COVID-19
German Real Estate Issues

26 March 2020

On 25 March 2020, the German Parliament (*Bundestag*) passed, in connection with the COVID-19 pandemic, significant changes in law (the "**New Law**"). These changes are subject to approval by the Federal Council (*Bundesrat*), which, however, is expected to be granted soon.

This document shall give an initial overview of the New Law as well as other legal aspects that we deem relevant in the German real estate sector. The below summary is given on a non-reliance basis and shall not replace specific legal advice in the individual case.

Rent reduction

a) Suspension of landlord's termination right

So far, it has been the general rule in German lease law that the landlord is able to terminate the lease agreement if the tenant has defaulted on two months' rent. This principle is temporarily suspended for lease agreements by the New Law insofar as the tenant 'fails to pay the rent in the period from 1 April 2020 to 30 June 2020 despite maturity provided the failure to pay is based on the effects of the COVID-19 pandemic.' In this regard, it is necessary for the tenant to credibly demonstrate the connection between the COVID-19 pandemic and the failure to pay. For tenants of commercial real estate, the legislative rationale assumes that they will generally be able to credibly demonstrate the corresponding connection by stating that the operation of their business was prohibited or significantly restricted by a statutory or official order.

The suspension of the landlord's termination right described above due to payment default is to be applied until 30 June 2022, meaning that the lease agreement can be terminated again after 30 June 2022 for payment arrears from the period from 1 April 2020 to 30 June 2020 provided the arrears for such period have not been settled by this time. This allows the affected tenants to pay back their arrears within a period of two years.

The suspension of the landlord's termination right can be extended by decree of the Federal Government for rent arrears which arise in the period from 1 July to 30 September 2020 if further significant impacts by COVID-19 pandemic can be expected.

b) Continuity of lease obligations

Apart from the above-mentioned suspension of the landlord's termination right in case of certain rent arrears, all other rights and obligations of landlords and tenants continue to apply. In particular, the New Law does not limit the obligation of tenants to pay their rent and does not include a right to reduce rent, suspend payments or refuse performance. If a tenant dos not pay its rent when due, it will run into payment default (in general without further warning notice) and has to pay default interest (currently 8.12 per cent p.a. if landlord and tenants are entrepreneurs and not consumers) and other damages caused by the default: Important: In the event of non-payment of the rent due, the landlord can also claim the rent deposit.

Regarding the question of whether usage restrictions caused by COVID-19 give the tenant the right to reduce their rent, there are still strong reasons to support there being no justification for a reduction in principle under statutory law. However, it depends very much on the individual circumstances, since in any case specific contractual provisions take precedence over the statutory provisions. As stated, the New Law adopted to mitigate the effects of the COVID-19 crisis does not provide for any change in this regard.

c) Insolvency law aspects

The New Law temporarily suspends the obligation to file for insolvency until 30 September 2020 if the insolvency is based on the COVID-19 pandemic and there are prospects for restructuring. On the back of this, the New Law contains far reaching privileges under the law governing insolvency challenges of collateral or payments received in the suspension period up until 30 September 2020. On that basis, any receipt of rent during the period until 30 September 2020 shall not be challengeable by the insolvency administrator of the tenant, unless the landlord was aware that the tenant's restructuring and financing efforts were not suited to remedying the insolvency which had occurred.

Against this background and if there is a risk that the tenant will later fall into insolvency, landlords need to be careful with granting a binding or informal suspension of rent payments and even with purely stopping the enforcement of rental claims:

- If the landlord agrees to a suspension of rental payments until a point in time within the period until 30 September 2020 and if the tenant that indeed makes the payment in time, the landlord benefits from the aforementioned privilege.
- If, however, the rent arrears are only paid after elapse of the suspension period (i.e. after 30 September 2020), the receipt of the payment is not protected by the above-mentioned privilege. Furthermore, due to the rental payment being made with delay, the general privilege of an immediate cash trade ("Bargeschäft") does not apply, i.e. the rent received with delay can be challenged and reclaimed by the insolvency administrator of the tenant. All this applies irrespective of whether the payment is made late on the basis of a deferral agreement between the landlord and the tenant or just occurs in practice. When entering into deferral agreements, however, a certain focus needs to be put on avoiding (assistance) on delaying insolvency.

A tenant seeking a suspension of its rental payments may possibly need to consider the effects of such a suspension on its ability to participate in the funding programmes of Germany's KfW development bank. These typically require that the company that seeks financial support is, due to the COVID-19 pandemic, in financial difficulties. There is no definition or more precise guidance on the interpretation of that term yet. However, we assume that in principle the suspension of rental payments is regarded as easing the relevant financial difficulties.

Real Estate Financing

The original draft of the New Law provided that claims to interest, redemption and repayment under all existing loan agreements concluded prior to 8 March 2020 would be suspended from 1 April 2020 to 30 September 2020 if making these payments is unbearable for the borrower due to the COVID-19 pandemic. This extensive borrower protection has been substantially limited in the New Law now passed in parliament, in particular – and this is important for real estate investors – it now only applies to consumer loan agreements.

Hence, real estate investors may **not** seek protection under the new law.

The federal government is authorised to expand the scope of persons covered to include 'in particular' micro businesses (less than 10 employees; annual revenue/balance sheet of not more than €2m, provided that revenue of affiliates is added). However, we do not see indications at the moment that would make it likely that the government will extend the scope in a way that would indeed cover larger real estate investors.

Subsidies for real estate companies?

In particular, the 'gap' in the protection of borrowers mentioned above may make it necessary for real estate companies to consider availing of government funding programmes.

a) KfW funding programmes

The basic idea behind all the funding programmes being put together by Germany's KfW development bank is essentially the same in each case, namely that a business that is forced into temporary financial difficulty as a result of the corona pandemic is granted a loan by its own main bank, which is then covered/guaranteed to the lender by the KfW or another state-owned body up to a certain percentage. This mechanism is designed to allow the lender (eg the business's own main bank) to grant the loan to the business at a very low rate of interest and without any further collateral or security being required.

In our view, it should generally be possible for domestically based real estate companies to avail of the KfW funding programmes if and to the extent that they meet the applicable criteria in each case (in particular, that they have come into financial difficulty as a result of the corona pandemic); the details are to be assessed on a case-by-case basis.

However, in our view, it looks like it will be difficult for real estate companies whose headquarters are located

abroad (eg in Luxembourg) to qualify here, given that almost all KfW funding programmes (more on the exception to this directly below) require that the relevant business have its headquarters in Germany, and in some cases it is even necessary for the HQ to be located in a certain state (*Land*). The information currently available on the relevant KfW funding programmes is not clear on the question of whether 'headquarters' means the de facto principal place of administration (for foreign companies this could also be located in Germany from a company law - but not a tax law - perspective) or the headquarters under the articles of association. Under the KfW's special programme 'Direct Investment for Syndicated Financing' ('*Direktbeteiligung für Konsortialfinanzierung*'), while foreign businesses from trade and industry are generally eligible for assistance, the majority holding in such businesses must be in private hands. The funding is also required to be used for investment. Mere debt rescheduling or supplementary financing of completed projects is not covered.

b) Economic stabilisation fund

In addition to the KfW funding programmes an economic stabilisation fund was also adopted in the New Law. The strategic impact of the fund is aimed at businesses in the real economy, meaning that real estate companies will not be covered by its scope, in our view. Its applicability to real estate companies is also generally hampered by the fact that the potential failure of the business seeking assistance must (potentially) have a significant impact on the economy, technological sovereignty, security of supply, critical infrastructures or the labour market (details to be assessed on a case-by-case basis).

Construction delays

a) Delays

With regard to building contracts (and forward deals, that are purchase agreements on project developments), the question is whether COVID-19-induced delays extend the delivery deadlines.

For contracts concluded on the basis of the VOB/B (or which refer to the VOB/B in this regard), it may be possible to qualify COVID-19-induced delays as 'force majeure' and for them for example under section 6(2)(1)(c) VOB/B to lead to an extension to the period of performance. According to established court rulings, force majeure for the present purpose means an external occurrence affecting operations which, even when applying utmost care, is unavoidable without endangering the contractor's economic success and is not to be charged to the contractor due to its frequency and must be accepted.

Whether force majeure is in evidence with COVID-19-induced delays depends on the details:

- For example, a building contractor must calculate in and accept a certain level of sickness, such as that caused by influenza. Force majeure would only be considered in relation to the absence of workers caused by Corona if this exceeded the normal rate of absenteeism; individual infections with the Corona virus are therefore insufficient. However, the presence of force majeure is likely to be confirmed in the event of far-reaching quarantine measures, and certainly also in the event of far-reaching curfews; by contrast, this would likely not be the case in the event of workers returning to their home countries as a precautionary measure, for example due to fear or infections or border closures.
- A distinction must be drawn in the event of delays to construction caused by a lack of building materials. Should difficulties in procuring building materials arise due to extreme price increases, under no circumstances is this to be deemed force majeure, since the contractor bears the procurement risk. The situation is different if there is a supply shortage which cannot be rectified by purchasing expensive materials.

This interpretation is supported by a letter from the Federal Ministry of the Interior of 23 March 2020 with regard to federal government construction sites (which shall – according to the latter – be continued to be operated if possible): A Corona-induced delay cannot be qualified as 'force majeure' within the meaning of section 6(2)(1)(c) VOB/B on the basis of a general reference to pandemic-induced adverse effects alone. Rather, the building contractor must specifically demonstrate that, in addition to the generally aggravated situation as a result of the pandemic, there are further aggravating factors, such as far-reaching quarantine measures or curfews.

In contracts which do not reference the VOB/B and its 'force majeure' provision, the law to date appears stricter for the building contractor or the seller of a project development, i.e. it can only rely on the concepts of impossibility or failure of contractual basis unless otherwise specifically provided for by the contract.

b) No changes on the basis of the New Law

The New Law finally adopted has not changed the legal situation with regard to forward deals, construction agreements and other property-related agreements like property purchase or management agreements (with the exception of the new special provisions introduced in the New Law for leases and loan agreements, see above at nos. 1 and 2).

Whereas the first draft of the bill originally provided for a general right of debtors to refuse performance due to the effects of Corona, the New Law limits the right to refuse performance to consumers and micro businesses and only with regard to certain continuing obligations. Continuing obligations of micro-business are those that are necessary to supply the business with goods and services for its adequate continuation.

This means that a construction company (which is not a micro-business) cannot simply stop performance under these new provisions since its obligation to deliver the building does not constitute a 'continuing obligation' in the above-mentioned sense. Rather, the construction company is – also according to the new law – limited to the existing provisions in case of delay in performance (e.g. 'force majeur').

Suspension of the obligation to file for insolvency

The New Law provides for a suspension of the obligation to file for insolvency until 30 September 2020 if the insolvency is based on the COVID-19 pandemic and there are prospects for restructuring.

The new law also comprises provisions to facilitate financing in the crisis. First, the otherwise applicable subordination of shareholder loans (but not of respective collateral) is suspended until 30 September 2020. Furthermore, the existing liability regime for financing provided in a financial crisis and delaying insolvency of the debtor is temporarily suspended; it may be granted without requiring a restructuring report.

Tax payments

The tax authorities can suspend tax payments wholly or in part if their payment at the maturity date would imply a 'material hardship' for the tax payer and if the tax claim is not endangered by the suspension. In the current Corona crisis, the tax authorities have been instructed not to impose strict requirements in this regard. The tax authorities have clarified by letter from 19 March 2020, that the entitlement to an 'eased suspension' of taxes on the basis of the current crisis requires that the tax payer is 'evidently immediately and not only immaterially affected'. If these requirements are fulfilled, the tax authorities may – according to the afore-mentioned letter – also waive the usual claim for suspension interest (6 per cent p.a.).

Foreign Investment Control

In public statements over the last few days, the federal government has explained that they are willing to help and protect German companies, whose value has dropped due to the Corona crisis. It is currently unclear whether this will lead to limitations on foreign direct investment into Germany. Such limitations may also be possible following from EU policy. On 25 March 2020, the European Commission published guidelines aiming to protect companies and infrastructure against offers from outside Europe (EU/EFTA). Both Germany's and the EU's main area of attention currently appears to be the health sector, e.g. companies that produce medical supplies particularly important now (vaccines, air supply, etc or related R&D). Hospitals and nursing homes may also attract more scrutiny.

We also assume that the German foreign investment regulator will likely show more interest in transactions relating to real estate, which is located close to important infrastructure, military bases etc Other regulators, in particular CFIUS who, among other transactions, has prohibited the purchase of real estate close to military installations), have reviewed transactions relating to such proximity issues in the past and it seems possible for the German regulator to follow suit.