The Real Estate M&A and Private Equity Review

Second Edition

Editors

Adam Emmerich and Robin Panovka

The Law Reviews

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This article was first published in The Real Estate M&A and Private Equity,
- Edition 2
(published in September 2017 – editors Adam Emmerich and Robin Panovk)

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-910813-77-5

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

AKALIN ATTORNEYS AT LAW

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO

ALLEN & OVERY LLP

ARENDT & MEDERNACH

ARTHUR COX

BINDER GRÖSSWANG RECHTSANWÄLTE GMBH

BONELLIEREDE

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PAYET, REY, CAUVI & PÉREZ ABOGADOS

PINHEIRO NETO ADVOGADOS

SLAUGHTER AND MAY

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WACHTELL, LIPTON, ROSEN & KATZ

WARDYŃSKI & PARTNERS

CONTENTS

Chapter 3

AUSTRIA

Tibor Fabian and Markus Uitz[1]

I OVERVIEW OF THE MARKET

In 2016, Austrian general M&A activity increased slightly in terms of the number of transactions announced: a total of 354 statistically relevant M&A transactions with Austrian participation. The general transaction volume has doubled from €4.7 billion in 2015 to €10.7 billion in 2016. Despite a surge in cross-border M&A activity, the domestic transaction volume has remained steady over the few past years. Therefore, Austria continues to remain an attractive market for foreign investors.

The most active sector in foreign investments in Austria is the real estate and construction sector, leading both in terms of the number of statistically relevant transactions (36) and the total transaction volume (€4.3 billion). From a general perspective, the demand for Austrian real estate is increasing because of the country's generally stable political and economic framework. This increase in demand is fostered by extremely low interest rates and available financing. Even though real estate prices have increased significantly over the past few years, Austria is still considered a key place for non-speculative real estate investments. In particular, the demographic development and expected urban expansion (with Vienna having been consistently ranked as one of the world's best cities to live in) have resulted in demand that exceeds availability. Therefore, real estate investments also appear attractive to foreign institutional investors. Consistent with the past, Germany plays a key role for Austrian inbound M&A activity, being involved in 29.5 per cent of the relevant transactions, followed at some distance by Switzerland (10.1 per cent) and the United States (8.5 per cent).

In 2016, public real estate companies actively participated in numerous acquisitions in Austria. Key M&A transactions included the acquisition by Venovia SE of all shares of Vienna-listed Conwert Immobilien Invest SE as well as the acquisition by Vienna-listed Immofinanz AG of approximately 26 per cent of bearer shares of Vienna-listed CA Immobilien Anlagen AG from Terim Limited and four registered shares of CA Immo from O1 Group Limited, which will be described in further detail in Section II.

Despite the overall impression of increasing appetite among private equity investors, driven by notable private equity transactions (such as the acquisitions of Frauscher Sensortechnik by Greenbriar, Tricentis by Insight Venture Partners and Automic by CA Technologies), the share of financial investor-driven transactions decreased in 2016, causing the share of strategic investors transactions to expand even further.

1 Tibor Fabian and Markus Uitz are partners at Binder Grösswang Rechtsanwälte GmbH.

II RECENT MARKET ACTIVITY

i M&A transactions

Below is a short summary of three of the most significant recent real estate M&A transactions in the Austrian market.

Aquisition of Conwert Immobilien Invest SE by Vonovia SE

Following a failed bid for Deutsche Wohnen, Vonovia made a voluntary tender offer for Conwert Immobilien Invest. This Austrian-based listed real estate corporation featured a transaction value of €2.86 billion. The offer targeted all outstanding shares of Conwert Immobilien with consideration offered in shares and alternatively in cash. Operational and financial synergies are expected as a result of the transaction.

Aquisition of shares of CA Immobilien Anlagen AG by Immofinanz AG

Immofinanz, an Austrian-based and listed real estate stock corporation, acquired a stake of approximately 26 per cent in CA Immobilien Anlagen AG from Terim Limited (Cyprus) and four registered shares of CA Immo from O1 Group Limited (Cyprus). The subsequent merger of Immofinanz and CA Immo has been put on hold because of a delay in the disposal of Immofinanz's Russian portfolio, which has been affected by the country's economic situation, resulting from low oil prices and international sanctions. However, as the economic situation in Russia begins to ease, Immofinanz hopes for an even higher sale price compared with an earlier sale of the portfolio. Immofinanz plans to launch the bidding process for its five Moscow shopping malls later in 2017.

Acquisition of commercial properties of Conwert Immobilien Invest SE by HanseMerkur Grundvermögen AG

HanseMerkur Grundvermögen AG acquired a portfolio of commercial properties for its real estate property fund HMG Grundwerte Chancen from Conwert Immobilien Invest SE. The portfolio contains 34 office and retail properties in major urban regions in Austria and Germany, with a total usable area of around 200,000 square metres. At €331 million, the purchase price is slightly above the book value of the properties. With this sale, Conwert has divested around 40 per cent of its non-core portfolio. Listed on the Vienna Stock Exchange, Conwert is a fully integrated property company with a focus on residential property and apartment buildings in Germany and Austria.

ii Private equity transactions

The number and volume of Austrian private equity and venture capital funds is well below the European average. Despite the overall increase in private equity investments, the share of financial investor-driven transactions decreased in 2016. Comprehensive information about the private equity market in 2016 is currently not available. In 2015, the Austrian Private Equity and Venture Capital Organisation (AVCO) reported a fundraising of €111 million, a significant increase compared with the fundraising in 2014 and 2013, which amounted to approximately €20 million. This increased activity was primarily due to one single fund focusing on early-stage investments. Apart from the one early-stage fund, there is no significant activity in the market, in particular because of the increased regulatory burden on funds under the Austrian Alternative Investment Fund Managers Act (AIFMG). In July 2016, the Austrian government announced plans to implement an initiative for startups, which should include a programme for early-stage investors and the reintroduction of the medium-sized business financing company. The SME Financing Act 2017, which aims to establish a more advantageous taxation system for investors, was published on 26 July 2017. Accordingly, dividends of up to €15,000 annually are exempt from capital gains, resulting in a maximum tax relief of €4,125 per investor per calendar year. It remains to be seen whether this new legislation will have a positive impact on fundraising activities.

III REAL ESTATE COMPANIES AND FIRMS

i Publicly traded REITs and REOCs – structure and role in the market

While real estate investment trusts (REITs) are common to many jurisdictions, this structure has not yet been incorporated into the Austrian legal system.

Choice of company structure is highly tax driven. For the purposes of indirect real estate investments in Austria, there are available general stock corporations that operate as real estate operating companies (REOCs) (such as Immofinanz, Conwert and CA Immobilien), as well as open and closed-ended real estate investment funds. Profits of Austrian REOCs are subject to Austrian corporate income tax at a flat rate of 25 per cent. Profits distributed to investors, as far as natural persons are concerned, are additionally subject to Austrian capital gains tax at a flat rate of 25 per cent. This is the reason the majority of the Vienna-listed real estate stock corporations do not distribute dividends to their investors but rather tend to retain profits for reinvestment. Investors merely profit through the appreciation of the stock, which is subject to general market fluctuations. Therefore, certain investors consider this reinvestment policy to be a disadvantage.

As an alternative to investments in public real estate stock corporations, the legislator established a new real estate funds investment vehicle in 2003 through the Austrian Real Estate Investment Fund Act, with a view to providing tax advantages comparable to those of REITs in other jurisdictions. While shares in an Austrian real estate investment fund are not allowed to be offered on a stock exchange, they are obliged to pay out dividends upon the shareholder's request (to the extent provided by the regulations of the fund concerned, and with certain exceptions allowing dividends to be carried forward for up to two years). The fund itself is not subject to corporate income tax; effective distributions as well as fictitious distributions of retained profits are subject to income tax at shareholder level. It is important to note that not only balance sheet profits derived from real estate, such as income from rent, but also 80 per cent of the increase in value of invested real estate is subject to taxation (even if not yet realised). For this purpose, the total asset value of a real estate fund has to be determined at least once a year by two independent experts. The related costs of yearly valuation and the taxation of unrealised profits are considered to be major disadvantages, especially if the fund is not able to generate an adequate return on investment.

ii Real estate PE firms – footprint and structure

Real estate private equity firms investing heavily in the Austrian market are currently rare. The main vehicles used for private equity funds established in Austria are limited partnerships or limited liability companies, as well as joint-stock corporations. Each of these types of entity has a separate legal personality, but partnerships are transparent for tax purposes.

However, most private equity firms active in Austria with significant investments are located offshore or are founded under laws granting private equity companies a selective tax advantage.

Since the introduction of the AIFMG, most private equity funds established in Austria qualify as alternative investment funds under this Act. The formation of an alternative investment fund (AIF) requires the prior approval of, and registration with, the Austrian Financial Market Authority (FMA). Funds pursuant to the Austrian Investment Funds Act, as well as funds qualifying under the Austrian Real Estate Investment Funds Act, are not captured by the AIFMG.

IV TRANSACTIONS

i Legal frameworks and deal structures

As in other jurisdictions, real estate acquisitions in Austria may differ both in the structuring of the sale process and in the deal structure itself.

The structuring of an investment for the acquisition of property is based on various economic, fiscal and legal considerations, whereby investments may generally be structured as asset or share deals. The advantage of an asset deal is that the investor may be better aware of the transaction scope (particularly in relation to the potential tax or other liabilities of a pre-existing company), whereas a share deal is generally tax advantageous as, with correct structuring, real estate transfer tax can be avoided. This is possible, as an asset deal generally triggers Austrian real estate transfer tax at a rate of 3.5 per cent of the consideration, whereas only a transfer of at least 95 per cent of the shares in a company holding Austrian real estate is subject to real estate transfer tax. In light of this, it has become common practice to implement a share deal structure with two acquiring entities that must each acquire more than 5 per cent in the target company (e.g., a 94 per cent/6 per cent structure). Furthermore, a share deal will not result in a change in the ownership of the property itself, which means that registration fees of 1.1 per cent of the market value of the real estate may also be avoided.

Real estate acquisitions through asset or share deals are not subject to a special legislation regime, but rather to various civil, corporate, tax, stock exchange and antitrust laws. The relevant provisions on asset deals can be found in the Austrian Commercial Code, as well as the Austrian General Civil Code. Mergers, demergers and transformations on the other hand are regulated in the Stock Corporation Act, the Act on Limited Liability Companies as well as specific laws. Listed companies, as well as the transactions in listed companies, are additionally regulated by the Austrian capital market laws. Acquisitions by foreigners are often subject to approvals by regional land authorities (see Section IV.v).

The following legal forms are typically used as real estate holding entities and acquisition vehicles (if an Austrian entity is chosen at all):

a Limited liability companies (GmbH) offer flexibility and can be established by legal entities or by one or more individuals, who are generally not personally liable for the company's liabilities. The minimum share capital amount is €35,000, of which at least €17,500 must be paid in. Since 2014, there has been an option to limit share capital to €10,000 (of which at least €5,000 must be contributed) for up to 10 years.

b Joint-stock corporations (AG) are legally liable entities, the shareholders of which participate in the share capital divided into shares by means of contributions, without being personally liable for the company's liabilities. The minimum capital stock is €70,000. The ongoing legal structure costs of an AG are higher than for a GmbH. In addition, they offer less flexibility – except in relation to share transfers.

c Partnerships can be incorporated by at least two parties as a general partnership (OG) or a limited partnership (KG). The difference between an OG and a KG is that in a KG at least one partner has limited liability, whereas all partners of an OG are personally fully liable. In addition to the flexibility of partnerships (which is even greater than that of a limited liability company), their main advantage is tax transparency, which allows the direct allocation of profits and losses to partners for tax purposes.

ii Acquisition agreement terms

In Austria, there are statutory rules on warranties and damages as well as indemnities. In general, a purchaser is entitled to remediation or exchange of the deficient object in the first instance. In the second instance, the purchaser has the right to request a price reduction or to rescind the contract. Unless otherwise agreed by the parties, the warranty period is two years for moveables and three years for real estate (with a period of up to 30 years applying for legal defects). The tort regime for damages arising from negligence on the part of the seller applies in parallel.

The contractual regime will seek to replace these statutory rules to the greatest extent possible and will usually exclude rescission of the agreement and limit the buyer to claiming damages, which are contractually defined and limited in scope and amount. Certain mandatory provisions may still apply and override contractual limitations and exclusions of claims, such as claims based on deceit or collusion. Caps, floors and baskets defining and limiting the amount of damage claims are generally consistent with international practice and usually determined by the bargaining power of the buyer and the seller.

Conditions precedent to closing regularly involve regulatory approvals like merger control (see below) and the approval of regional land authorities, particularly in the case of non-EU purchasers (see Section IV.v). Additionally, conditions precedent may relate to contractual partners waiving termination rights in the event of change of control. Material adverse changes clauses are heavily negotiated but frequently incorporated into the transaction documentation.

In line with international practice, covenants between signing and closing will usually relate to limitations on the conduct of business until closing (ordinary course) and information obligations on the buyer as to business development, and usually also provide for a prohibition of dividend or other payments to the seller by the target between signing and closing.

In the event of a portfolio sale (potentially also involving multiple jurisdictions) in the form of an asset deal, typically a framework agreement governing the legal terms is negotiated. Short transfer deeds relating to each individual land plot will then have to be executed at the closing of the transaction allowing the purchaser to register the ownership with the applicable land register. These documents generally need to be notarised.

Hostile transactions

A hostile takeover of a public real estate company in Austria has not occurred yet.

iii Financing considerations

Generally, real estate financing is provided by banks via loans. Restrictions on who may provide financing in relation to real estate transactions mainly stem from banking regulations that restrictively regulate the commercial granting of loans (including within groups). Typically, mortgages serve as collateral for real estate financings. In the case of share deals, pledges over the shares of the borrower, pledge of moveables, accounts pledges, assignments of receivables or rights under any major contracts are also considered. To create a mortgage, pledgor and pledgee must execute a mortgage agreement in writing, with the signatures being notarised. Generally, both fixed-amount mortgages (securing a specific amount) as well as maximum amount mortgages (which may be recurrently used under a specific relationship) are possible under Austrian law. The mortgage is only established upon its registration with the land register, which triggers a registration fee (see below).

iv Tax considerations

In the event of a sale or acquisition of real estate in Austria, the following taxes need to be taken into consideration.

Real estate transfer tax

The following are subject to Austrian real estate transfer tax:

a the acquisition of Austrian real estate; and

b the consolidation in the hand of a single shareholder of more than 95 per cent of the shares in a company owning Austrian real estate.

The taxable base for the determination is the value of the consideration. As a rule, this is the purchase price or at least the market value of the real estate (if the purchase price is lower). Real estate transfer tax generally amounts to:

a 3.5 per cent in the case of an asset deal; and

b 0.5 per cent in the case of a consolidation of more than 95 per cent of the shares in a company.

Further, transfers without consideration (i.e., donations) are subject to real estate transfer tax at a progressive tax rate ranging from 0.5 per cent to 3.5 per cent.

Real estate profit tax

The profits from the sale of real estate are subject to a real estate profit tax, which is generally subject to a flat tax of 30 per cent, provided that a flat tax rate of 25 per cent applies to all profits generated by profits from corporate entities (including from the sale of real estate).

General corporate income tax

Profits from the sale of real estate by a corporate entity are subject to corporate income tax at a flat rate of 25 per cent (see above).

Registration fee

In addition to real estate transfer tax, a registration fee amounting to 1.1 per cent of the market value of the property applies for entering the right of ownership in the land register. For the registration of mortgages, an additional 1.2 per cent of the mortgage amount must be paid.

Stamp duty

The execution of a purchase agreement and the contemplated acquisition of real estate does not generally trigger stamp duties.

VAT

Real estate transactions are generally not subject to VAT. However, if the selling party is an entrepreneur, they may opt to treat the sale of real estate as VAT taxable at a rate of 20 per cent. Entrepreneurs typically take this option into consideration if they have reclaimed input tax regarding the real estate (which would otherwise have to be refunded) within the past 10 years.

v Cross-border complications and solutions

Under the land transfer regulations, the transfer of property rights to non-Austrian resident investors may require an approval. In this respect, each Austrian federal province has its own legal framework defining the applicable restrictions and approval process. If the necessary approval is not obtained, a transfer of ownership cannot be registered in the relevant land register and the contemplated transaction cannot be carried out (as real estate ownership is generally obtained only through registration of the new owner in the land register). Persons and corporate bodies of EU Member States or signatory parties to the European Economic Area agreement have the same status as domestic persons and corporate bodies. For certain federal provinces, the creation of an Austrian holding structure is sufficient for fulfilling the requirements of the applicable land transfer regulations.

V CORPORATE REAL ESTATE

Even though a separation of corporate real estate from operating companies seems to occur in the Austrian market in certain cases (including for purposes of real estate financings), the number of transactions does not indicate that this will become a major trend.

VI OUTLOOK

The general market outlook for real estate investments in Austria is positive; the reasons being the consistently low interest rate and therefore cheap financing, and the positive economic outlook due to the low unemployment rate and predicted economic growth. Moreover, demand should be steady as the general consumer climate is positive because of relatively low oil prices and growth of the total population through immigration. Therefore, the total volume of transactions will depend on supply, with the rate of return being expected to decline even further.

Political discussions about a reform of the Austrian Tenant Act and the general legal tenancy system will most likely continue in 2017 as in past years. The main points of discussion in this context are a general cap on rent, substantial decreases in the rent allowed for time-limited lease agreements, a prohibition or at least a limitation on obligations for tenants to pay broker commissions, and certain limitations on landlords passing on maintenance costs to tenants (e.g., real estate tax and insurance fees). However, with the antagonistic positions of the political players becoming even more entrenched lately, solutions for these issues, or even the (highly necessary) reform of the tenancy regime, seem as unlikely to occur in 2017 as in past years. Also, the prospect of long-requested reforms of the administrative law and the abolishing of unnecessary legal and administrative barriers occurring in the near future is very unlikely. Real estate developments and construction projects will thus continue to face the same administrative burdens as they do presently.

As a result, the Austrian real estate market is unlikely to see the benefits that would result from a more favourable environment. Nonetheless, given the general political and economic stability, investments and real estate prices are expected to rise.

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ISBN 978-1-910813-77-5