer hat dem Auftraggeber seine Leistung zum Zeitpunkt der Abnahme frei von Sachmängeln zu verschaffen. Die Leistung ist zur Zeit der Abnahme frei von Sachmängeln, wenn sie die vereinbarte Beschaffenheit hat und den anerkannten Regeln der Technik entspricht. Ist die Beschaffenheit nicht vereinbart, so ist die Leistung zur Zeit der Abnahme frei von Sachmängeln, a) wenn sie sich für die nach dem Vertrag vorausgesetzte, sonst b) für die gewöhnliche Verwendung eignet und eine Beschaffenheit aufweist, die bei Werken der gleichen Art üblich ist und die der Auftraggeber nach der Art der Leistung erwarten kann.
2. Bei Leistungen nach Probe gelten die Eigenschaften der Probe als vereinbarte Beschaffenheit, soweit nicht Abweichungen nach der Verkehrssitte als bedeutungslos anzusehen sind. Dies gilt auch für Proben, die erst nach Vertragsabschluss als solche anerkannt sind.
3. Ist ein Mangel zurückzuführen auf die Leistungsbeschreibung oder auf Anordnungen des Auftraggebers, auf die von diesem gelieferten oder vorgeschriebenen Stoffe oder Bauteile oder die Beschaffenheit der Vorleistung eines anderen Unternehmers, haftet der Auftragnehmer, es sei denn, er hat die ihm nach § 4 Nr. 3 obliegende Mitteilung gemacht.
4. (1) Ist für Mängelansprüche keine Verjährungsfrist im Vertrag vereinbart, so beträgt sie für Bauwerke 4 Jahre, für Arbeiten an einem Grundstück und für die vom Feuer berührten Teile von Feuerungsanlagen 2 Jahre. Abweichend von Satz 1 beträgt die Verjährungsfrist für feuerberührte und abgasdämmende Teile von industriellen Feuerungsanlagen 1 Jahr.
(2) Bei maschinellen und elektrotechnischen/elektronischen Anlagen oder Teilen davon, bei denen die Wartung Einfluss auf die Sicherheit und Funktionsfähigkeit hat, beträgt die Verjährungsfrist für Mängelansprüche abweichend von Absatz 1 2 Jahre, wenn der Auftraggeber sich dafür entschieden hat, dem Auftragnehmer die Wartung für die Dauer der Verjährungsfrist nicht zu übertragen.
(3) Die Frist beginnt mit der Abnahme der gesamten Leistung; nur für in sich abgeschlossene Teile der Leistung beginnt sie mit der Teilabnahme (§ 12 Nr. 2).
5. (1) Der Auftragnehmer ist verpflichtet, alle während der Verjährungsfrist hervortretenden Mängel, die auf vertragswidrige Leistung zurückzuführen

sind, auf seine Kosten zu beseitigen, wenn es der Auftraggeber vor Ablauf der Frist schriftlich verlangt. Der Anspruch auf Beseitigung der gerügten Mängel verjährt in 2 Jahren, gerechnet vom Zugang des schriftlichen Verlangens an, jedoch nicht vor Ablauf der Regelfristen nach Nummer 4 oder der an ihrer Stelle vereinbarten Frist. Nach Abnahme der Mängelbeseitigungsleistung beginnt für diese Leistung eine Verjährungsfrist von 2 Jahren neu, die jedoch nicht vor Ablauf der Regelfristen nach Nummer 4 oder der an ihrer Stelle vereinbarten Frist endet.

(2) Kommt der Auftragnehmer der Aufforderung zur Mängelbeseitigung in einer vom Auftraggeber gesetzten angemessenen Frist nicht nach, so kann der Auftraggeber die Mängel auf Kosten des Auftragnehmers beseitigen lassen.

6. Ist die Beseitigung des Mangels für den Auftraggeber unzumutbar oder ist sie unmöglich oder würde sie einen unverhältnismäßig hohen Aufwand erfordern und wird sie deshalb vom Auftragnehmer verweigert, so kann der Auftraggeber durch Erklärung gegenüber dem Auftragnehmer die Vergütung mindern (§ 638 BGB).

7. (1) Der Auftragnehmer haftet bei schuldhaft verursachten Mängeln für Schäden aus der Verletzung des Lebens, des Körpers oder der Gesundheit.

(2) Bei vorsätzlich oder grob fahrlässig verursachten Mängeln haftet er für alle Schäden.

(3) Im Übrigen ist dem Auftraggeber der Schaden an der baulichen Anlage zu ersetzen, zu deren Herstellung, Instandhaltung oder Änderung die Leistung dient, wenn ein wesentlicher Mangel vorliegt, der die Gebrauchsfähigkeit erheblich beeinträchtigt und auf ein Verschulden des Auftragnehmers zurückzuführen ist. Einen darüber hinausgehenden Schaden hat der Auftragnehmer nur dann zu ersetzen,

a) wenn der Mangel auf einem Verstoß gegen die anerkannten Regeln der Technik beruht,

b) wenn der Mangel in dem Fehlen einer vertraglich vereinbarten Beschaffenheit besteht oder

c) soweit der Auftragnehmer den Schaden durch Versicherung seiner gesetzlichen Haftpflicht gedeckt hat oder durch eine solche zu tarifmäßigen, nicht auf außergewöhnliche Verhältnisse abgestellten Prämien und Prämienzuschlägen bei einem im Inland zum Geschäftsbetrieb zugelassenen Versicherer hätte decken können.

(4) Abweichend von Nummer 4 gelten die gesetzlichen Verjährungsfristen, soweit sich der Auftragnehmer nach Absatz 3 durch Versicherung geschützt hat oder hätte schützen können oder soweit ein besonderer Versicherungsschutz vereinbart ist.

(5) Eine Einschränkung oder Erweiterung der Haftung kann in begründeten Sonderfällen vereinbart werden.

§ 14 Abrechnung

1. Der Auftragnehmer hat seine Leistungen prüfbar abzurechnen. Er hat die Rechnungen übersichtlich aufzustellen und dabei die Reihenfolge der Posten einzuhalten und die in den Vertragsbestandteilen enthaltenen Bezeichnungen zu verwenden. Die zum Nachweis von Art und Umfang der Leistung erforderlichen Mengenberechnungen, Zeichnungen und andere Belege sind beizufügen. Änderungen und Ergänzungen des Vertrags sind in der Rechnung besonders kenntlich zu machen; sie sind auf Verlangen getrennt abzurechnen.
2. Die für die Abrechnung notwendigen Feststellungen sind dem Fortgang der Leistung entsprechend möglichst gemeinsam vorzunehmen. Die Abrechnungsbestimmungen in den Technischen Vertragsbedingungen und den anderen Vertragsunterlagen sind zu beachten. Für Leistungen, die bei Weiterführung der Arbeiten nur schwer feststellbar sind, hat der Auftragnehmer rechtzeitig gemeinsame Feststellungen zu beantragen.
3. Die Schlussrechnung muss bei Leistungen mit einer vertraglichen Ausführungsfrist von höchstens 3 Monaten spätestens 12 Werktage nach Fertigstellung eingereicht werden, wenn nichts anderes vereinbart ist; diese Frist wird um je 6 Werktage für je weitere 3 Monate Ausführungsfrist verlängert.
4. Reicht der Auftragnehmer eine prüfbare Rechnung nicht ein, obwohl ihm der Auftraggeber dafür eine angemessene Frist gesetzt hat, so kann sie der Auftraggeber selbst auf Kosten des Auftragnehmers aufstellen.

§ 15 Stundenlohnarbeiten

1. (1) Stundenlohnarbeiten werden nach den vertraglichen Vereinbarungen abgerechnet.
   (2) Soweit für die Vergütung keine Vereinbarungen getroffen worden sind, gilt die ortsübliche Vergütung. Ist diese nicht zu ermitteln, so werden die Aufwendungen des Auftragnehmers für Lohn- und Gehaltskosten der Baustelle, Lohn- und Gehaltsnebenkosten der Baustelle, Stoffkosten der Baustelle, Kosten der Einrichtungen, Geräte, Maschinen und maschinellen Anlagen der Baustelle, Fracht-, Fuhr- und Ladekosten, Sozialkassenbeiträge und Sonderkosten, die bei wirtschaftlicher Betriebsführung entstehen, mit angemessenen Zuschlägen für Gemeinkosten und Gewinn (einschließlich allgemeinem Unternehmerwagnis) zuzüglich Umsatzsteuer vergütet.
2. Verlangt der Auftraggeber, dass die Stundenlohnarbeiten durch einen Polier oder eine andere Aufsichtsperson beaufsichtigt werden, oder ist die Aufsicht nach den einschlägigen Unfallverhütungsvorschriften notwendig, so gilt Nummer 1 entsprechend.
3. Dem Auftraggeber ist die Ausführung von Stundenlohnarbeiten vor Beginn anzuzeigen. Über die geleisteten Arbeitsstunden und den dabei erforderlichen, besonders zu vergütenden Aufwand für den Verbrauch von Stoffen,

für Vorhaltung von Einrichtungen, Geräten, Maschinen und maschinellen Anlagen, für Frachten, Fuhr- und Ladeleistungen sowie etwaige Sonderkosten sind, wenn nichts anderes vereinbart ist, je nach der Verkehrssitte werktäglich oder wöchentlich Listen (Stundenlohnzettel) einzureichen. Der Auftraggeber hat die von ihm bescheinigten Stundenlohnzettel unverzüglich, spätestens jedoch innerhalb von 6 Werktagen nach Zugang, zurückzugeben. Dabei kann er Einwendungen auf den Stundenlohnzetteln oder gesondert schriftlich erheben. Nicht fristgemäß zurückgegebene Stundenlohnzettel gelten als anerkannt.

4. Stundenlohnrechnungen sind alsbald nach Abschluss der Stundenlohnarbeiten, längstens jedoch in Abständen von 4 Wochen, einzureichen. Für die Zahlung gilt § 16.
5. Wenn Stundenlohnarbeiten zwar vereinbart waren, über den Umfang der Stundenlohnleistungen aber mangels rechtzeitiger Vorlage der Stundenlohnzettel Zweifel bestehen, so kann der Auftraggeber verlangen, dass für die nachweisbar ausgeführten Leistungen eine Vergütung vereinbart wird, die nach Maßgabe von Nummer 1 Abs. 2 für einen wirtschaftlich vertretbaren Aufwand an Arbeitszeit und Verbrauch von Stoffen, für Vorhaltung von Einrichtungen, Geräten, Maschinen und maschinellen Anlagen, für Frachten, Fuhr- und Ladeleistungen sowie etwaige Sonderkosten ermittelt wird.

§ 16 Zahlung

1. (1) Abschlagszahlungen sind auf Antrag in Höhe des Wertes der jeweils nachgewiesenen vertragsgemäßen Leistungen einschließlich des ausgewiesenen, darauf entfallenden Umsatzsteuerbetrags in möglichst kurzen Zeitabständen zu gewähren. Die Leistungen sind durch eine prüfbare Aufstellung nachzuweisen, die eine rasche und sichere Beurteilung der Leistungen ermöglichen muss. Als Leistungen gelten hierbei auch die für die geforderte Leistung eigens angefertigten und bereitgestellten Bauteile sowie die auf der Baustelle angelieferten Stoffe und Bauteile, wenn dem Auftraggeber nach seiner Wahl das Eigentum an ihnen übertragen ist oder entsprechende Sicherheit gegeben wird.
   (2) Gegenforderungen können einbehalten werden. Andere Einbehalte sind nur in den im Vertrag und in den gesetzlichen Bestimmungen vorgesehenen Fällen zulässig.
   (3) Ansprüche auf Abschlagszahlungen werden binnen 18 Werktagen nach Zugang der Aufstellung fällig.
   (4) Die Abschlagszahlungen sind ohne Einfluss auf die Haftung des Auftragnehmers; sie gelten nicht als Abnahme von Teilen der Leistung.
2. (1) Vorauszahlungen können auch nach Vertragsabschluss vereinbart werden; hierfür ist auf Verlangen des Auftraggebers ausreichende Sicherheit zu leisten. Diese Vorauszahlungen sind, sofern nichts anderes vereinbart wird, mit 3 v. H. über dem Basiszinssatz des § 247 BGB zu verzinsen.

(2) Vorauszahlungen sind auf die nächstfälligen Zahlungen anzurechnen, soweit damit Leistungen abzugelten sind, für welche die Vorauszahlungen gewährt worden sind.

3. (1) Der Anspruch auf die Schlusszahlung wird alsbald nach Prüfung und Feststellung der vom Auftragnehmer vorgelegten Schlussrechnung fällig, spätestens innerhalb von 2 Monaten nach Zugang. Die Prüfung der Schlussrechnung ist nach Möglichkeit zu beschleunigen. Verzögert sie sich, so ist das unbestrittene Guthaben als Abschlagszahlung sofort zu zahlen.
(2) Die vorbehaltlose Annahme der Schlusszahlung schließt Nachforderungen aus, wenn der Auftragnehmer über die Schlusszahlung schriftlich unterrichtet und auf die Ausschlusswirkung hingewiesen wurde.
(3) Einer Schlusszahlung steht es gleich, wenn der Auftraggeber unter Hinweis auf geleistete Zahlungen weitere Zahlungen endgültig und schriftlich ablehnt.
(4) Auch früher gestellte, aber unerledigte Forderungen werden ausgeschlossen, wenn sie nicht nochmals vorbehalten werden.
(5) Ein Vorbehalt ist innerhalb von 24 Werktagen nach Zugang der Mitteilung nach den Absätzen 2 und 3 über die Schlusszahlung zu erklären. Er wird hinfällig, wenn nicht innerhalb von weiteren 24 Werktagen eine prüfbare Rechnung über die vorbehaltenen Forderungen eingereicht oder, wenn das nicht möglich ist, der Vorbehalt eingehend begründet wird.
(6) Die Ausschlussfristen gelten nicht für ein Verlangen nach Richtigstellung der Schlussrechnung und -zahlung wegen Aufmaß-, Rechen- und Übertragungsfehlern.

4. In sich abgeschlossene Teile der Leistung können nach Teilabnahme ohne Rücksicht auf die Vollendung der übrigen Leistungen endgültig festgestellt und bezahlt werden.

5. (1) Alle Zahlungen sind aufs äußerste zu beschleunigen.
(2) Nicht vereinbarte Skontoabzüge sind unzulässig.
(3) Zahlt der Auftraggeber bei Fälligkeit nicht, so kann ihm der Auftragnehmer eine angemessene Nachfrist setzen. Zahlt er auch innerhalb der Nachfrist nicht, so hat der Auftragnehmer vom Ende der Nachfrist an Anspruch auf Zinsen in Höhe der in § 288 BGB angegebenen Zinssätze, wenn er nicht einen höheren Verzugsschaden nachweist.
(4) Zahlt der Auftraggeber das fällige unbestrittene Guthaben nicht innerhalb von 2 Monaten nach Zugang der Schlussrechnung, so hat der Auftragnehmer für dieses Guthaben abweichend von Absatz 3 (ohne Nachfristsetzung) ab diesem Zeitpunkt Anspruch auf Zinsen in Höhe der in § 288 BGB angegebenen Zinssätze, wenn er nicht einen höheren Verzugsschaden nachweist.
(5) Der Auftragnehmer darf in den Fällen der Absätze 3 und 4 die Arbeiten bis zur Zahlung einstellen, sofern eine dem Auftraggeber zuvor gesetzte angemessene Nachfrist erfolglos verstrichen ist.

6. Der Auftraggeber ist berechtigt, zur Erfüllung seiner Verpflichtungen aus den Nummern 1 bis 5 Zahlungen an Gläubiger des Auftragnehmers zu leis-

ten, soweit sie an der Ausführung der vertraglichen Leistung des Auftragnehmers aufgrund eines mit diesem abgeschlossenen Dienst- oder Werkvertrags beteiligt sind, wegen Zahlungsverzugs des Auftragnehmers die Fortsetzung ihrer Leistung zu Recht verweigern und die Direktzahlung die Fortsetzung der Leistung sicherstellen soll. Der Auftragnehmer ist verpflichtet, sich auf Verlangen des Auftraggebers innerhalb einer von diesem gesetzten Frist darüber zu erklären, ob und inwieweit er die Forderungen seiner Gläubiger anerkennt; wird diese Erklärung nicht rechtzeitig abgegeben, so gelten die Voraussetzungen für die Direktzahlung als anerkannt.

§ 17 Sicherheitsleistung

1. (1) Wenn Sicherheitsleistung vereinbart ist, gelten die §§ 232 bis 240 BGB, soweit sich aus den nachstehenden Bestimmungen nichts anderes ergibt.
   (2) Die Sicherheit dient dazu, die vertragsgemäße Ausführung der Leistung und die Mängelansprüche sicherzustellen.
2. Wenn im Vertrag nichts anderes vereinbart ist, kann Sicherheit durch Einbehalt oder Hinterlegung von Geld oder durch Bürgschaft eines Kreditinstituts oder Kreditversicherers geleistet werden, sofern das Kreditinstitut oder der Kreditversicherer
   - in der Europäischen Gemeinschaft oder
   - in einem Staat der Vertragsparteien des Abkommens über den Europäischen Wirtschaftsraum oder
   - in einem Staat der Vertragsparteien des WTO-Übereinkommens über das öffentliche Beschaffungswesen zugelassen ist.
3. Der Auftragnehmer hat die Wahl unter den verschiedenen Arten der Sicherheit; er kann eine Sicherheit durch eine andere ersetzen.
4. Bei Sicherheitsleistung durch Bürgschaft ist Voraussetzung, dass der Auftraggeber den Bürgen als tauglich anerkannt hat. Die Bürgschaftserklärung ist schriftlich unter Verzicht auf die Einrede der Vorausklage abzugeben (§ 771 BGB); sie darf nicht auf bestimmte Zeit begrenzt und muss nach Vorschrift des Auftraggebers ausgestellt sein. Der Auftraggeber kann als Sicherheit keine Bürgschaft fordern, die den Bürgen zur Zahlung auf erstes Anfordern verpflichtet.
5. Wird Sicherheit durch Hinterlegung von Geld geleistet, so hat der Auftragnehmer den Betrag bei einem zu vereinbarenden Geldinstitut auf ein Sperrkonto einzuzahlen, über das beide Parteien nur gemeinsam verfügen können. Etwaige Zinsen stehen dem Auftragnehmer zu.
6. (1) Soll der Auftraggeber vereinbarungsgemäß die Sicherheit in Teilbeträgen von seinen Zahlungen einbehalten, so darf er jeweils die Zahlung um höchstens 10 v. H. kürzen, bis die vereinbarte Sicherheitssumme erreicht ist. Den jeweils einbehaltenen Betrag hat er dem Auftragnehmer mitzuteilen und binnen 18 Werktagen nach dieser Mitteilung auf ein Sperrkonto bei dem vereinbarten Geldinstitut einzuzahlen. Gleichzeitig muss er veranlas-

sen, dass dieses Geldinstitut den Auftragnehmer von der Einzahlung des Sicherheitsbetrags benachrichtigt. Nummer 5 gilt entsprechend.
(2) Bei kleineren oder kurzfristigen Aufträgen ist es zulässig, dass der Auftraggeber den einbehaltenen Sicherheitsbetrag erst bei der Schlusszahlung auf ein Sperrkonto einzahlt.
(3) Zahlt der Auftraggeber den einbehaltenen Betrag nicht rechtzeitig ein, so kann ihm der Auftragnehmer hierfür eine angemessene Nachfrist setzen. Lässt der Auftraggeber auch diese verstreichen, so kann der Auftragnehmer die sofortige Auszahlung des einbehaltenen Betrags verlangen und braucht dann keine Sicherheit mehr zu leisten.
(4) Öffentliche Auftraggeber sind berechtigt, den als Sicherheit einbehaltenen Betrag auf eigenes Verwahrgeldkonto zu nehmen; der Betrag wird nicht verzinst.

7. Der Auftragnehmer hat die Sicherheit binnen 18 Werktagen nach Vertragsabschluss zu leisten, wenn nichts anderes vereinbart ist. Soweit er diese Verpflichtung nicht erfüllt hat, ist der Auftraggeber berechtigt, vom Guthaben des Auftragnehmers einen Betrag in Höhe der vereinbarten Sicherheit einzubehalten. Im Übrigen gelten die Nummern 5 und 6 außer Abs. 1 Satz 1 entsprechend.

8. (1) Der Auftraggeber hat eine nicht verwertete Sicherheit für die Vertragserfüllung zum vereinbarten Zeitpunkt, spätestens nach Abnahme und Stellung der Sicherheit für Mängelansprüche zurückzugeben, es sei denn, dass Ansprüche des Auftraggebers, die nicht von der gestellten Sicherheit für Mängelansprüche umfasst sind, noch nicht erfüllt sind. Dann darf er für diese Vertragserfüllungsansprüche einen entsprechenden Teil der Sicherheit zurückhalten.
(2) Der Auftraggeber hat eine nicht verwertete Sicherheit für Mängelansprüche nach Ablauf von 2 Jahren zurückzugeben, sofern kein anderer Rückgabezeitpunkt vereinbart worden ist. Soweit jedoch zu diesem Zeitpunkt seine geltend gemachten Ansprüche noch nicht erfüllt sind, darf er einen entsprechenden Teil der Sicherheit zurückhalten.

§ 18 Streitigkeiten

1. Liegen die Voraussetzungen für eine Gerichtsstandvereinbarung nach § 38 Zivilprozessordnung vor, richtet sich der Gerichtsstand für Streitigkeiten aus dem Vertrag nach dem Sitz der für die Prozessvertretung des Auftraggebers zuständigen Stelle, wenn nichts anderes vereinbart ist. Sie ist dem Auftragnehmer auf Verlangen mitzuteilen.

2. (1) Entstehen bei Verträgen mit Behörden Meinungsverschiedenheiten, so soll der Auftragnehmer zunächst die der auftraggebenden Stelle unmittelbar vorgesetzte Stelle anrufen. Diese soll dem Auftragnehmer Gelegenheit zur mündlichen Aussprache geben und ihn möglichst innerhalb von 2 Monaten nach der Anrufung schriftlich bescheiden und dabei auf die Rechtsfolgen des Satzes 3 hinweisen. Die Entscheidung gilt als anerkannt,

wenn der Auftragnehmer nicht innerhalb von 3 Monaten nach Eingang des Bescheides schriftlich Einspruch beim Auftraggeber erhebt und dieser ihn auf die Ausschlussfrist hingewiesen hat.

(2) Mit dem Eingang des schriftlichen Antrages auf Durchführung eines Verfahrens nach Absatz 1 wird die Verjährung des in diesem Antrag geltend gemachten Anspruchs gehemmt. Wollen Auftraggeber oder Auftragnehmer das Verfahren nicht weiter betreiben, teilen sie dies dem jeweils anderen Teil schriftlich mit. Die Hemmung endet 3 Monate nach Zugang des schriftlichen Bescheides oder der Mitteilung nach Satz 2.

3. Bei Meinungsverschiedenheiten über die Eigenschaft von Stoffen und Bauteilen, für die allgemein gültige Prüfungsverfahren bestehen, und über die Zulässigkeit oder Zuverlässigkeit der bei der Prüfung verwendeten Maschinen oder angewendeten Prüfungsverfahren kann jede Vertragspartei nach vorheriger Benachrichtigung der anderen Vertragspartei die materialtechnische Untersuchung durch eine staatliche oder staatlich anerkannte Materialprüfungsstelle vornehmen lassen; deren Feststellungen sind verbindlich. Die Kosten trägt der unterliegende Teil.
4. Streitfälle berechtigen den Auftragnehmer nicht, die Arbeiten einzustellen.

List of references

Erbguth W (2000) Factory-Outlet-Center: Landesplanungs- und städtebauliche Fragen, verfassungs- wie verwaltungsrechtliche Aspekte. In: Neue Zeitschrift für Verwaltungsrecht, Munich Frankfurt am Main, pp 969 - 977

Erbguth W, Wagner J (2005) Grundzüge des öffentlichen Baurechts, 4th edn. C. H. Beck Munich

Finkelnburg K, Ortloff K-M, (2005) Öffentliches Baurecht Vol II: Bauordnungsrecht, Nachbarschutz, Rechtsschutz, 5 th edn. C. H. Beck, Munich

Kleiber X, Simon X, Weyers X, (1998) Verkehrswertermittlung von Grundstücken, 3rd edn. Bundesanzeiger Verlag, Cologne

Kopp F O, Ramsauer U (2005) Kommentar zum VwVfG, 9th edn. C. H. Beck, Munich

Oehmen K, Bönker C (2004) Einführung in das öffentliche Baurecht, Basiswissen für die Praxis, 2nd edn. Werner Verlag, Darmstadt

Reichel G H, Schulte B H (2004) Handbuch Bauordnungsrecht, C. H. Beck, Munich

Schäfer J, Conzen G (2002) Praxishandbuch der Immobilien-Projektentwicklung, C. H. Beck, Munich

Stollmann F (2005) Öffentliches Baurecht, 3rd edn. C. H. Beck, Munich

Stüer B (2001) Der Bebauungsplan, 2nd edn. C. H. Beck, Munich

Voß R, Buntenbroich L (1999) Das neue Baurecht in der Praxis, RWS Verlag Kommunikationsforum GmbH, Cologne

Index

Q