

General Explanation of Purchase Contracts used in Real Property Transactions in Germany and the Process of Notarization:

Advice for Buyers and Sellers

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1. Introduction

There are basically three types of real property acquisition transactions in Germany:

- (a) the purchase of a piece of real estate on which nothing has been constructed (a building site);
- (b) the purchase of a piece of real property together with existing buildings on the site (or rights to a portion of a building) – for example, a single family house or a single apartment;
- (c) the purchase of a piece of real estate for development (commercial property, house or apartments) under a building developer's contract.

Because of fundamental differences between the third category and the first two, the following explanation is limited to a discussion of the first two types of acquisition.

Real property purchase contracts must be signed before a notary, and this is a legally significant act. There are a number of legal issues that must be discussed in connection with this act, because, as a result of these issues, a certain practice and procedure for concluding and performing a real estate contract has developed.

The following memorandum is intended to provide an overview of a German real estate purchase contract and the notarization process. It is organized chronologically in accordance with the steps one takes in concluding such a contract and is intended to deal with the most important legal issues that may arise. This memorandum cannot and does not replace direct advice from an attorney or notary, particularly in special cases or complex transactions. For instance, special advice may be needed with respect to additional issues that may arise in connection with the transfer of real property located in the German states that formerly composed the German Democratic Republic.

2. Preparation

a) Survey of the property

Before the parties agree on the date of the meeting before the notary (where notarization of the purchase agreement will take place), we recommend that the purchaser makes a careful inspection of the property, including commissioning a technical examination of the construction of all buildings on the site by a qualified engineer. Any defects that are discovered should be discussed with the seller and if necessary covered in the purchase agreement. In the purchase agreement, material defects are regularly excluded from the seller's guarantee and responsibility, so that, unless the seller has given a description of the property or a guarantee, the purchaser may not have recourse against the seller for defects that appear or become evident after notarization, except for defects which the seller has fraudulently concealed or failed to mention.

A purchaser should give special attention to any refit or other work with respect to the heater which was done after the ordinance regarding energy saving, which came into effect on February 1, 2002, even if the seller was not subject to this ordinance.

Similarly, a purchaser, particularly a purchaser of a building site, should obtain precise information concerning the status of the development and the calculation of its costs from the responsible community, and if appropriate, from the sewage authorities as well as the firms and authorities that supply services, such as electricity. Often certain measures or work relating to the development of a property are completed, but the owner is charged for those measures or work only at a much later time, so that in effect "latent" charges encumber the property. Also payments may become due if

development measures in the affected area have been agreed upon, but have not yet been completed. The resulting future costs of such actions can be considerable and should, before any contract is signed, be identified and dealt with.

Early in the process the purchaser and seller should discuss which objects and property, in addition to the real property, the building or buildings situated on the property and their essential components, are being transferred. Consideration should be given to built-in- and other furniture or furnishings, outside facilities and also, for instance, stocks of heating oil located in the building or on the premises. All of these objects should be separately listed in the purchase contract, together with the portion of the purchase price attributed to each. If a large amount of movable property is included in the sale, it is advisable to prepare a list of these objects which can be an attachment to the notarized purchase agreement.

In connection with the purchase, a division between the amount of the purchase price attributable to the land, that attributable to the buildings and that attributable to movable property should also be contemplated for the purpose of any later rental of the property. The division made at this time is significant for later depreciation by the buyer (which in the case of a rental are calculated only on the basis of the amount attributable to the buildings), as well as for the amount of the property purchase tax and land registry charges (“Grundbuchsteuer” and “Grundbuchgebühren”) (which do not cover the part of the purchase price attributable to movable objects). Thus a careful clarification in the purchase agreement can result in later cost savings.

b) Review of the land registry and drafting of the purchase contract

In order to prepare a draft purchase agreement, the lawyer and the notary will review the information relating to the property contained in the land registry. Here they will find information that is essential for the preparation of the purchase agreement. It is also helpful to answer and fill out the written “Questionnaire for Property Purchase Contracts” we offer and hand out to our clients. In this questionnaire specific important information is requested from those who are party to the transaction.

If this questionnaire is carefully and precisely filled out, this will make the task of preparing a purchase contract considerably easier and will reduce the time it takes to draft the purchase contract.

The active participation of your attorney in this process should help assure that you are legally protected and that your wishes are reflected in the contract in accordance with applicable law and regulations.

Although often just as important, the economic points (as, for instance, the reasonableness of the purchase price or the credit worthiness or trustworthiness of any of the parties to the contract) cannot be evaluated or guaranteed by the attorney or the notary. In addition, because of his profession, the notary may not intervene in the process of negotiation between the parties. In particular, negotiations concerning the price are matters between the parties to the contract and should be concluded before the beginning of the meeting with the notary at which notarization takes place.

c) Financing of the purchase

If the buyer intends to finance the purchase price, or a portion thereof, he should speak with his bank or other lender as soon as possible concerning both the terms and conditions of the purchase agreement and the conditions to disbursement of loan proceeds applicable to his loan. This should certainly be done before the notarization meeting. In this way, the bank or the credit institute can in a timely manner forward to us and to the notary the documentation required for the mortgage, so that the mortgage may be notarized at the same meeting with the notary as the purchase agreement. This

will save the buyer time, money (because “postponement of priority” costs are avoided) and additional correspondence.

Security for loan funds for “prior financing” of the purchase price by the purchaser by the way of the registration of a mortgage on the transferred property is in practice the most reliable and customary course and does not present a greater risk to any party. Only through this means can the “devils’ circle” be broken: the seller is still the owner of the property during the financing phase, but at the same time the purchaser, as the future owner, must have already given its lender the security in the property in order to fulfil a precondition to the disbursement of loan proceeds for the purchase. For this reason, the seller, as owner, cooperates in connection with the registration of the mortgage and allows the mortgage to be entered in the land registry against the property and thus satisfies the credit institute’s precondition for payment of the purchase price. In the purchase agreement, the seller gives the buyer a power of attorney to permit the buyer to certify the registration of the mortgage in the seller’s name. The seller does not assume any personal liability for the amount of the mortgage or for any costs. The loan amount, up to the amount of the purchase price, is to be paid out only to the seller (or his bank) in fulfilment of the buyer’s obligation to pay the purchase price for the property. Use of the loan proceeds for private purposes of the buyer is excluded through this “financing power of attorney given for a single purpose”. As soon as the seller has received the purchase price and the property purchase price has been paid, the purchaser is free to use any unused loan proceeds for construction or reconstruction of the property.

d) Encumbrances

The employees of the notary should examine the land registry, at the latest, immediately before registering the rights of the purchaser because the land registry also includes information concerning encumbrances in Parts II and III of the registry.

In order to know what should be done about encumbrances and other entries in the land registry, it is important to distinguish the different types and their consequences.

- Often there are entries of a merely informational character – for instance, the so-called “redevelopment notation”. This indicates, that the property lies in a formally designated redevelopment area, with the consequence that the purchase agreement may be concluded only with the permission of the authorities. The same requirement applies to any subsequent registration of an encumbrance. The notary will obtain this permission. Such notations are removed by the authorities only when the redevelopment restrictions are formally removed.
- Not infrequently one encounters additional entries, which evidence a general obligation affecting the property with the effect that the owner must permit or prohibit certain circumstances or activities – for instance, “easements” or “limited personal easements”. Examples include rights of way, pipe or cable rights of way, obligations to maintain a certain distance from the buildings on the neighbouring property, etc. These must as a rule remain in the land registry, unless their purpose has been satisfied – for instance, an easement is no longer necessary because the affected property is now connected to a public road.
- Personal rights contained in Part II of the land registry – for instance, rights to an apartment or pension entitlements, as a rule, are to be cancelled, because the buyer wants the unencumbered right to use the building. Depending on the type of encumbrance that is on record, cancellation can be effected through public documents (for instance, a death certificate, if the person benefited is no longer alive) or through a notarily certified approval of cancellation of the encumbrance. Preparation of the release documentation is a matter for the notary.

- As a rule, entries in Part III of the land registry (encumbrances such as mortgages and land charges) must be cancelled. The bank financing the buyer will insist that the mortgage to be obtained by the buyer (for instance, through use of the power of attorney given for advance financing) must have the highest rank possible. The cancellations or declarations of release from previous creditors necessary to achieve this ranking will be obtained by the notary. In this connection it should be noted that often a mortgage or land charge is recorded, although in reality no underlying loan is still outstanding. It is reasonable to allow such encumbrances to remain in the land registry for the purpose of “Neuvalutierung”, thus as security for a loan to be borrowed by the buyer in the future. The remaining loan is repaid out of the purchase price. The method of “Neuvalutierung” is described immediately below.
- In rare cases it is recommended that the buyer assume the encumbrance already entered into the land registry by the seller for “Neuvalutierung”. The buyer assumes no liability for the debt of the seller. Instead, if the buyer finances the purchase with the same credit institute and the institute states that it is in agreement with the reuse of the already registered mortgage, a new loan is made by the credit institute secured by the existing mortgage. Often creditors demand a supplemental notarial “submission to execution” in respect of the personal estate of the buyer, with the result that no savings in notarial costs is achieved, although one does avoid the otherwise unreasonable cost of registering the mortgage in the land registry. If this method of “in rem” assumption of the mortgage is chosen, the notary provides a so called “Nichtvalutierungserklärung”, which is the confirmation by the creditor that the mortgage is no longer binding on the seller but is binding on the buyer to secure the buyer’s debt.
- In even rarer cases, the mortgage is assumed by the buyer with underlying liability, with a continuation of the seller’s loan but with the buyer as the new debtor on that loan. This form of “pure” debt assumption requires the express permission of the creditor, which as a rule is obtained through the notary. You should however beforehand check with the creditor whether it is in fact willing to agree to the transfer of the loan to the buyer with the existing terms and conditions applicable to the loan. In the case of a “pure” debt assumption, the amount of this loan, which is transferred to the buyer on a fixed date, is deducted from the purchase price and only the remaining amount of the purchase price is to be paid directly to the seller.

If the property subject to the contract is outside Bavaria, in addition the already-mentioned encumbrances in Parts II and III of the land registry, one must consider whether further encumbrances known as “Baulasten” exist. These building encumbrances are entered in the so-called building encumbrance registry (Baulastverzeichnis), which is maintained as a rule by the district administration authorities (Landratsamt bzw. Kreisfreie Stadt). The notary does not have a duty to examine this registry. The subject of such building encumbrances, which are binding on future owners even without express mention, are for instance obligations to permit certain things or limitations on development, which in the land registry would be noted in Part II as easements. Enquiries should be made as soon as possible concerning such building encumbrances, so that the possibility of building permits for any intended development of the property by the purchaser may be checked with the local building authorities.

If the property is rented or leased, under applicable law the buyer automatically becomes a party to the rental contract, and the purchase does not terminate the lessee’s obligation to pay rent. The buyer may terminate a lease only in accordance with the conditions set out in the law – for instance, if the buyer intends to occupy the property himself. In addition, other restrictions may apply to the property, for instance a

right to purchase the property under § 577 BGB (in favor of the tenant, if the property was divided into apartments and then will be sold; less likely in favor of the community in accordance with the German Baugesetzbuch, in an area where there is a development plan or for public purposes). Whether such rights to purchase will be exercised can be officially checked by the notary only after notarization. As a rule the seller must provide a declaration that any rights to purchase will not be exercised as a precondition to receiving any portion of the purchase price.

In addition, it is possible that someone recorded as the owner of the property in the land registry is dead or legally incapable of executing documents, in which case special measures must be taken (proof of inheritance by way of a certificate of probate; appointment of a guardian who then requires the permission of the guardianship court in order to effect a sale, etc.)

It is very important that the agreed purchase price, as well as all other agreements relating to the purchase, be correctly stated in the purchase contract. This applies also to any payments of the purchase price that have already been made. These must be separately mentioned in the purchase contract.

No legal form contemplates all of these points, but careful consideration of these points in the preparation of the purchase contract will insure that it reflects the interests and intentions of the parties.

3. Notarization

As a rule, prior to the meeting with the notary, you will receive a draft purchase contract. If, in your review of this draft, you should have questions, you should discuss these questions at your convenience with an attorney at our firm. You may also raise questions while the contract is being read by the notary. The timing of the meeting with the notary should be coordinated with the other parties. We are happy to do this for you.

To the extent another party to the contract acts not commercially but as a consumer only, he must be allowed at least 14 days between delivery of the draft and the meeting with the notary to examine the contract (§ 17 Abs. 2a Beurkundungsgesetz).

For the notarization, please bring with you your passport or an official identity card.

If you have documents from creditors which are needed to cancel an entry in the land registry which must be cancelled in connection with performance of the purchase contract, you can forward these documents to our law office or bring them at the time of notarization. In this way, later action will be unnecessary and the process will be expedited. To the extent that you will be financing all or a part of the purchase price through a bank credit, please arrange with your banker that the documentation relating to the mortgage is forwarded to us and to the notary in a timely manner, so that proper documentation for the mortgage may be prepared by the notary and is notarized at the same meeting with the notary as the purchase contract.

During the notarization process, the entire text of the purchase contract will be read aloud to you by the notary. This is a requirement of law and is intended to ensure that the parties to the contract know the precise contents of the contract and also that the notary once again checks that the legal form of the contract is in accordance with the agreement of the parties and that the contract contains all necessary provisions. Questions and inquires may be posed at any time during the notarization process, including during the reading of the contract. Naturally, after notarization, this firm as well as the notary are available to provide you with any needed information and to answer any questions you may have. Later, you will receive from the notary an "official"

copy of the notarized purchase contract, together with the contract details of the persons in the notary's office who are responsible for your file.

4. Organization of the contract

A real property purchase contract often follows a specific form so that the contract is properly drafted.

a) Beginning of the document

In this part it is particularly important that the personal details of the parties to the contract are correctly entered. The required information is each party's first names, last name, date of birth and current address, as well as how the property is held or will be held (e.g., marital status).

The next section consists of a recital of facts relating to the property, deriving from the current contents of the land registry, as well as possible further descriptions which are necessary and useful for an understanding of the records.

b) Sale, land registry declarations

In the next section then follows the actual contractual declaration relating to the sale, as well as the required land registry declarations (agreement over the passing of title, entry of a priority notice (Eigentumsverschaffungsvormerkung)). The priority notice is an entry in the land registry to protect a claim to a registrable right in land property, making dispositions which run counter to the claim of the person in whose favor the notice has been registered void as against that person. Thus the priority notice prevents the seller from selling the property again (for instance, to receive the purchase price twice), prevents the property from becoming encumbered with additional subsequent mortgages, and prevents a third party from seizing the property during the period of concluding the contract (for instance, the Finance Ministry on the basis of income taxes which the seller has failed to pay and which are due and owing). It is therefore essential, with the exception of certain cases of the conveyance of property among relatives.

The real "conveyance", that is the passing of title to the property, will as a rule already be stated in the notarial instrument, in order to avoid a separate additional and costly notarization of the conveyance. However, the conveyance may be presented by the notary only when the seller has confirmed that the purchase price has been paid, or the buyer has proved this by way of a bank receipt. In this way both sides are protected: The buyer pays the purchase price (as described in the next section of this memorandum) only when the necessary protections are in force for him and the seller does not give up his ownership before he has received the purchase price.

c) Purchase price

In this section the purchase price is stated, as well as all provisions relating to when and how the purchase price is to be paid. This section provides particular protection for the buyer, in that he is not required to make any payments when his interests are not protected in accordance with the requirements of the contract. Usual points at which the purchase price, or instalments of the purchase price, become payable are the entry of the priority notice (Eigentumsvormerkung) with the proper priority in the land registry, the issuance of a clearance certificate by the community indicating that it does not have a right to purchase the property and the delivery to the notary of all documents necessary to release encumbrances in proper form for entry in the land registry. In certain cases there may be further conditions to payment, for instance, the waiver of any private rights to purchase, the issuance of further authorizations (by the guardianship court, probate court, a principal in case of a ratification of acts done without power of attorney, etc.).

To the extent the encumbrances (land charges or mortgages) to be cancelled secure amounts still owed by the seller, the creditor will send to the notary, to be held in trust, the documentation necessary to cancel the relevant encumbrance (land charge certificates, consents to cancellation and releases of mortgages). The notary will make use of this documentation only after the payment of the remaining outstanding amount of the secured debt. Repayment of this debt takes place on the basis of a notification to the notary from the buyer as to the date the repayment is to be made and is a deduction from the purchase price. Therefore economically it is paid at the expense of the seller. Only the amount of the purchase price that is not to be used to release encumbrances will be transferred directly to the private account of the seller. The details of this account should be set forth in the purchase contract or otherwise communicated to the notary in writing.

Under no circumstances should any payment be made before the buyer has received notice from the notary that the payment is due. This notice will be sent by a registered letter. The seller as well as the bank providing financing to the buyer (to the extent known to the notary) will receive a copy of this notice for their information.

d) Possession, use, charges (i.e., security interests)

This section sets forth the exact point in time at which the right to occupy and use the property as well as the obligation to bear costs and expenses relating to the property pass to the buyer. This time is not the same as the time at which title passes to the buyer – title passes only upon the entry of the purchaser's name in the land registry.

From the tax perspective the decisive time of purchase is the time at which the right to possession and use and the obligation to pay charges pass to the buyer. As a rule this occurs upon the receipt by the seller of the full purchase price, since otherwise the seller would grant the rights without any protections (he would already enable the buyer to move into or use the premises before it is certain that the purchase price can and will be paid). In order not to put a delaying buyer in a better position, the obligation to pay charges and the duty to maintain safety on the premises (obligations relating to maintaining the area and with respect to litter) pass to the buyer when the full purchase price has become due and payable. If it is necessary to transfer possession before the purchase price is paid, it is advisable to provide an alternative protection for the seller – for instance, a financing confirmation from the credit institute of the buyer or a letter of credit.

Also, as a rule in this section any questions concerning the development of the property are dealt with. A decisive question is whether the property is sold as “fully developed” – in that case the seller bears the risk to pay for the connection to public main services like water, sewage and power facilities. Alternatively, the buyer may agree that the seller is responsible only for previously invoiced fees and costs. In the case of an undeveloped property in every case the buyer bears the so-called “connection costs”, that is to say the costs for the direct connection of the building to be built with the public networks, as well as any additional assessments in relation to the development costs assessed on the basis of a greater structured use than was previously the case (in particular with respect to contributions to the constructions of canals).

As a rule this same section will deal with any rentals as well as any evictions by the landlord. Under the law rentals pass to the buyer automatically but nevertheless the buyer is customarily given a power of attorney, coming into effect on the date of payment of the purchase price, allowing him to give instructions and other communications directly to the tenant. Often is eviction an addition precondition to payment of the purchase price (or at least a considerable portion thereof), but not one that is to be confirmed by the notary. Alternatively, consideration should be given to including an agreement between the parties as to the penalty to be paid by the seller if an eviction is delayed.

e) Guarantee

Here one must distinguish the guarantee in respect of physical defects or deficiencies and the guarantee in respect of legal defects or deficiencies. While the seller guarantees the transfer of encumbrance-free property to the buyer, the seller, as a rule, gives no guarantee as to the condition of the property or the “old” buildings located on the property. This corresponds to usual contract practice and does not constitute an illegal disadvantage to the buyer. Only in the case of the sale of movable property by a firm to a consumer (“Verbrauchsgüterkauf”) and in the case of so-called serial contracts, to which the strict provisions of §§ 305 ff. BGB with respect to terms and conditions (allgemeine Geschäftsbedingungen) apply, such terms excluding liability of the seller might be illegal.

f) Power of attorney for financing

In order to enable the buyer to obtain the money needed to pay the purchase price, as a rule it is provided that the seller agrees to the prior mortgaging of the property to the buyer’s bank, and the seller gives the buyer a power of attorney for this purpose. This does not involve any risk to the seller, because through a corresponding notarial arrangement it is ensured that the buyer can use the proceeds of the financing only for the payment of the purchase price. (claims for payment are transferred to the seller, or if applicable its creditor) and not for other purposes. It is highly advisable to have the mortgage notarized at the same meeting as the purchase contract. Should at a later time delivery of another mortgage be necessary, the presence of the buyer will be sufficient since he has received a power of attorney in the purchase contract.

g) Final explanations

The documents will as a rule conclude with the notary instructed to put it into effect, the necessary instructions, mutual powers of attorney (perhaps for construction preparations prior to the transfer of possession of the property, or in relation to a contracting party consisting of several persons), as well as the concluding provisions relating to costs and as to copies of the contract.

In this section any broker fees will also be dealt with.

The costs provisions provide as a rule that the costs of preparing the contract, the land registry costs and the land transfer tax are borne by the buyer, while the costs of removing encumbrances are borne by the seller subject to agreements otherwise. The representative without power of attorney bears the costs of his authorization. For completeness it should be noted, that under the law both parties to the contract have liability for all costs and this liability cannot be contractually excluded, and all contractual provisions relating to costs are effective only between the parties.

5. Performance of the contract

The notary is responsible not just for notarization of the purchase contract but also for a variety of related matters. Thus the notary gives certain notifications which the law entitles him to give. He supervises the proper entry of priority notices, mortgages and title transfer in the land registry. He obtains permissions, approvals and clearance certificates which are necessary for the transaction, and undertakes, with full liability, to notify the parties when the purchase price becomes payable. He also has the responsibility to insure that the change in ownership takes place only after the purchase price has been paid in full to the seller.

The sale of real property has other legal consequences which should be noted. Property tax is payable with respect to every piece of real property. The person responsible for paying the property tax is the owner at the beginning of the calendar year. This means that in case of a sale during the course of any calendar year, a proportionate settlement between the parties of the advance payment of the property

tax must take place, because the local government will allocate the property tax to the buyer only on January 1st of the following year. Also the buyer has a legal obligation to report to the responsible office of finance the change of ownership within three month after it takes place. Also under law the insurance for the property passes to the purchaser. Both, the insurer and the purchaser has one month within which it may terminate the insurance. Notice of the transfer must be given to the insurance company immediately. Otherwise the insurance company has no obligation to perform if an insurable event occurs more than one month after the transfer.

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