The new normal – the future of the real estate industry

WebCast – 19th August 2020 – 10:00-11:00

Real Estate Insights & Restrukturierungen

• Outlook economic situation - after the crisis is before the crisis?
• Restructuring and real estate - tenants, landlords, financiers
• Withdrawal of the banks - New opportunities for mezzanine financiers?
• Update Legal
• Update Tax

Registration via LINK: https://blogs.pwc.de/real-estate/
Updates and information also on https://blogs.pwc.de/real-estate/

Germany in crisis!

Economic recovery vs. second wave?

- **Recession** in Germany - GDP falls by 6.5% in 2020 (compared to the previous year), forecast for 2021 only slightly positive; decline from Q1/2020 to Q2/2020 10.1%

- **Business climate index** at a historic low of 74.3 points in April, now recovering

- **Economic figures 07/2020** – 6.3% unemployment rate additional 5.6 million employees in short-time work

- Against the background of the currently rising corona cases, the short-term recovery seems unlikely
Asset classes in the New Normal are affected by pandemic-related changes in the value chains

### Types of use - possible effects of the crisis

<table>
<thead>
<tr>
<th>Impact on asset</th>
<th>Assisted living</th>
<th>Data Center</th>
<th>Social housing</th>
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</thead>
<tbody>
<tr>
<td>slightly negative</td>
<td>Retail (Food)</td>
<td>Residential (privat)</td>
<td>Affordable living space</td>
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<tr>
<td>0% to -15%</td>
<td>Logistics</td>
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<td>Residential</td>
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<thead>
<tr>
<th>Impact on asset</th>
<th>Serviced Apartments</th>
<th>Student Housing</th>
<th>Healthcare</th>
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<tbody>
<tr>
<td>negative</td>
<td>Businessparks</td>
<td>Office (prime location)</td>
<td>Industrial / Warehouse</td>
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<tr>
<td>-5% to -25%</td>
<td>Office (Rest)</td>
<td>Office (outskirts of town)</td>
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<tr>
<td></td>
<td>Parking</td>
<td>Parking</td>
<td></td>
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<tr>
<td></td>
<td>Office (Prime)</td>
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<table>
<thead>
<tr>
<th>Impact on asset</th>
<th>Retail parks</th>
<th>Highstreet-Retail</th>
<th>Restaurants, Bars &amp; Events</th>
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<tbody>
<tr>
<td>very Negative</td>
<td>Shopping-Center</td>
<td>Shopping-Center (City)</td>
<td></td>
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<tr>
<td>-10% to -35%</td>
<td>Retail (Non-food)</td>
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<th>Expected resilience / flexibility</th>
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<tbody>
<tr>
<td>Low</td>
</tr>
<tr>
<td>Medium</td>
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<tr>
<td>High</td>
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- **Crisis winners** in RE are in short supply and are triggered by changes in the value chains (e.g. through increasing demand for logistics space and digital capacities).
- In addition to the direct effects: **Crisis as a catalyst** for online, delivery and digital working models and thus potential need for office space redeployment.
- Asset classes under pressure from the ongoing online trend, now combined with strong effects of the lockdown and potential spending cuts as a result.

(differentiates the effects based on moods / conversion possibilities)
Great need for adaptation towards the New Normal

1. Re-use - new usage concepts/tenant behavior
   - Trend towards redistribution of operator risks and opportunities in rental contract negotiations
   - New office use concepts (PwC US/NL study)
   - Trend towards urbanisation continues in the long term (innovation and creativity), but opportunities
   - Study on the conversion of department stores

2. Re-finance - trends in financing
   - New entrants in the mezzanine segment
   - New investment opportunities
   - Banks cooperative so far, no NPLs yet

3. Re-Structuring - Comparison with financial crisis?
Restructuring Real Estate: Triangle of Tenant-Landlord-Financier

**Tenant**
- Great tension especially in retail (consumer) in all non-food segments
- Numerous "Rent Attack" projects in retail:
  - Review of rental contracts (according to various clusters)
  - Option analysis
  - Negotiation - out of court or in court (e.g. protective screen proceedings)

**Landlord**
- Loss of rent / rent reduction / variabilisation (if necessary, preparation of continuation forecast, refurbishment report on the tenant)
- Imminent disruption of debt service
- Impending covenant breach (especially ICR / DSCR / debt yield)
- Re-planning, scenario analyses, modelling

**Financier**
- Credit exposure analysis (business planning, scenario analysis)
- Adjustment covenant and / or debt service
- Documentation (expert opinion according to IDW S11, S6 or IBR, alternatively current "short expert opinion", property valuation)

**Legal framework (COVID-19 Mitigation Act*)**
- Conditional suspension of the obligation to file for insolvency
- Privilege of rescission

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Restructuring options

1. Company/portfolio valuation
2. Balance sheet / capital structure
3. Tenants and their solvency
4. Debt capacity / structure under consideration:
   - Which capital assets are still of value?
   - Who gives "fresh" money?
   - How is new capital secured?
   - What are the conditions for new and old capital?
   - Waterfall at exit?
   - Positive reorganization report
   - Tax effects
5. Treatment of excess debt
Significantly changed financing environment

Change in financing structures

Drivers of the last few years:

- Banking regulation (after 2008/09)
- Corona pandemic 2020
- [Introduction of Basel IV]
Mezzanine capital as part of the solution for real estate

Demand and supply of mezzanine capital are shifting apart

Market reflection:

Persistent gap:
- "Early stage" project developments
- small volumes (<5 million euros mezzanine)
- short maturities (<12 months)
Legislator has already reacted early

Law to mitigate the consequences of the COVID-19 pandemic in civil, insolvency & criminal proceedings

- Art. 1 - Law on the temporary suspension of the obligation to file for insolvency and to limit the liability of organs in the event of insolvency caused by the COVID-19 pandemic (COVInsAG)

- Art. 2 - Measures in company, cooperative, association, foundation and residential property law

- Articles 3 and 4 - Amendments to the Introductory Act to the Code of Criminal Procedure

- Art. 5 - Amendments to the Introductory Act to the Civil Code, including those concerning rental and lease agreements

- Art. 6 – Regulations on entry into force and expiry

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The regulatory content of COVInsAG is extensive

Suspension of the obligation to file for insolvency in the event of insolvency and overindebtedness

- **Precondition:** insolvency maturity is pandemic-related and there is a prospect of restructuring
- Otherwise, the obligation to file an application subject to **sanctions** continues to exist
- Restriction of the **right of creditors' insolvency petitions**

Limitations of the insolvency challenge

- **Granting of a new loan** (until 30.09.23) & provision of collateral for it not detrimental to creditors
- **Shareholder loan:** Restriction of the right of rescission for restitution but not for collateral
- Claims for repayment of shareholder loans not **subordinated** if loans were granted during the suspension period and an application for insolvency was filed by 30.09.23
- **KfW loans/state aid programmes:** Insolvency appeal limited, even if credit is granted after the end of the suspension period

→ **Consequence:**

COVInsAG reduces the risk of contestation of potential lenders and thus indirectly facilitates the raising of new loans for companies in crisis.
Extension of the suspension of the obligation to file for insolvency is li

Outlook - current status

• Decision expected by end of September

• Current discussion: Extension until 31 December 2020 or until 31 March 2021

• Extension of the suspension of the obligation to apply for insolvency and over-indebtedness or extension only for over-indebted companies (under insolvency law)?

• Most probable variant: Extension of the suspension of the obligation to file for insolvency until 31 March 2021, but limited to the reason for opening the insolvency proceedings. After that, if insolvency has occurred, the obligation to file for insolvency will be required again from October 1, 2020.
Legal implications in the context of restructuring

**Commercial leases in insolvency**

- **Principle:** Tenancies continue to exist in principle with effect for and against the insolvency estate
  - Landlord's block on termination (section 112 no. 2 InsO)
  - 3-month termination right of the insolvency administrator (or in the protective shield or self-administration proceedings of the insolvency debtor)
- **Operating and ancillary costs**
- **Dealing with rental collateral**
- Claims for **eviction and dismantling** are usually insolvency claims; landlords often have to carry out eviction / dismantling themselves and declare the costs; risk: delay in subsequent letting
- **Subletting** by the insolvency estate
- **Recommendation:** Balanced legally compliant and ESG-compliant rental contract adjustments.

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Reduction of VAT to stimulate the economy

"Second Corona Tax Assistance Act"

- Reduction of sales tax rates from 1.7.2020 to 31.12.2020 from 19% to 16% and from 7% to 5%
- Temporary increase of the loss carryback, Reduction of advance payments for 2019 and provisional loss carryback from 2020
- Introduction of degressive depreciation for movable assets
- Temporary extension of the reinvestment periods of § 6b EStG and § 7g EStG by one year
- Increase of the allowance for the additional elements of § 8 No. 1 GewStG to EUR 200,000 (e.g. interest on loans, charges for rent and leases)

Update on DAC6 reporting requirements

- Old cases (25.06.2018-30.06.2020) for which a reporting obligation exists must be reported by 31.08.2020
- Current cases (from 1.7.2020) must be reported within 30 days

DAC 6 = Offenlegungspflichten für grenzüberschreitende Steuergestaltung

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Tax implications of Refinance & Restructure

**Refinancings**

- **Increased refinancing needs:**
  - Interest rates in the light of the audit and ATADII

**Restructuring**

- Update Real Estate Transfer Tax Reform
- **OECD:** no effects of home office and travel restriction regulations on tax residency and permanent establishments for a period of 6 months
- **NoPE structures** - FG Berlin-Brandenburg, 9 K 11108/17 (Rev. pending I R 10/20)
Your questions to the PwC experts

- **Economic situation**
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- **Restructuring**
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PwC information about the New Normal and its impact on the real estate industry can be found here:

Current information about real estate also in the context of New Normal
https://blogs.pwc.de/real-estate/

Central email address for questions to PwC experts on New Normal
de_covid19_pwc_real_estate@pwc.com

PwC Plus - All information about real assets with push messages function
https://pwcplus.de/

Bi-weekly expert session via WebCast on current topics always Wednesday 10:00 to 11:00
The new normal – the future of the real estate industry

Next session on 02 September from 10:00 am

Registration via link: www.pwc-events.com/Real-Estate-WebCast