

Briefing

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Germany
July 2009

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Editorial

Placing the focus on asset management is still one of the main topics in times, where investment and development play a rather secondary role in the market. Also lease agreements are to be put to test which is advisable in view of a number of high court decisions on leases in recent months. Also in this edition we inform you about recent rulings on leases with significant practical impact. Further, we have talked with Helmut Schüchl, managing partner of Knight Frank in Germany (Interview p. 4), and have learned about his view on the further development of the real estate market in Germany.



*Thomas Ziegler
Practice Group
Head*

We wish you a good read

Thomas Ziegler

Leases

Shut-down of utility supply – landlord is entitled to turn off the heating after termination of the commercial lease



*Gero Martin,
Munich*

The German Federal Court of Justice (*Bundesgerichtshof – BGH*) has decided that the landlord is entitled to interrupt the utility supply after termination of the lease (BGH of 06 May 2009, XII ZR 137/07). This decision applies to commercial leases and – at least – if the landlord would occur a considerable loss by continuing the supply, in particular if the landlord has to provide the supply on his own expenses due to outstanding advance payments from the tenant.

Facts

The BGH had to decide on the following case: Landlord and tenant had concluded a commercial lease agreement with a fixed lease term until 31 December 2008. Pursuant to the lease terms the landlord was obliged to – inter alia – provide for the heating in the rented premises.

The tenant ceased to pay rent in January 2007. Consequently, the landlord terminated the lease for cause with immediate effect on 10 August 2007 due to default of payment and requested handover of the rented premises.

During the following action for eviction the landlord threatened the tenant with shutdown of the heating supply. The tenant filed an action for injunction and



HEISSE KURSAWE EVERSHEDS

asked for a declaratory judgement that the landlord was not entitled to such cessation of supply. The BGH, however, has decided in favour of the landlord and declared the landlord entitled to stop the heating supply.

Reasons

The main arguments of the BGH are as follows:

The lease has been validly terminated by notice of termination for cause by the landlord with immediate effect on 10 August 2007. As a consequence, the landlord is no longer obliged to continue the supply services pursuant to the terms of the lease agreement.

In principle, the landlord could – pursuant to a post-contractual duty – be obliged to provide supply services even after termination of the lease agreement in accordance with the principles of good faith, e. g. if an interruption of supply would cause health risk or a considerable loss on the side of the tenant. In addition, the landlord would not be entitled to stop supply if the tenant was granted a period of eviction by the court and a compensation for use is paid for this period. Moreover, the landlord is not entitled to interrupt supply – e. g. to exercise pressure on the tenant – in case the tenant purchases the corresponding services (water, electricity, heating) directly from the provider under an own contractual relationship.

In this specific case, however, the tenant received the respective services from the landlord, thus the landlord would have had to provide further supply of the premises, due to outstanding (advance) payments of the tenant, on his own expenses. As a consequence, an obligation to continued supply would have resulted in a respective loss on the side of the landlord. In the view of the BGH, under these circumstances and with respect to commercial leases the landlord is entitled to interrupt the supply of the premises.

Comment

By this judgement the German Federal Court of Justice has decided against the currently prevailing view in jurisdiction and experts' literature: at least in case of commercial leases a shutdown of water, electricity and heating supply by the landlord after termination of the lease agreement is allowed. This will be of significant importance in practice since this enables the landlord to exercise pressure on the tenant by (threatening with) interruption of supply in order to achieve an immediate eviction of the premises after effective termination of the lease agreement. In each individual case, however, a detailed examination of the principles of good faith, which were explicitly declared applicable for such case by the BGH – i.e. reasonableness of the interruption of supply for the tenant or unreasonableness of a continued supply for the landlord – is necessary.

Tenant can claim compensation for execution of final decorative repairs based on an invalid clause

If a tenant of a residential property relies on the validity of a contractual clause on final refurbishment and renovates the property upon termination of the lease irrespective of the invalidity of that refurbishment clause, the tenant is entitled to claim compensation from the landlord for the refurbishment.



*Christoph Müller,
Munich*

Facts

Pursuant to the lease agreement the tenants were obliged to refurbish the property prior to handover at the end of the rental term (so-called final refurbishment clause). Relying upon the validity of the clause the tenants carried out the due paintwork. Later on, the tenants claimed compensation from the landlord for the refurbishment costs, arguing that the final refurbishment clause in the lease agreement had been invalid, which they had learned only after handover of the property to the landlord.

Reasons

The BGH has decided in favour of the tenants: If a tenant carries out decorative repairs on the basis of an invalid refurbishment clause, such works are rendered

without legal basis and thus appropriate compensation can be claimed from the landlord because of unjustified enrichment. The respective claim of the tenant is calculated in line with the value of the customary, or, alternatively, the appropriate remuneration for the performance of the executed decorative repairs. If the tenant carried out the works in person, the respective claim is usually calculated on the basis of the time spent, the costs for the necessary material and the remuneration actually paid or which would have to be paid to his helpers (friends and relatives). It is not relevant whether and to what extent the refurbishment in fact led to an increase in value of the property for the landlord.

Comment

By this judgement the BGH continues its tenant-friendly jurisdiction on refurbishment obligations. Further to the decisions in the recent years, by which the BGH had declared several clauses on decorative repairs as invalid (cf. our Briefings of January 2008 and January 2009), the BGH now grants the tenant a reimbursement claim against the landlord, in case – in spite of an invalid final refurbishment clause – he renovates the apartment before moving out. This has considerable financial impact on leases which are subject to such invalid final refurbishment clauses. According to the German law on unjust enrichment the reimbursement claim of the tenant is excluded, however, if the tenant was aware of the invalidity of the refurbishment clause (the tenant's doubt on the validity of the clause would not be sufficient).

One has to wait and see whether the BGH will use the same principles also for decorative repairs carried out by the tenant on the basis of an invalid clause already during the rental term. A decision of the BGH on such a case is still outstanding. It is also still undecided whether such rules will apply to commercial leases as well. In its recent judgements the BGH tended to apply its jurisdiction on decorative repairs for residential leases also to commercial tenancies, as a commercial tenant would require the same level of protection as a residential tenant. Consequently, it is likely that the above mentioned principles will apply to commercial leases as well.

In view of this most recent judgement of the BGH, a very careful drafting of clauses on decorative repairs is obligatory for landlords of both residential and commercial premises (please also see our respective comments in our Briefings of January 2008 and January 2009).

Banking, Insolvency

Payment by third party debtor to assignee of debt after opening of insolvency proceedings

The payment of a third party debtor to the assignee after the opening of insolvency proceedings does not have redemptive effect if the third party debtor is aware of the opening of insolvency proceedings and that the assignment is only for security purposes (German Federal Court of Justice dated 23 April 2009, IX ZR 65/08).



Melanie Kersting,
Munich

Facts

The judgement was based on the following facts: The holder of a bank account had assigned the balance of the bank account for security purposes to an insurance company. Shortly afterwards insolvency proceedings were opened over the assets of the bank account holder. Later the account holding bank paid EUR 31,496.68 from the account balance to the insurance company after receiving a respective request of the insurance company. At the time of the payment to the insurance company the bank was aware that insolvency proceedings had been opened and that the assignment of the account balance had been for security purposes.

The insolvency administrator claimed payment of the amount paid to the insurance company from the bank.

Reasons

The insolvency administrator is entitled to claim monies assigned for security purposes from the third party debtor if insolvency proceedings have been opened. The Federal Court of Justice (*Bundesgerichtshof* – BGH) has confirmed several times that as of the opening of insolvency proceedings the right to col-

lect claims passes from the assignee to the insolvency administrator with the consequence that the insolvency administrator has the sole collection right regarding claims assigned for security purposes. So far the BGH had not commented on whether payments can still be made to the assignee with redemptive effect. This question is not explicitly regulated by statutory law. Referring to similar cases regulated by statutory law, the BGH ruled that the payment does not have redemptive effect if the bank at the time of the payment (1) has knowledge of the nature of the assignment as a security assignment and (2) is aware of the opening of insolvency proceedings. In relation to knowledge of the opening of insolvency proceedings, the third party debtor does need to have positive knowledge, whereas, however, after public announcement of the opening of insolvency proceedings the third party debtor bears the burden of proof, so that he would have to provide proof of his lack of knowledge if necessary.

Comment

Consequently, the bank was obliged to pay an amount of EUR 31,496.68 to the insolvency administrator and had to claim repayment from the insurance company on the grounds of unjust enrichment.

The BGH left open whether payments of a third party debtor to an assignee during the preliminary insolvency proceedings would likewise not have redemptive effect. Based on the reasons of the judgement this should be the case at least in those cases in which the right to collect claims passes to the preliminary insolvency administrator and the third party debtor has positive knowledge thereof.

Interview

... Knight Frank has been awarded on 21 April 2009 at the Property Marketing Awards 2009. Only few days before at the Property Awards the Knight Frank team was elected "Professional Agency Team of the Year". In Germany the property consultancy Knight Frank is represented with offices in Munich and Frankfurt/Main. Thomas Ziegler has spoken with Helmut Schüchl, managing director of Knight Frank in Munich.

**"Best Corporate
Property Adviser"**



Helmut Schüchl,
Managing Director
Knight Frank, Munich

HKE: Congratulations to your recent awards! What do they mean to you?

HS: *We are very proud of these awards, especially because they show how much our services are appreciated.*

HKE: 2008 was a difficult year for the real estate industry. How was your start in 2009?

HS: *We started very successfully in all our business sectors – letting, investment and valuation. For Munich alone we are exclusive broker of three clients in search of lease area of 30,000 sqm. We successfully concluded a consulting mandate for the state of Malaysia with the rent of office premises to the governmental organisation MIDA (Malaysia Investment Development Authority). Together with our Frankfurt office we found office premises for the state of Malaysia of more than 3,300 sqm. In the Munich investment sector the first three to four months of the year business were sluggish, in the last weeks however we completed two transactions. In the Munich city centre we procured a commercial building valued below EUR 20 million and a residential complex of about 5,000 sqm in Nuremberg. As far as valuation is concerned, we are very pleased about the constantly stable situation. Moreover, we have expanded our team in Munich to 17 employees with two new colleagues for valuation and one colleague for letting.*

HKE: Whereas real estate markets all over Europe had to deal with considerable price decreases, the German top locations experienced only moderate falls in prices. What do the comparatively low initial yields mean for the further development of the German investment market?

HS: *On a European scale the German market is regarded as rather stable. In Germany price increases were more moderate than for example in Great Britain, which is why there is less of a slump in the downturn. Germany - as Europe's biggest economy - is and will remain a very attractive location to invest due to*

its large and meanwhile rather transparent real estate market. This is particularly true for the six or seven main office centres where prices for top locations decreased significantly less than in medium-sized towns.

HKE: Are there any specific regional developments?

HS: *Yes there are, in cities like Munich or Hamburg prices for high quality properties in the inner city, for example in the Munich city centre, remained almost unchanged.*

HKE: Export champion Germany is particularly affected by the world wide economic crisis. How does the decline in economic performance impact the market for office letting?

HS: *Demand for office space has dropped. In the first half-year of 2009 new lettings in Munich amounted to not more than approx. 260,000 sqm. This means a decline of more than 30 per cent compared with the same period of the previous year. Rents in the metropolitan area as well as in the vicinity are slightly decreasing. The market situation is dominated by smaller lettings. In the first six months of the year these made up three quarters of total letting volume. The vacancy rate is supposed to increase slowly but nevertheless constantly.*

HKE: How does this affect the investment market in this sector?

HS: *In Munich, prices for top-located mid-sized properties up to about EUR 50 million should remain relatively stable. However, office properties in secondary locations will continue to decrease in value, in our opinion by 1-1.5 of the annual rent. For large properties, due to the credit crunch there are hardly any buyers.*

HKE: What is your prognosis for the medium and long term?

HS: *For 2010 we estimate the demand for office space in Munich to be below the annual average of the last few years and to consolidate very slowly. The market for speculative project development will nearly come to a halt, only projects with sufficient pre-letting or top city centre locations with realistic rents will be financed. Compared to 2009 we expect increasing transaction volumes in Munich in 2010, which is supposed to tie in with the values of 2003 - 2005 with an annual turnover of approximately EUR 1.4 billion.*

HKE: Helmut, many thanks for this conversation.

Contacts

For further information, please contact your usual Eversheds contact or

Thomas Ziegler
Head of Real Estate, Germany
Tel ++49 (0) 89 545 65 316
t.ziegler@heisse-kursawe.com
www.heisse-kursawe.com

For a full list of Eversheds International offices and contact details please visit www.eversheds.com

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The editorial contact person according to § 55 RStV is: Daniela Vogt, Heisse Kursawe Eversheds Rechtsanwälte Partnerschaft, Maximiliansplatz 5, 80333 Munich, Germany, d.vogt@heisse-kursawe.com

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