

Sellers call the shots

Clauses in real estate purchase agreements favour the seller because it is a seller's market, say law firms



BY **ROBIN MARRIOTT**

There are plenty of wise sayings about the art of winning a negotiation. But no matter how accomplished the lawyer might be for a buyer, the strength of the underlying property market is perhaps the greater deciding factor.

For some years now, Europe has been a seller's market. Sure enough, certain seller-friendly contractual terms have become increasingly frequent in purchase agreements. As Volker Zerr, a partner in CMS Germany, says: 'High and rising prices always point to a seller's market, and our detailed analysis of purchase agreements underlines how sellers are translating their strong negotiating positions into contractual advantage.'

CMS undertakes an annual study examining the frequency of clauses across the transactions it has acted on. The latest CMS Real Estate Deal Point Study was published in October. It is a 40-page study covering more than 1,300 transactions in 14 countries that CMS was involved in during the years 2010 to 2017.

It is very apparent from reading the report that sellers

have indeed enjoyed the upper hand. It seems they have felt empowered because of continuing high demand stemming from a lack of alternative investment options, low interest rates and a positive economic environment as well as limited supply.

These factors seem to mean that hungry bidders lining up for precious assets for sale have a weaker negotiating position and will therefore tend to comply with a seller's terms or else potentially miss out on the deal.

MAXIMUM LIABILITY CLAUSES

For almost all of the clauses it examined, CMS found that those ostensibly friendly to the seller have increased in use sometimes to reach record levels. For example, it found that in 66% of the 1,300-plus agreements it examined, those in 2017 contained a maximum liability clause. This does what it sounds like it does – restricts the amount a seller can be liable to the buyer for should the buyer have a grievance. Such a grievance might occur due to a defect with an asset or title it has acquired. CMS says 66% is the highest figure the firm has recorded in the seven-year period in question and is double the fre-

quency it recorded for 2010.

To limit a seller's liability in the first place is obviously an advantageous thing for a seller. It is now common practice to write individual liability provisions into agreements rather than to abide by statutory warranties, which can be more generous to the buyer. The proportion of agreements in which the statutory warranty provisions were not excluded (insofar as they exist in a particular country) was less than 10% in the period covered by the study, with the average being 6%. More to the point, the lowest level in the survey period was reached in 2017, at just 4%. Deals with individually-drafted liability provisions have thus become established as the absolute market standard in the past three years.

EXCLUSION OF LIABILITY

One of the most fascinating aspects of seller-friendly terms is to what extent a seller can restrict liability or warranties if the buyer had 'knowledge' of the issue it is complaining about (see chart). 'Knowledge' is a debatable thing and is therefore spelt out in agreements. Exclusion of liability if the buyer had knowledge of the issue or was negligent in not knowing is very common. For example, in 67% of contracts, a buyer agreed the seller would not be liable if the disclosure was made in the data room compared to 35% in 2013.

Terms are also more favourable to the seller when they address how long a buyer might have to make a claim. What the market now sees is the preponderance of short, seller-friendly warranty limitation periods of 6 to 18 months. Seller-friendly 'de minimis' and 'basket clauses' are also seller-friendly provisions that were agreed in more than half of all transactions in 2017. Furthermore, providing for a maximum contractual liability (a cap) was agreed in two-thirds of the evaluated agreements, the highest figure ever since 2010.

MARKET CONFIDENCE

But apart from demonstrating how sellers have been able to insist on terms to protect themselves, CMS' study also shows how some terms have become more common because of a sense of confidence in the real estate market.

A good example is the rise in provisions for purchase price adjustments. Purchase prices may not always be set in stone between the parties, particularly for forward purchase development agreements for which rental income might be an unknown quantity at the time a purchase contract is agreed. In the real world, the value of an investment would depend on what is achieved in terms of gaining a permit, the exact sq ft measurement, and the detail of rental agreements. Not only has there been an uptick in terms allowing for the future adjustment of the price but also in earn-out clauses. This is no doubt because sellers have been feel-

ing bullish about their development – enough to gamble on earning a higher price if certain objectives are met than accept a lower price upon signing. CMS says last year saw the highest figure so far in the period under review for purchase price provisions. The key factor in this respect is the high proportion of forward deals (development project transactions) over the past two years.

A second example of confidence among sellers is to do with the financial strength of a potential buyer. If sellers are concerned about a potential buyer's capacity to come through with the money they can insist on a mechanism. This can mean insisting on payment into an escrow account. But sellers do not seem overly bothered with this. CMS found the level has remained consistently at only around 50% in the last three years. 'One of the factors here is probably the high proportion of financially strong institutional investors on the buyer side,' the law firm says. It also reports a notary's escrow was used in 27% of sales in 2012 but that figure has fallen in the last two years. It has been more popular

'Sellers are translating their strong negotiating positions into contractual advantage in purchase agreements'

to seek advance payment on the purchase price, or a guarantee provided by a third party or an escrow operated by a law firm or bank. Such methods are found in 25% of deals.

COUNTRY IDIOSYNCRASIES

The other fascinating aspect of the study is how the use of clauses vary from country to country or at least European region. For example, though it is common for sellers to exclude liability for something the buyer 'knew', some countries seem to say this more than others. For example, in Germany and Austria, 83% of contracts have this clause but in Western Europe it occurs in 69% of deals and in other regions it drops to 50%. Again, in Germany and Austria, 58% of contracts exclude liability due to grossly negligent ignorance of facts on the buyer's part, but that kind of exclusion is only found in 11% of transactions in Western Europe.

Other regional differences pop up everywhere. For example, provisions for purchase price adjustment were agreed in an average of only 15% of the transactions analysed in the German-speaking countries. This figure is markedly lower than in Western and Eastern Europe (Western European countries: 33%; Eastern European countries: 49%).

Edited excerpts from CMS's Real Estate Deal Point Study 2018

LIMITS ON LIABILITY

When a buyer enters into a contract to acquire an asset, it wants the right to be able to claim against the seller perhaps if it turns out there is a defect in the property or title. But there are a few mechanisms in real estate contracts to minimise liability for the seller, and such clauses have been tipped in their favour in the past year. Here are some of the most common of them.

A liability cap

The seller stipulates that it cannot be liable for a figure above a stated amount. ***Finding:** CMS found that the year with the highest proportion of agreements with a contractually-agreed maximum liability clauses was 2017. It reached 66% in 2017, the highest-ever level in the period covered by the survey. The percentage has more than doubled since 2010. This clearly indicates a seller friendly trend. Looking only at transactions worth more than €100 mln, the proportion of agreements with a cap was even higher, standing at 82% in 2017.

A de minimus clause

In an opposite tactic to the liability cap, sellers can insist not to be bothered with trivial claims from buyers by stipulating a claim will only be considered if it exceeds a certain amount. ***Finding:** The highest figure in the period under review was reached in 2017 (50%) having already risen to 45% in 2016. This further increase reflects the strong bargaining position enjoyed by sellers.

A basket clause

These are closely connected with de minimus clauses and stipulate that the buyer can only assert a warranty claim if the aggregate of individual claims that exceed the de minimis threshold exceeds the basket threshold. A basket clause is consequently a seller-friendly provision. Just as with de minimus clauses, the percentage has risen from 45% of contracts in 2016 to the highest figure in the period under review - 50%.

Limitation period

It is in the interests of the seller to get the buyer to agree a maximum time limit after which a claim cannot be lodged against it. Limitation periods in real estate contracts are usually shorter than the statutory maximum allowed

under a country's own law. ***Finding:** There has also been a clear rise in the number of contracts that provide a limitation clause. CMS expresses this by saying the number of contracts without a limitation period (and thus leaving it to a nation's statutory limit which tend to be more generous to buyers) fell to just 18% of cases in 2017 from 56% in 2016. Furthermore, there has been a trend towards shorter limitation periods of 6 - 18 months in real estate contracts.

Knowledge

Things can go wrong in a real estate transaction that can upset a buyer. But the situations in which a buyer can claim against the seller for breach of warranty can, and frequently are, limited. One method is by excluding liability on the part of the seller if the buyer had knowledge of the relevant circumstance when the agreement was signed.

***Finding:** The chart here shows there was no provision for excluding liability when a buyer had knowledge of an issue in only 21% of cases. Clauses that restrict liability for information provided in the data room are now very common. They occur in 67% of contracts. Furthermore, contracts can contain 'objective' and 'subjective' clauses. An objective guarantee is buyer-friendly because it means the seller can be liable even if the seller was unaware of a problem. In 2015, the percentage of agreements that only included buyer-friendly 'objective' guarantees was 25% but fell in 2016 (15%) before plummeting to 5% in 2017. In contrast, the proportion of agreements in 2017 that only included subjective guarantees was significantly above the level of the previous years. A subjective guarantee will help the buyer only when the buyer

can prove the seller was aware of the issue. Notwithstanding the above, there is evidence of some evenness overall. The proportion of transactions including both objective and subjective guarantees has risen over the last three years from 63% in 2015 and 71% in 2016 to 75% in 2017.

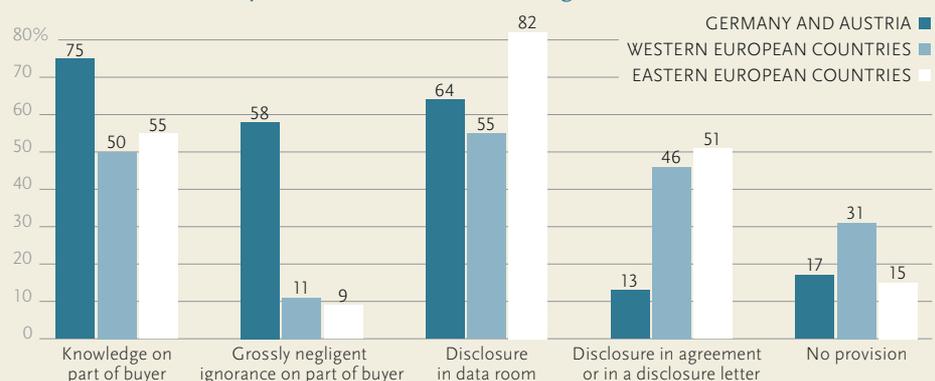
PROVISIONS FOR ADJUSTING THE PRICE

The contracting parties may agree either a fixed price or a variable price. ***Finding:** Last year saw the highest figure so far in the period under review. The key factor in this respect is the high proportion of forward deals (development project transactions) over the past two years, in which sellers benefited from positive market trends through purchase price adjustments and earn-out clauses. It should be noted, however, that purchase price adjustment clauses are still not the norm across real estate deals as they exist in about 28% of cases.

SAFEGUARDING PAYMENT

This is yet another mechanism designed to safeguard a seller. The seller wants to be confident a potential buyer is good for the money. One option is to insist on the buyer paying funds into an escrow account. ***Finding:** It is actually quite common for there to be no such protection for the seller, so this is one area where it cannot be said terms have reflected the seller's market. Overall, CMS says the percentage of contracts where there was no safeguarding mechanism in fact rose to 53% in 2017 from 52% in 2016. One of the factors in this rise is probably the high proportion of financially strong institutional investors, such as pension funds and insurance companies, the law firm says.

Exclusion of liability in the event of knowledge



SOURCE: CMS

Limits on liability such as de minimis clauses (28%), basket clauses (23%) and liability caps (36%) were agreed less often in the Western European countries than in transactions conducted in the German-speaking and Eastern European countries. Compared with other countries, limits on liability such as de minimis clauses (68%), basket clauses (53%) and caps (87%) were agreed with much greater frequency in the Eastern European countries.

CORROBORATION

It is not just CMS that is aware of the trends highlighted above. Other legal advisers contacted by PropertyEU concur the market has given rise to more seller-friendly terms. Evan Lazar, co-chairman of the Global Real Estate Group at Dentons who leads a team of 300 lawyers across Europe, says his firm has seen a rise in instances when warranty and indemnity insurance is used to offer protection in the case of a breach of a warranty by the seller.

Lazar says that two or three years ago, buyers would ask sellers for escrow or guarantees when they were perhaps concerned about the seller's financial strength to back its

'We are seeing sellers saying to buyers: either accept the minimal warranties or pay the costs of warranty insurance'

warranties and indemnities. They might also be concerned about a seller's attempt to put a cap on liability.

'What we are seeing in 2018 where there are more buyers than sellers is that sellers are saying to buyers either that they accept the minimal warranties or pay the costs of warranty insurance,' says Lazar. 'We do not see that on every deal, but it is a trend that we have seen on many.'

Ciaran Carvalho, co-chair of CMS Global Real Estate Group, agrees. 'On sales and purchases of corporate vehicles, warranty and indemnity insurance is increasingly the norm. That means transactions can take a week or two longer, but it helps those sellers who want a cap on liabilities.' ■

Artificial intelligence and globalisation come to the fore

Eversheds Sutherland was instructed on one of the most coveted UK sell-side instructions of the year – the privatisation of Network Rail's £1.46 bn (€1.57 bn) commercial property portfolio. Network Rail is a longstanding client of Eversheds Sutherland and is responsible for managing most of Britain's railway network. It took the decision in November 2017 to offload a portfolio of around 5,200 commercial real estate railway arch assets, which Telereal Trillium and Blackstone eventually succeeded in being

selected to buy in September 2018.

David Watkins, the law firm's co-head of global real estate, said elements of the instruction highlighted two big themes in real estate law: the use of technology and globalisation.

He said artificial intelligence systems, such as Kira and Luminence, in which Eversheds Sutherland has invested, allowed automation of parts of the due diligence work on thousands of underlying leases and other documents in around 15 hours – work that a team of lawyers would have taken over two

weeks to do. 'The majority of clients expect us to have technology solutions, and it is a question of how to deploy it and make use of it,' said Watkins.

The mandate also reaffirmed a decision by the company to provide clients with dedicated sectoral teams following globalisation trends.

One of the products Eversheds Sutherland has developed is Global Estate Management. This mirrors sector-specific teams that lawyers are grouped in such as real estate transport, real estate technology and real estate energy. Watkins explained the practice's offering to corporate occupiers 'What we find with major corporates is that they occupy vast portfolios of property throughout the world that is not core to their business. That is a challenge. Major companies with property all over the world do not want to work with 60 different law firms but with one that provides consistency of documentation, pricing and service. Being aligned to their sectors such as energy, transport, natural resources, financial institutions or technology provides a response to those challenges.' [See page 18](#)



Revealed: the top law firms for Europe's large cap deals

For the first time, the law firms active in Europe's biggest transactions have been tracked and here we present the results

BY **ROBIN MARRIOTT**

Which law firms do property owners appoint on the largest European real estate deals? In the first project of its kind for PropertyEU, we have decided to answer that question.

Our debut law firm tracker (see opposite page) shows who acted on the top 25 real estate equity deals of 2018 ranked by size of transaction. The tracker has been compiled using our proprietary pan-European database of real estate transactions and gathering intelligence on which firms acted for buyer and seller.

Most of the information on which law firm acted in each instance has come directly from the law firms and/or the buyers, sellers or other advisers to the transaction. Where there were any gaps, we conducted desk research. In some instances, law firms volunteered details of individual lawyers, which we have included. We capped this inaugural list at the largest 25 transactions, but the tracker is open to be extended in 2019.

The threshold for a top 25 equity ranking of transactions this year was €586 mln. Transactions of that minimum size occurred in

Top law firms

THOSE THAT ACTED ON TWO OR MORE TOP 25 TRANSACTIONS

APPEARANCES IN TOP 25

1 Clifford Chance	9
2 CMS	5
3 Allen & Overy	4
4 Loyens & Loeff	3
4 Linklaters	3
5 Dentons	2
6 Goodwin Procter	2
7 Herbert Smith Freehills	2
8 Freshfields	2
10 Houthoff	2
11 Gibson Dunn	2
12 Taylor Wessing	2

SOURCE: PROPERTYEU RESEARCH

six different countries (Spain, the UK, Netherlands, Germany, France, and Finland). As well as noting every law firm involved, we also publish a league table above showing which advisers show up most frequently. The table lists those that acted on two or more of the top 25 transactions during 2018. In total, the ranking finds that 11 law firms managed to act

on two or more of the biggest deals of 2018.

Clifford Chance, the London-based global firm, takes the plaudit for being the most active law firm in Europe's top 25 transactions having acted in 9 out of the 25. Those deals included the largest of them all – the €5 bn sale of 68,000 assets and a servicing platform by Spanish bank BBVA to Cerberus Capital Management. In second spot is CMS, having acted on 5 deals, with Allen & Overy in third place.

Jonathan Solomon, global head of real estate at Clifford Chance, said: 'Clifford Chance has had an extremely busy year advising clients on large transactions across Europe. It is clear that the real estate market has benefited from strong demand among investors and this looks set to continue into 2019 notwithstanding potential headwinds. Looking at the pipeline of transactions Clifford Chance is involved with, it seems that 2019 is likely to continue to see significant activity in the logistics, residential and healthcare space as well as in offices. We are delighted to have been named the most active firm in large cap transactions and we welcome PropertyEU's initiative.'

Star lawyer of 2018

Clifford Chance's Carlos Portocarrero de las Heras is a star lawyer who acted on the largest deal in Europe and the fifth largest – both of which took place in Spain. He has been a partner at Clifford Chance in Madrid since 2002. Chambers Europe describes him as known for his 'excellent corporate real estate work'. Chambers also said interviewees describe him as 'splendid, a very reliable lawyer with fantastic technical skills' and, in

a possibly humorous comment, 'also with very good manners'! He advised Spanish bank BBVA on the sale to Cerberus of 68,000 REOs with an appraisal value of €13 bn and a servicing platform including 450 employees. The transaction was structured through the contribution of all assets to a company in which BBVA retained 20% and Cerberus acquired 80%. The transaction was closed in October 2018 and the



CARLOS PORTOCARRERO DE LAS HERAS

deal value was €5 bn. Portocarrero de las Heras also led Clifford Chance in advising Cerberus in the acquisition from Banco Santander of a residential portfolio with approximately 35,700 assets with an appraisal value in the region of €4 bn and a price exceeding €1.5 bn. The investment by Cerberus is structured via the acquisition by a newly incorporated company of the

whole portfolio, with Santander retaining a minority stake in the company.

Top 25 Deals 2018

ASSET NAME AND CITY	TYPE	COUNTRY	BUYER	LAW FIRM FOR BUYER	PRICE €MLN	LAW FIRM FOR SELLER
68,000 assets and servicing platform, across Spain	M		Cerberus Capital Management	Linklaters	5,000	Clifford Chance (Carlos Portocarrero de las Heras) (BBVA)
5,200 railway commercial properties, across UK			Telereal Trillium/Blackstone	Kirkland & Ellis (Michael Steele, Carlos Gil Rivas), Gowling	1,640	Eversheds Sutherland led on the transaction, with Clifford Chance (Network Rail)
5 shopping centres, the Netherlands			ARC Real Estate Partners-led consortium	Loyens & Loeff	1,600	Houthoff (CBRE Global Investors)
6,777 residential assets in Amsterdam/Amstelveen/Utrecht			Vesteda Investment Management	Allen & Overy LLP, Buren Legal and Loyens & Loeff	1,509	Houthoff (NN Group)
35,000 REO portfolio			Cerberus Capital Management	Clifford Chance (Carlos Portocarrero de las Heras)	1,500	Uría Menéndez (Banco Santander)
Plumtree Court, London			LaSalle IM for NPS	DWF	1,296	Linklaters (Goldman Sachs)
5 Broadgate UBS HQ, London			CK Asset Holdings	Clifford Chance (Nick Rees)	1,100	Herbert Smith Freehills (British Land & GIC)
14 four and five-star hotels, UK			Foncière des Régions	Macfarlanes	976	Paul Hastings (Michael James), (Starwood Capital)
33 residential assets, Century portfolio			PFA Pension Fund	Gorissen Federspiel (Søren Fogh)	900	Heussen (Industria Wohnen)
6,458 residential properties, Spain (70% in Madrid)			CBRE GIP/Madison	Jones Day, Pérez-Llorca	870	Freshfields (Azora)
20 UK hotels			Dayan Group Real Estate	Taylor Wessing	843	Gibson Dunn & Crutcher (Apollo Global Management)
50% stake in a portfolio of 71 post-acute hospitals, Germany			Primonial REIM	Clifford Chance	820	Goodwin Procter, Arendt & Medernach (Medical Properties Trust)
Capital 8, Paris			Invesco Real Estate	Linklaters, Victoires Notaires Associés, Archers	789	Maître François Thomé, SCP Ginisty & Associés and Lacourte Raquin Tatar
123 grocery stores, Finland			Cibus Nordic Real Estate	Aleksandra Attorneys, Clifford Chance	767	Roschier (Sirius Fund I Grocery and Sirius Fund II)
Ropemaker Place, London			Ho Bee Land	Dentons	742	CMS UK (AXA)
Omniturm, Frankfurt am Main			Commerz Real	Taylor Wessing	700	Freshfields Bruckhaus Deringer
30 nursing homes, mostly Hamburg			Deutsche Wohnen	n/a	680	Hengeler Mueller (Oaktree)
5 micro-apartment projects, Germany			BVK (Corestate/Universal)	GSK Stockmann	670	Rechtsanwalt (CG Gruppe)
Trianon, Frankfurt am Main			IGIS Asset Man./Hana Financial Inv.	Allen & Overy, Goodwin Procter	670	Clifford Chance (Northstar Realty Corp)
Devonshire Square Estate, London			WeWork, TH Real Estate, PFA Pension	Gibson Dunn & Crutcher, Allen & Overy, Bech-Bruun, CMS UK, Clifford Chance (Andrew Carnegie, Alis Pay)		Herbert Smith Freehills (Ian Cox) (Blackstone Group)
Goodman Azurite portfolio, Germany/Poland/France			Blackstone Group	Clifford Chance (Janicka Kruzewski Namiotkiewicz)	640	Allen & Overy (Goodman Group)
Mesdag Delta portfolio, Netherlands	M		Highbrook Investors	Loyens & Loeff, Bryan Cave Leighton Paisner	615	Dentons Boekel, CMS Netherlands (Breevast)
Alpha Industrial, portfolio of 16 properties, Germany and Austria			Frasers Property Europe	Clifford Chance (Frankfurt)	600	CMS Germany (Alpha Industrial Holding)
Apple store Champs-Élysées, Paris			Hines/Universal-Investment (BVK)	Lacourte Raquin Tatar, Mayer Brown, Freshfields Germany	600	White & Case, TAJ and Franklin (EPI Group)
Enigma student portfolio, UK			Brookfield Property Partners	Mishcon de Reya, Allen & Overy adviser to Davidson Kemper as financier (Leon Hoppenbrouwers)	586	CMS UK (Curlew Capital, CBRE Global Multi Manager)

SOURCE: PROPERTYEU RESEARCH