

Market update: Legal developments in the German real estate market

I. The planned Berlin rent act and “Berlin Rent Freeze”

1. Background

The seemingly unabated rise in rents combined with the difficult situation on the housing market, in particular in the major metropolitan regions of Germany, have led authorities in a number of federal states, and in particular the city states of Berlin, Hamburg and Bremen, to consciously pursue the introduction of rent controls over and above the limit mechanisms provided for under the Civil Code (*Bürgerliches Gesetzbuch*) in the form of a so-called "rent freeze".

In the spring of 2019, Berlin's city government, the Senate, set up a cross-division working group to address initial legal questions. In view of the political will to alleviate the stress on Berlin's residential market and to relieve public concerns regarding spiralling rents, the Berlin Senate approved the key elements of a new Berlin law on residential rents, including the so-called "rent freeze" as its main feature, at its meeting held on 18 June 2019.

On this basis, the Senate Department for Urban Development and Housing presented a draft bill entitled the "Act on Limiting Rents on Berlin's Residential Market"¹ (*Gesetz zur Mietenbegrenzung im Wohnungswesen in Berlin*) on 30 August 2019, which has since given rise to substantial criticism in parts. The cornerstones of the draft bill are the so-called "rent freeze" (i.e. freezing the rents at their current rate for a period of five years) and the prescription of a rent cap. On Friday, 18 October 2019, the Berlin Senate reached a compromise regarding the rent freeze and a Senate resolution to submit a draft version of the legislation (the **Rent Act**) to Berlin's parliament was passed on 22 October 2019.

The Rent Act is expected to enter into force in early 2020, but to apply with retroactive effect from 18 June 2019; this is subject to the Berlin parliament approving the Senate's draft legislation.

¹ Source: https://stadtentwicklung.berlin.de/download/mietendeckel/Referententwurf_MietenWoG.pdf (retrieved on 17 October 2019).

2. Key elements of the rent act

The draft legislation passed by the Senate provides in particular for the following features, which are to apply for a limited term of five years:

- Applying a rent freeze to all existing leases. From 2022, landlords will, however, have the opportunity to impose an annual inflation-related rent increase of 1.3% p.a. on their tenants.
- Specifying rent caps according to building age classes. The caps are based on the 2013 rent index and apply to re-lettings and renewals as well as to existing rental agreements. In order to account for the increase in incomes in Berlin since 2013, the rent caps will be adjusted to account for real wage developments and be 13.4% higher than 2013 levels. A corresponding rent table was published together with the bill resolution on 22 October 2019.
- In the case of housing with "modern furnishings", the rent cap is raised by EUR 1.00/m². "Modern furnishings" are deemed to exist if the dwelling has at least three of the following five features:
 - barrier-free access to a lift from the apartment door and the building entrance;
 - fitted kitchen;
 - "high-end" sanitary appliances;
 - "high-end" flooring in the majority of the living space and/or
 - energy consumption value of less than 120 kWh/(m²a)..A clear description of what constitutes "high-end" has not as yet been issued, however.
- Increasing the rent cap by an additional 10% for residential properties containing no more than two apartments.
- In the case of "extortionate" rents in excess of 120% of the permitted maximum, tenants can demand to have their rent lowered to the appropriate level. The possibility for tenants to have their rent reduced is, however, only to apply once the law has been in effect for nine months, and thus, based on the current status of the legislative process, not before December 2020.
- For new lettings, the re-letting rent is to be limited to the amount effectively agreed with the previous tenant on or before 18 June 2019; if the rent agreed with the previous tenant exceeds the rent ceiling, it must be capped at this level. Particularly low rents of under EUR 5.02/m² may be raised by max. EUR 1.00/m² to max. EUR 5.02/m².
- The location of the dwelling also plays a role when determining the maximum legitimate rent. The bill provides for surcharges and discounts for a "simple" location (-28ct/m²), "average" location (-9ct/m²) and "good" location (+74ct/m²).
- It will, in general, be possible to perform modernisation work in future and to increase the rent to cover the corresponding costs, provided the rent increase does not exceed EUR 1.00/m² and the relevant rent cap is not exceeded by more than EUR 1.00/m². The possible rent cap in this context is raised by EUR 1.00/m². If the future rent exceeds this cap that has been raised by EUR 1.00/m², the landlord must have the increased rent formally approved. Subvention programmes should be used to cover additional modernisation costs; these costs cannot be passed on to tenants. Moreover, prior notification of any and all such costs must be submitted to the *Investitionsbank Berlin*.
- It is not possible to pass on to tenants the costs of "luxury refurbishments", i.e. modernisation work

that is not designed to achieve barrier-free access or energy savings.

- The draft legislation provides for cases of economic hardship, whereby landlords can apply for approval of higher rents if the net basic rent (without utilities)

under the rent cap would cause the landlord to suffer losses or place the substance of the leased space at risk; such applications must be submitted to the *Investitionsbank Berlin*.

3. Planned scope of application and legal consequences of non-compliance

TERM AND REGIONAL SCOPE

The Senate resolution provides for the planned law to apply with retroactive effect as of the date on which the Senate resolved the initial cornerstones of the rent freeze legislation (18 June 2019).

As a piece of legislation at state level, the Rent Act would only apply to leases in Berlin. It is currently

impossible to predict whether and to what extent other states will issue copycat legislation. We do not anticipate other German states to introduce similar legislation before the Rent Act has actually entered into force and its constitutional compliance (see below) has been clarified.

PROPERTIES COVERED

The legislation is to apply to all existing rental properties in multi-family residential units located within the City of Berlin which are not price-linked (approx. 1.5 million apartments in total).

According to the Senate's resolution, exemptions are to be granted for government-sponsored residential construction ("social housing"), housing provided by social welfare organisations for persons with urgent housing needs ("welfare organisation housing"), housing in respect of which public funds were granted for

modernisation and refurbishment work and apartments in residences (such as student halls or retirement homes) and new builds.

"New builds" applies to all residential properties that were ready for occupancy on or after 1 January 2014.¹

¹ Source: https://www.stadtentwicklung.berlin.de/aktuell/pressebox/archiv_vol1text.shtml?arch_1910/nachricht6802.html (retrieved on 22 October 2019).

LEGAL CONSEQUENCES

Breaches of the planned provisions of the Rent Act are to be treated as administrative offences that will be punished with fines. According to the draft legislation,

landlords breaching the terms of the rent freeze could incur fines of up to EUR 500,000.

4. Assessment – Constitutionality of the rent act and political reception

The Senate Chancellery and the Senate Department for the Interior and Sport (both *Social Democratic Party of Germany* (SPD)) have each raised legal concerns relating to the Rent Act in internal letters addressed to the Senator for Urban Development Katrin Lompscher (leftist *Die Linke*). The opposition parties regard the draft bill in its current form as unconstitutional.

The planned Rent Act throws up numerous unanswered legal questions, some of which have not yet been the subject of judicial clarification, and countless strong arguments are being introduced which may lead to the Rent Act being ruled unconstitutional on both formal grounds (of competence) and on its merits (i.e. content).

The legal debate focuses primarily on the questions of (a) the extent to which the State of Berlin has legislative competence to pass the planned provisions, (b) the extent to which the Rent Act represents an unreasonable infringement of fundamental rights, (c) how the basis for assessment of the planned rent cap is to be legally structured and (d) whether the planned backdating of the law is constitutional.

Not least the constitutional concerns have given rise to substantial political resistance to the planned legislation. The Berlin representatives of the *Free Democratic Party* (FDP) and the *Christian Democratic Union* (CDU) have already announced their intention to have the compliance of the Rent Act with Berlin's state constitution reviewed in the context of judicial review proceedings (*Normenkontrollverfahren*). After the draft legislation had been approved by the Senate on 22 October 2019, the Berlin CDU faction stated that, if the Rent Act were to

come into force, it would "certainly take legal action against it".²

According to our sources, the Federal Government and parliamentary factions are also raising competence issues with regard to the planned Berlin legislation, and thus it is as yet uncertain, on both constitutional and political grounds, whether the law will come into force at all. It is, however, almost certain that the Rent Act will be subject to review by the Federal Constitutional Court and/or at state level by Berlin's Regional Constitutional Court. Clarification of the issue of constitutionality by the competent courts would, however, then be a lengthy process.

² Source: <https://www.rbb24.de/politik/beitrag/2019/10/berliner-cdu-fraktion-kuendigt-klage-gegen-mietendeckel-an.html> (retrieved on 29 October 2019).

5. Conclusion

Although the draft legislation has still to pass Berlin's House of Representatives (and it is thus still possible that the proposals may be thrown out), a number of "anticipatory effects" on landlords should not be ignored.

While no fines can be imposed in matters pre-dating the date of effectiveness of the Rent Act, the fact that the rent freeze is to apply with retroactive effect as of

18 June 2019 would render any rent increases agreed after this date invalid once the Rent Act becomes effective. Only new builds that are currently under construction or which have been completed since 1 January 2014 can be given the "all-clear" for the moment under the present draft bill, since they are to be exempted under the provisions of the Rent Act.

II. Update on the German Real Estate Transfer Tax Reform

Quite surprisingly, the members of the German government coalition (CDU/CSU and SPD) have agreed on October 25 to not vote on the German real estate transfer tax (RETT) reform in the German Bundestag this week as originally intended but to postpone the reform in order to further analyse and discuss the provisions of the draft bill. In particular, the findings from the public hearing in the finance committee (*Finanzausschuss*) of the Bundestag early last week shall be fully taken into account. According to a press release of the parliamentary group of the CDU/CSU the real estate transfer tax reform shall therefore only be implemented **in the first half of 2020**.

As the recent draft bills – despite originally deviating intentions of the German Federal States – did not foresee a retroactive application of the reform package, in our view it can therefore be reasonably expected that the reform will not come into effect (retroactively) as per 1 January 2020. Fortunately, for all transactions currently contemplated under the existing RETT rules this may take away some pressure with regard to timing the relevant Closing. Furthermore, this could be beneficial also for past transactions with option arrangements on partnership interests if the 5 year holding period under the current rules is fulfilled within the first months of 2020. It remains unclear, however, what the new effective date of the RETT reform will be. Furthermore, it cannot completely be excluded that the bill will nevertheless foresee a retroactive effect as of 1 January 2020. Also, it may be keenly awaited whether and to which extent there will also be major changes to the reform package content-wise.

Due to the outstanding practical impact on the transaction practice we will of course keep you updated about any new developments.

Your key contacts

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