

Due diligence process – Germany

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1 What is Due Diligence?

Origin

Literally translated nothing else signifies "Due Diligence" than "compulsory care". Due Diligence calls with it, the completion of certain behaviour and the care duties for managers and boards of directors, excluding all professional advisers, for example lawyers, chartered accountants, tax advisers.

Aims

Due Diligence serves several lines. On the one hand, it creates a systematic basis for the adequate assessment of the purchase object and serves thus the purchase price finding. On the other hand it creates legal security by the protection of fault rights and influences with it, the intensity of the contractual guarantee and liability system. Besides, it serves the risk minimisation, because it identifies early whether serious reasons stand in the way of a purchase or not (push Breaker). Finally, Due Diligence plays an important role with the contract creation, because it helps to recognise questions which can be introduced into the contract afterwards.

It is clear that the argument of guarantee questions should occur before purchase completion of the contract, because the guarantee arrangements belong to the bill of sale. Furthermore, the purchase price is dependent on the guarantee arrangements, because the purchase price reflects the risks which the parties take on.

The check Due Diligence begins with the fact that the buyer leaves to the seller a checklist which contains a comprehensive list of questions. In this, all areas necessary from buyer's point of view, therefore, automatically all the necessary information and data is included in the price.

The seller can answer the list of questions by correspondence, or the seller can make a complete set of documents available to the buyer. There must be a reason for purchasing the object - in the real estate area these would be the real estates even (Asset Deal) or the real estate as well as the suitable object society (Share Deal) - to be informed completely. On the basis of the saved, and the available documents, one is provided a so-called "Due Diligence Report"; this allows the problematic areas to be seen, for which guarantees are required.

2 Due diligence in the German legal context of purchasing real estate

However, compared with American "common law" there are some significant differences: Firstly, in Germany there is no principle "caveat emptor" "buyer beware". Hence, the buyer is not obliged to carry out Due Diligence and there is also no relevant custom. However, something else is still much more significant. According to German guarantee rights, genuine awareness of damage, or reckless lack of knowledge of known faults which are not connected to the buyer, in view of his rights concerning hidden faults.

The question which poses itself therefore is: In Germany, does the buyer do themselves a disservice in view of their rights, and they only have themselves to blame if they carry out a careful Due Diligence? Furthermore, they can again only have themselves to blame if they carry out careful Due Diligence and find that there are further, defects affecting the purchased object?

Following the German Civil Code, the rights of the buyer are forfeited due to the faults detected, if they are aware of the faults at the time of completion of the contract From this it is quite

clear that all faults about which the buyer receives positive knowledge as a result of the Due Diligence; the legal protection comes into force. However, the buyer must have recognised that from the known circumstances the fault arises. The burden of proof for this knowledge carries according to general rules of the seller, for which it might be generally difficult to prove. In general, it is the buyer and not the seller who must provide the results from the Due Diligence.

The Due Diligence in the German right

Also in German State Law, it is Due Diligence; in the meantime, not only with international transactions, but also with the purely German contract with creations, which one can rely on much better than "common law" for legal guarantee rights. Quite obviously however, there is a trend towards Due Diligence and for several reasons: Today, first many significant real estate transactions are prepared by professional advisers and are accompanied who belong either to international adviser's enterprises, or they have taken over the international transaction standards to remain competitive in the international consultation business., secondly a considerable part of the significant real estate transactions are financed by international capital. Neither buyer nor bankroller do reluctantly and the usual transaction standard. Thirdly, the legal situation is also suitable in the German law with regard to guarantee rights.

Are there still possibilities of meeting the possible guarantee losses?

In the way of the negotiations every fault is incorporated in the contract negotiations, either by contractual guarantees or by a price reduction. If available defects are discovered during Due Diligence, no guarantee losses arise. If the defects are discovered through the examiners Due Diligence process, if defects are discovered and do not affect the negotiation process, then the buyer does not lose their guarantee claims.

However, according to the prevailing opinion, it is important with Civil Law, i.e. the parties can renounce this contract. However, this is excluded if the seller does not agree. If the buyer is allowed to do a full-extensive Due Diligence process, the seller does not have to agree to further exclusion under Civil Law. Probably, though the possibility is practically oriented, the parties could make a specific exclusion under Civil Law to show that they want to can come to an agreement about a price reduction or a guarantee.

In the end, the juridical question still remains to be sorted, whether or not there is a duty of the buyer to carry out a Due Diligence process, or - if they have already done one - to carry

out carefully the Due Diligence, so that all defects are recognised. After Civil Code, a buyer to whom a fault has remained unknown as a result of extreme negligence, can assert fault rights only if the seller has hidden the damage knowingly, or a guarantee of the condition, in keeping with German Law there is neither a duty to carry out a Due Diligence process, nor a duty, to carry out Due Diligence carefully.

A Due diligence process can also be important for the seller, this type of Due Diligence is called "Vendor Due Diligence". With this form, the principal of the Due Diligence is the seller who instructs external advisers with the realisation of the process. The purpose of this Due Diligence is to provide information from the seller in order to strengthen the negotiation position and to create a uniform base of information to pass on to the prospective buyer. The Vendor Due Diligence has the following advantages: If the seller performs Due Diligence and the seller hands over to the buyer the report provided by him, Civil Code comes into force, the Due Diligence the guarantee exclusion §442 and can, under circumstances, relieve the seller of their guarantee duties, at least partially.

3. Normal Due Diligence process

Step 1 Expose offer

Step 2 Central capture Akelius Berlin Office (Broker's clauses) – Check on pre-knowledge

In Germany, brokers are paid for their mediation services. The fees vary and can be negotiated individually. It is important to note with the brokers first offer, what the brokers receives for commission. However, apparently there are many special cases. (Mainly we have to pay an extra fee from 1% up to 6%)

Step 3 The first check with two ways (other check / negotiations or cry-off)

Step 4 During the first pre check, the basic data for example number and size of the trade, position and price are checked etc. With a positive result it progresses to a more in-depth check. With a negative result it is called-off by the supplier.

The real estates Due Diligence is carried out on the basis of checklists (pattern). However, these check lists must be adapted in isolated cases, they can be extended, very often they are often shortened if necessary. – **See point 5 (Checklist)**

- Step 5 The precise object check occurs after the necessary exam measures and check lists.
- Step 6 The Report
All assumptions used for the assessment, assessment criteria and results are summarised into a Due Diligence report. The representation occurs in the form of texts, graphs, and pictures.

Organisation and time management Due Diligence

The time management Due Diligence depends very much on the cost of the assessment and the scope of the assessment of the object.

Expenditure

High

- Legal Fact Finding
- Share-deal
- Poor documentation
- Many specific features

Low

- No specific features
- Good documentation
- Asset-Deal
- Data packet

4 Due diligence on real estate

4a Economic/ Financial /Market Due Diligence

Economic Due Diligence frequently becomes called Market or Commercial Due Diligence. It is obvious that a potential buyer of a real estate is anxious to carry out a very precise analysis and assessment of location and market situation of the real estate. This can occur with suitable competence and resources "in-house" or by external real estate experts and analysts. On this occasion, it needs to be understood that the assessment is based on many different assumption and parameters that come into play. In the end, if Economic Due Diligence is the major factor, a dependable appraisal and yield calculation is a must.

4b Technical Due Diligence

A main focus in real estate Due Diligence Reports is the regular architectural and building-technical analysis. The buyer will examine in general the building, the buildings technical equipment, and the secure the technical situation (e.g., fire prevention) thoroughly. A screening of all plans and documents is essential here is important to assess possible renovation costs. With the formal investigation the planning permission, conditions are checked as regards content. Besides, a review of the decrease is an important point, because this phase is a guarantee release and stamps in the so-called “return of burden of proof.”

Among the rest, other central areas of the technical Due Diligence process are, the analysis of the functionality and flexibility of the building, judging of future technical expenditure, including subsequent costs, for example, for company, servicing and maintenance as well as handing in the assessment result with costs.

4c legal Due Diligence

Within the scope of the juridical real estate Due Diligence, the complete contract network is checked, concerning the real estate for risks or gaps. The following other areas belong with a real estate acquisition by way of the Asset deal, beside the general statements about the seller (HR extract, statute, solvency) to the central area of the real estates Due Diligence:

- General description of the property and the real estate
- Civil and public law charges of the property
- Cultivation of the property
- Use and management of the property and the real estate
- Development potential of the real estate
- Environment and old burdens

With a share deal, the normal statutory social areas for assessment come into play. Thus Commercial register extracts, social contracts, proof of cash investments, any offence against capitals preservation regulations, interest acquisitions of the seller, any interest charges, companion's decisions, antitrust legislation limits, and agendas must be checked by management and supervisory boards, staff under contracts or agreements.

4d Environmental / Tax Due Diligence

With tax Due Diligence, it is a matter of examining or creating the optimum tax structure for the buyer. The purpose is to have to pay as little as possible purchase of land tax with the transaction and for foreign investor the avoidance of trade taxes. In this context, a decision about whether the real estate through an Asset-Deal should be bought or whether acquisition of the shares in the object is more advantageous for the company (share deal).

Finally, the questions about the income tax should be cleared up, land transfer tax, real estate tax, sales tax and to the procedure.

The existence of, old road dangers to the property or the building connected with the purchased object, it is necessary to integrate an environmental analysis into the exam process. Old expenses, in respect of the military, or petro chemical industry. Other areas show assessments, questions about the air, water and sewage, dangerous material storage, as well as building pollutants. In particular, US investors are extremely sensitive for materials, for example: asbestos, radon, lead and other harmful materials.

5. Checklist (Required documents)

1. Property

- 1.1 Ground plan / extract from the land register
- 1.2 Land utilisation / land-use plan
- 1.3 Information to road rights and rights of passage
- 1.4 Old expense land register
- 1.5 Information as to the historical use of the property
- 1.6 Old expense certificates incl. documentation of the renovation
- 1.7 Other environmental certificates (e.g., ground water, noise, air)
- 1.8 Development site investigation
- 1.9 Certificate of the fight moving services (project development)
- 1.10 Information for the development, entrance, and care facilities

2. Approvals and acceptances

- 2.1. Planning permissions incl. all arrangements like measurement of the land use, surface calculation, parking lot proof, plan documents etc.
- 2.2. Supplementary texts, approvals to tenant removals
- 2.3. Drainage proof
- 2.4. Approval of technical arrangements
- 2.5. Concessions and other relevant approvals
- 2.6. Construction preliminary notices (by project developments)
- 2.7. Fire prevention certificates and inspection report
- 2.8. Test static
- 2.9. Sound insulation
- 2.10. Heat insulation identity card, power requirements
- 2.11. Official reductions (final reduction, usage acceptance certificate, etc.)
- 2.12. Authorised reductions (safety standards authority Reports, Fire brigade, VdS, etc.)
- 2.13. Certificates of the executive companies
- 2.14. Other relevant approvals (e.g., conversation protocols)

3. Cultivation

- 3.1. Continuance plans (plans, cuts, views, outside arrangements)
- 3.2. Check documents TGA, patterns of the technical arrangements
- 3.3. Construction description
- 3.4. GU Contract / functional achievement description or single contracts
- 3.5. Rent surfaces calculation
- 3.6. Installation about running guarantee terms
- 3.7. Defect free announcement of the executive companies
- 3.8. Installation for reducing errors and other benefits
- 3.9. Certificates of building pollutants incl. documentation of the renovation
- 3.10. Other technical certificates

4. Servicing, construction equipment, operating expenses

- 4.1. Report of the last fire drill
- 4.2. The appropriate reports / test reports
- 4.3. Servicing proof
- 4.4. Servicing contracts
- 4.5. Other service contracts (management, technical building management, Security, cleaning, emergency call etc.)
- 4.6. Contracts with waste disposal companies
- 4.7. Operating expenses of the last 3 years
- 4.8. Expenses settlement of the last 3 years

- 4.9 Description of the title documents incl. suitable contracts
- 4.10 Installation about maintenance measures and modernisation measures / investments during the last 3 years
- 4.11 Installation of planned maintenance measures and modernisation measures / investments

5. Tenant

- 5.1 Rent incl contracts. Technical description cold-rent, letting, previous arrangements etc.
- 5.2 Regulations about the reallocation ability of operating expenses and additional costs
- 5.3 Regulations about maintenance and cosmetic repairs
- 5.4 Other regulations and special arrangements with residential tenants and especially trade tenants
- 5.5 Current complete tenant lists
- 5.6 Current vacancy list
- 5.7 Security list
 - Level of the security
 - State of the security with interest
 - Kind of security (savings book, guarantee, cash etc.)
- 5.8 List of reduced rent amounts, with information about amount and reason for the reduced rent
- 5.9 Information about the rent increases

6. Other

- 6.1 Plan plans A3
- 6.2 Contact data of the contact on site
- 6.3 Further important technical, economical, legal documents