



LEGALINK

INTERNATIONAL BUT PERSONAL

GUIDELINES FOR INVESTMENTS IN **REAL ESTATE**

2019



INTRODUCTION

The world has changed a lot since we launched the 2nd edition of this book in 2012 with an overview regarding Investments in Real Estate all over the world.

In recent years the world has faced some difficult situations not only in the political, but the economic world. We face a crisis in the EU with the never-ending Brexit discussion over the last two years. Some important political leaders, both inside and outside of the EU, seem to lack the ability to carefully listen to others or take diverse views into account and sacrifice compromise and “win-win” solutions on the altar of egoism. Such attitudes jeopardize not only the political but the economic relationships between countries, and disrupt the balance needed for good relations over the long term.

In these times it is very important to have personal contacts and friends in the world you really can trust, who are familiar with the laws in their area. Our Legalink network, which is grown internationally over the last 25 years, is exactly what is needed these days, because our prominent experts in the network know each other personally from attending at least two meetings a year. At our conferences, therefore, we meet as friends, and not just as lawyers.

In uncertain political times many people look to diversify their investments into safe havens, but still want something more than the interest banks pay on simple monetary investments, which do not even keep pace with the inflation rates in most countries. Therefore, in addition to investments in the stock markets, we see not only in Germany, but in other stable economies throughout the world, substantial investment in real estate, with accompanying increases in prices. Such price increases, however, while seemingly rewarding the investor, make it more necessary than ever before to carefully evaluate the long-term viability of investments in the real estate market, keeping in mind that history shows that if investments are professionally reviewed and professionally executed, then most are ultimately successful.

We are very happy to have in our growing Legalink network, which has more than 3000 lawyers in about 70 independent law firms located in most business centers on all five continents, recognized experts in the field of real estate acquisition and finance. These lawyers are ready to advise and assist investors in all aspects of investments and transactions involving residential and commercial real estate, and all other real property issues, as well.

From working together on cross-border projects in our network and in discussions with our clients, we found that many of them, as well as other potential investors, would like to receive an introduction to the rules governing investing in real estate throughout the world, as well as other aspects that have to be taken into account in real estate transactions. In this 3rd edition of our book we are pleased to give potential investors a first overview of various factors which must be considered when investing in residential or commercial real estate in many countries of the world in which they might be interested. Of course, every single transaction is unique and the laws and tax aspects of it must be reviewed in detail by specialists.

You will find contact data of the firms within this book and on the website of our Legalink network (www.Legalink.ch). All firms are pleased to assist in this field and will give you professional advice.

If you require a cross-border analysis of diverse law aspects, a joint effort to facilitate a cross-border transaction, or if you have any questions concerning how our network can get you the most advantageous solutions for investments in commercial real estate, please do not hesitate to contact us. We will be happy to refer you to the specialists of our network who can best assist you in your case.

Berlin, October 2019

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I. Procedure of a real estate transaction

1. Could you give a short outline with regard to the formal procedure of a real estate transaction in your country, starting from the signing of the purchase agreement (including the closing) until formal ownership vests in the purchaser?

In Germany, real estate transactions are governed by state law. In order to understand the German law in this field, it is important to see that all properties in Germany are formally registered in land registers.

Land register

Land registers are in most areas administrated by the local courts. The land register contains information regarding all private law aspects of the property, i.e.

- size of the property,
- if it is open area or landed property,
- where exactly it is located according to special field cards that authorities in Germany provide for,
- who the owner is, and
- what encumbrances are on the property, e.g. rights of way, rights of pipes and very important land charges as securities for loans.

In order to transfer ownership of a property from the seller to the buyer, the transfer of ownership has to be formally entered into the land register. This entry of transfer of title is constitutive for getting the ownership. Communication with the land register is held by notaries, who in Germany are specialised lawyers in this field of law. In some areas of Germany they act only as notaries; in other areas, like for example in Berlin, some lawyers get the privilege to act as lawyer and as notary. The notaries normally draft the contracts for property transactions, but it is possible as well that the parties draft contracts through their lawyers and send it to the notary, who has to check them from a notarial point of view, meaning the notary has to take into account both sides of the deal, since the notary has to be neutral in between the parties of the deal.

Contact and first negotiations of the parties

The parties of a property transaction may meet through contacts within networks, real estate platforms in the internet or newspaper or other advertisements published by the owner himself or, often, through specialised real estate agents. The parties usually first negotiate the main economic aspects like the price of the property, if movables are to be sold as well (for example, kitchen or other furniture) or the warranties that shall be given by the seller to the buyer as to the status quo of the object. The latter may vary highly depending on, for example, the age or stage of the property and its site.

Due diligence

On bigger deals regarding bigger commercial or residential properties, the negotiations are often more complex, since a lot of aspects have to be clarified and taken into account for the deal itself and finding the price agreement. The purchaser is interested in avoiding superfluous costs of research into aspects of the object when the owner might in between his research sell to another party, and

therefore often tries to agree with the owner on a specific price, if the due diligence still to be taken within an agreed time slot will not bring evidence to negative aspects. The parties then often agree on a so-called non-disclosure agreement (NDA) and the owner side brings all details as to the property or properties in question (e.g. lease contracts, building permits, construction loads, insurance contracts and maintenance agreements) into a special data room (today this is a virtual data room) so that the side of the purchaser can prepare through his lawyers a due diligence on all important related law aspects of the object(s), beside other technical due diligence that may be organised in parallel through engineers and other technical specialists organised by the purchaser. The agreed time slot differs on the complexity of the object(s) and the pressure in the market. In projects worth more than €10 million, a time slot in Germany may be two to three weeks.

Notarisation and further realisation of the deal

Recording of the contract

After the parties have decided, with or without special due diligence, to agree on the deal, the parties give this information to a chosen notary public in Germany. Every notary public in Germany may record any real estate in Germany, means a Berlin notary public may record a deal regarding an object in Berlin or Munich and vice versa. The only rule is that the notary should not travel for the recording, which means the recording itself should take place in his office or somewhere in the town where the notary is located. In most areas of Germany the purchaser has the unwritten right to choose the notary, because in most areas of Germany it is at least legal custom that the buyer has to fully pay for the notary's work. The notary who records the deal has to take care of the interests of both parties. He drafts the purchase contract or checks and revises a draft if the lawyer of a party has drafted the contract. The contract should cover all rights and obligations of the parties and the rules of the execution of the deal.

When to pay the purchase price?

Both parties of course are in particular interested in when to pay/get the purchase price. In Germany most deals are organised with direct payment from the purchaser to the seller. Only on specific aspects is it allowed to organise the payment through a notarial escrow account. Direct payment to the purchaser does not mean that the purchase price has to be paid before the recording or at or straight after the recording. In normal transactions, the average time to pay the purchase price is around seven to eight weeks after the day of the notarial recording of the purchase contract.

In real estate transactions in Germany you cannot normally exactly name the relevant day when the purchaser has to pay the purchase price, since payment shall only be done after specific aspects of the deal are, from a notarial point of view, secured, and these aspects can take some time and cannot exactly be calculated by the notary. The acting notary has in particular to secure in every case that the purchaser only pays after it is secured that he will later really get the ownership of the object and, on the other hand, the notary has to take care that the seller will get safely the money before the purchaser gets the title of ownership. The parties can relax a bit after recording of the purchase contract, since the notary will file a formal letter to the parties ('notarielle Kaufpreisfälligkeitsteilung') and confirm therein when all prerequisites for paying the purchase price he has to take care of have been fulfilled.

The system works as follows:

- After the recording, the notary sends the signed contract:

- not only to the parties but to the municipal county to confirm that they will not exercise their (under specific circumstances) existing pre-emption right ('Vorkaufsrecht der Gemeinde'), which, if existing, has to be exercised formally within a two-month period after formal information of the deal through copy of the contract. In 99.9% of cases this right either does not exist and you get the negative clearance ('Negativattest') or, if yes, the municipal county has not the money and the interest to buy the plot of real estate in question and gives you the pre-emptive right waiver ('Vorkaufrechtsverzicht'), but in the last few years in specific booming areas like Berlin the authorities are interested to take care in particular of the milieus of tenants and in specific cases make use of the pre-emption right if the purchaser does not agree on some terms with the authorities to preclude excessive raising of rents;
- to the land register to ask for the entrance of a so-called priority notice ('Eigentumsvormerkung'). After the priority notice is entered in the land register the buyer gets security, as long as no pre-emption right of the municipal authorities is exercised, that he will become the owner if he further complies 100% with the notarial contract;
- to banks and other mortgagees the seller has financed the property with so far and which have to release the real estate of the pledge after they are paid their loans. The mortgagees send to the notary a settlement of the loans in question and deletion papers regarding the mortgage in case the trust requirements of repayment of the loans of the seller are fulfilled; and
- to the tax authorities, since the transfer of title is only allowed for purchasers who have paid the real property transfer tax ('Grunderwerbsteuer'), to ask for the tax clearance certificate ('Unbedenklichkeitsbescheinigung'), which the notary gets sent by the tax authorities after payment of tax has occurred.

Change of use and costs of the object

After payment of the full purchase price the buyer gets the possession of the property and all benefits and costs of it, but not yet the full title in law.

Transfer of title

After payment of the purchase price and the real property transfer tax, the notary organises the formal transfer of title in the land register to the buyer. The entrance of the transfer of title happens in normal cases around five months after recording of the purchase agreement. As already said, the purchaser gets nevertheless the keys long before, normally around seven to eight weeks after the recording of the purchase contract.

2. Does your legal system permit different sorts of ownership, like ownership of the whole land and construction or ownership, for example, only of one unit or lots of units (condominium) of the improvements?

Yes, in Germany we know the normal property of land which includes usually by law the ownership of any buildings erected on the concerned land (see further two questions below). You can check in the

land register (notaries can check online) who the owner is and if there is a building on the property. Furthermore, the German law knows condominiums. Every single condominium gets a special deed in the land register and you can see on the name of the land register if the object is only a condominium or if the whole land is owned by a specific person.

3. Does the legal system of your country permit joint ownership of real property? Which kind of entities can be owner of real property in your country?

Yes, the German system knows joint ownership. There can be couples or friends or almost all kinds of companies holding property alone or jointly by percentages they can freely choose. Foreigners and foreign companies are permitted to directly have ownership in all real estate in Germany.

4. In some countries the ownership of a building is implied in the ownership of the land. Is it this way in your country as well, and/or is it possible to have different owners of the land and the building erected on it?

Yes, in Germany usually the owner of the land owns all buildings erected on it. This may differ in cases where the land is, for example, divided into condominiums or if there is a so-called hereditary building right ('Erbbaurecht'). This can be checked easily by having a look into the land register. The hereditary building right is the right to have a whole building in ownership on the land that is in ownership of another natural person or company. We see this hereditary building right in Germany often in areas where the big churches, i.e. the Roman Catholic and the Protestant church, own land. The churches often do not sell the land to people but give hereditary building rights to have a building on the property for, for example, 50 or 100 or even more years. The hereditary building right is entered formally in the land register, and the land register opens a further land register for the hereditary building right since this is handled like a property, which means that it can be used as security for land charges on this right and so on.

5. Is the land and/or the building registered in a formal register, and is a good-faith purchaser protected with regard to the entries in this formal register?

Yes, as mentioned above almost all (some property in ownership of the state has not to be registered) properties in Germany are registered in the land register that is organised by, in real estate matters, special educated persons ('Rechtspfleger'), and good faith in the correctness of the civil rights entered in the land register (not to the size and use of the buildings erected on it) is protected. If the land register was false and a land charge was deleted by mistake and the buyer buys it on first sight free of charges, he is protected in his good faith (sec. 892 German Civil Code). The bank in the given example would have a claim against the Federal Land in Germany where the court of the land register is located for the damages suffered because of the false land register.

II. Financing tools of the transaction

6. How do investors finance the transaction? Can purchases be financed through real estate purchase contracts? Are mortgages the typical way of coverage for banks?

In many cases buyer need to finance all or at least a big part of the purchase price and usually banks

or insurance companies lend the money to these customers and in return ask for land charges ('Grundschulden') or, in law aspects quite similar but in Germany seldom used, mortgages ('Hypotheken') to be placed on the property their clients intend to buy. Therefore the notaries include in the purchase contract corresponding clauses that allow the purchaser to place one or more land charges/mortgages for financing the purchase price on the related property.

Financing through cession of claims from other real estate purchase contracts is very complicated, since the notary has to take care that the seller only loses his title after he has got the purchase price.

7. What should be taken into account when thinking about the financing of a purchase project in your country?

If the purchaser is a foreign person or company one should discuss whether the financing is done with a bank accredited in Germany or a foreign bank. It is most times easier to finance with a bank accredited in Germany since the system to safeguard the bank is a land charge/mortgage according to German law. Of course, there might be the chance that the foreign investor finances the object of purchase though another real estate located abroad. Then it might be easier to finance with a bank of that country.

It further should be taken into account what the plans are with the real estate in question. Shall it be sold soon after acquisition, or shall it stay with the purchaser for longer? Tax aspects may have an impact on the answer to this. Furthermore, foreign investors should think of creating a company in Germany, which is easily done, which then will be formally the purchaser as a German entity.

III. Costs for transaction

8. What tax aspects are directly involved in a purchase of real property – for example, real property transfer tax – and what is the percentage of it?

Real property transfer tax has to be paid on real property transactions, and in most areas of Germany the percentage of this tax is dependent on the location you buy. It ranges from 3.5% to 6.5% of the purchase price; in Berlin it amounts actually to 6%. According to tax rules in general, when real property transfer tax is applicable no further turnover tax (at the moment 19%) is due in parallel. This rule does not apply when both seller and buyer are companies or businesspersons and the seller waives the right of buying the property without turnover tax. This waiver can be good for the seller if, for example, he had paid pre-tax for erecting a building on this land in recent years. Then he can count up the part of the turnover tax against his pre-tax. The buyer can count up the turnover tax against his pre-taxes as well, so that he has often no negative result out of this tax aspect. However, this requires that the buyer has pre-taxes in Germany, which foreign investors usually only have if the building is or will be rented to entities or businesspersons who have to pay turnover tax on the rents. These tax aspects need to be checked before the purchase contract is notarised.

9. Do you have to hold the property for a specific time with respect to tax reasons, or is it in this context no problem to buy and sell property on a short-term basis – for example, within a year?

In Germany, one normally has to hold the property for ten years calculated from the notarial purchase contract to avoid speculation tax that can occur if the selling price (including costs) of the property

is higher than the purchase price has been. If speculation tax is applicable, the amount depends on the income tax rate of the seller of the property. Foreign investors should check possible further tax aspects of their home country in this respect.

10. Can the seller get his money out of your country after the transaction (repatriation of funds)?

In Germany this aspect is no problem at all.

11. If you buy real estate that is leased to one or more persons, are you allowed to terminate the lease contract(s), or which restrictions have to be taken into account?

We have the rule that the purchase of a property does not break the lease contract (sec. 566 German Civil Code), which means that the purchaser by law enters into the lease contract, and normally a commercial lease contract cannot be terminated prior to the contractual term neither by the new owner nor by the lessee. For example, if the commercial lease has a term of ten years and the purchase takes place after one year, the purchaser cannot terminate the lease at an earlier date than ten years after start of the lease term. This is different when you acquire property in a sale by court order or from the insolvency administrator in insolvency cases. In these cases the purchaser has a special right to terminate the lease contract ('Sonderkündigungsrecht') under sec. 57a of the Compulsory Auction of Immovable Property Act ('Zwangsversteigerungsgesetz') and sec. 111 of the Insolvency Act ('Insolvenzordnung').

12. Are you allowed to change the use of a building from residential use to office space or vice versa? Do you need official approval for doing so, or is it not allowed at all?

You have to check for every case separately. Two aspects have to be taken into account:

- if the building permit allows the intended use of the purchaser; and
- if in the area in question the local authorities have set a development freeze ('Veränderungssperre').
Local authorities do this sometimes in areas with too little residential property.

13. To get a feeling as to the amount of costs involved, what costs should be taken into account if a foreign investor bought an existing building (and land) for a purchase price of €5 million, particularly

- notarial costs?
- land register?
- real estate transfer tax?
- advising lawyer (due diligence)?
- estate agent?
- others?
- Notarial costs:
 - about €25,000 plus 19% turnover tax for German entities,
 - normally no turnover tax for foreign entities;
 - if financed, for example, with a land charge, amounting to €4 million, further costs of about €6,100 occur plus VAT depending as outlined before.
- Land register:
 - about €12,500;
 - if financed, for example, with a land charge amounting to €4 million, further costs of about €6,100

- Real estate transfer tax:
 - €300,000 (6% in Berlin)
- advising lawyer (due diligence):
 - depending on the agreement with the lawyers. Normally they act for international clients on hourly rates. Most specialised law firms have ranges of rates between €250 and €450 or more. Legal assistance from day one of the deal until transfer of title would take about 50 hours plus time for due diligence, if a due diligence is requested by the client.
- estate agent:
 - between 4% and 6% net of the purchase price, depending on the market situation and the specific plot of land. If the purchase price is higher, it might be possible to get the estate agent a bit down with his costs. VAT (19%) for German entities, normally no turnover tax for foreign entities
- others?
 - if you do a technical due diligence, these costs have to be added

IV. Costs for holding real estate

14. What tax aspects are directly involved when holding a property – for example, yearly land tax after the transfer of ownership – and what is the percentage of it?

This part of the law is under discussion to be changed with respect to a decision of the Federal Constitutional Court. Actually, you have to pay in Germany land tax ('Grundsteuer') as owner of property. The rates are different depending on the area where the object is located. Three factors are relevant for the costs:

- first you have to check the rateable value of the object ('Einheitswert'),
- then multiply this amount with the base value for tax purposes ('Steuermessbetrag') and
- multiply this amount with the multiplier ruled by the local authorities ('Hebesatz').

For example, in Berlin the base value for tax purposes is 0.0035 and the multiplier is 810%. The rateable value for tax purposes is not the real value, but much less, because it is a calculated value the object had in the year 1964 for objects in western parts of Germany and the year 1935 for objects in the former GDR. If the rateable value would be €900,000, the outcome would be €25,515 per year. You have to calculate, depending on the kind of property and the area, about 0.3% to 0.4% of the real value of the object per year.

15. What are the costs you have to calculate as a foreign investor, if you engaged a professional property management for the purchased property? How does the property management normally charge for their work?

This depends on the property and the number of tenants. In commercial real estate you can roughly calculate about 2% of the net rent of the object per month.

IV. Foreign investors

16. Would you advise foreign investors at the moment to invest in your country

- directly in real estate?
- through real property funds, open or closed ones?
- through other clear and secure financial products?
- at the moment not because of the impacts of the worldwide financial crisis?

Prices for commercial and non-commercial real estate in Germany have gone up within the last two years about 15% on average; in good locations, even more. Nevertheless, we think that this is no big blow, sometimes perhaps a bit, but compared to other countries like France, Netherlands, Belgium or Great Britain you will still have good value in the German market. It is very stable, and we do not see panic on a longer view. Therefore I would advise to invest in commercial (and non-commercial) real estate in Germany in very good or upcoming areas.

17. Is any individual person and legal entity allowed to buy property in your country, or are there restrictions with regard, for example, to nationality or registered office of legal entities? If there are restrictions, are there ways to organise a domestic entity for the purchase on a valid legal structure notwithstanding?

There are no restrictions in Germany. You can buy property as private or businessperson, or as an entity with no seat or branch office in Germany.

18 If a foreign investor buys a plot of land in your country to run a business there, what kind of official approvals are needed, and what time and effort are needed normally to get it?

It depends whether the investor is from

- an EU member state, or
- a country Germany has conventions in this respect with, like US or Canada, or
- a country where no convention is applicable.

In cases (i) and (ii) the official approvals are practically no big deal; in case (iii) one has to check precisely what is needed.

19. Could your firm assist foreign investors in

- Finding interesting real estate and related valid investment products in real property in your country where required through personally known estate agents and other advisers?
- Developing construction projects?
- All legal aspects involved in these contexts?

Yes, we would be pleased to assist foreign investors in all these aspects, since this field of law is the key specialisation of our firm and we have many contacts into the real estate market in Germany. Please contact Markus Jakoby or Lotte Herwig.

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