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UPDATE ON DUTY TO MAINTAIN PROPERTY CONDITION UNDER TENANCY LAW AND IN REAL ESTATE LEASING

On 18 March 2015, the German Federal Court of Justice (Bundesgerichtshof – BGH) laid and confirmed the new groundwork for assessing the validity of maintenance clauses under residential landlord-tenant law in not one but three decisions. Here we provide you with an update concerning the duty to maintain the condition of leased property under residential and commercial landlord-tenant law as well as current information on real estate leasing contracts.

1. Initial Situation

If the parties do not agree otherwise, statutory landlord-tenant law provides that the landlord is responsible for maintaining the leased property in a condition suitable for use. This duty to maintain the property can, however, be contractually assigned to the tenant, also in general terms and conditions of business within certain limits. The Federal Court of Justice has now further restricted these limits.

2. Invalidity in the Case of Unrenovated Residential Property

Contrary to previous jurisprudence, a standard form clause imposing the duty to carry out decorative repairs on a tenant who has leased residential property that has not been renovated or is in need of renovation without fair compensation is invalid (decision of 18 March 2015 - VIII ZR 185/14). This has serious consequences for the landlord – the landlord is responsible for maintaining the condition of the leased property to the full extent, especially without limitation to the unrenovated areas of the leased residential property.

Such a clause is invalid because it breaches the applicable basic principle that the tenant can only be obligated to carry out renovation work that is attributable to the tenant's own lease term. This type of clause would transfer the responsibility for the traces of use of the previous tenant to the current tenant. Consequently, the current tenant would be obligated to carry out premature decorative repairs and improve the condition of the property to better than when the tenant received it from the landlord.

When drafting future contracts, a question arises over whether it is possible to limit the assignment of the duty to carry out decorative repairs to only the renovated parts of the leased property. The Federal Court of Justice has expressly left this question unanswered. In any case, the following two parameters are decisive when assessing the validity of such clauses:

2.1 When is the leased property considered renovated or unrenovated?

The differentiation between a 'renovated' and 'unrenovated' residential property depends on whether or not the leased property gives the overall impression of a renovated housing space according to the circumstances of each individual case:

- The residential property is thereby not first then considered unrenovated if it has been subject to excessive wear and tear or is completely worn down.
- On the other hand, insignificant wear and tear and traces of use do not already constitute an unrenovated condition.
- It is not always necessary for the housing space to have been completely and freshly renovated at the beginning of the lease in order for the leased property to be considered renovated. In individual cases, minor retouching work can also be sufficient.
- The tenant has the burden of proof with regard to the requirements for the invalidity of a clause concerning unrenovated housing space at the beginning of the lease.

2.2 When is the provided compensation fair?

The compensation that the tenant receives is considered fair if it compensates the tenant for the additional renovation expenses (e.g. by waiving the rent) in such a way that the tenant is placed in a position as if the tenant had been provided with renovated housing space.

3. Invalidity of Quota Compensation Clauses

With so-called quota compensation clauses, in the past, a landlord was able to assign the tenant a portion of the future costs for decorative repairs with the approval of the Federal Court of Justice, in the case that the tenancy should end prior to the date on which such decorative repairs were to be carried out by the tenant.

The Federal Court of Justice has now declared that quota compensation clauses are invalid (decision of 18 March 2015 – VIII ZR 242/13). This is because such clauses require the tenant to take a number of hypothetical factors into consideration in order to determine the financial burden arising for the tenant at the end of the lease, which do not allow for a reliable and realistic estimation of the actual financial burden.

4. Nothing New in Terms of Strict Deadlines

In an additional decision, the Federal Court of Justice confirmed its jurisprudence concerning the invalidity of strict deadlines (decision of 18 March 2015 – VIII ZR 21/13). According to this decision, general terms and conditions, which assign the tenant the duty to carry out decorative repairs, can only withstand a review in terms of their content if the deadlines for the renovations contained in the clause are not strict and unchangeable, but leave room to take the concrete need for renovations of the leased premises into consideration due to their flexible structure so that the agreed deadlines ultimately only have the character of a guideline or non-binding orientation.

It is important for the contract to have a consistent structure. If a contract partly contains a (valid as such) regulation that depends on the need for renovations and partly contains a (invalid) regulation with strict deadlines, the required overall assessment of the regulations will lead to the invalidity of the entire clause.

5. What Applies for Commercial Lease Agreements?

5.1 Applicable requirements

The decisions presented above were made with regard to residential landlord-tenant law. However, the Federal Court of Justice has already transferred the jurisprudence developed for decorative repair clauses under residential landlord-tenant law to commercial landlord-tenant law to a large extent in the past, especially with regard to the invalidity of strict deadlines and clauses on final renovations (cf. BGH, decision of 12 March 2014, XII ZR 108/13). It has not yet been decided at present whether such a transfer will also be made with regard to the new decisions concerning unrenovated leased premises and quota compensation clauses.

In any case, it should be noted that the Federal Court of Justice has already used the criteria of (a lack of) controllability and manageability for the tenant expressed in the new decisions as decisive factors in commercial landlord-tenant law (decision of 26 September 2012 - XII ZR 112/10). The duty to maintain the leased property that is transferred to the tenant must be manageable and within the control of the tenant. The manageability can be ensured by agreeing a reasonable maximum cost limit. The controllability can be achieved by limiting the tenant's duty to maintain the property to only those damages, which are attributable to the tenant's use of the property or sphere of risks.

Under commercial landlord-tenant law, it is therefore invalid, for example, to agree a duty of the tenant to maintain the condition of common areas or facilities, which are usually provided in a used condition, without agreeing a reasonable maximum cost limit. This is because the tenant will thereby be assigned the responsibility for already existing wear and tear and the actions of third parties that are not attributable to the tenant (no controllability) and the costs of which are not foreseeable for the tenant (no manageability).

5.2 Further structuring options

We would also like to highlight an additional decision of the Federal Court of Justice, which introduces two situations in which the restrictions concerning the validity of such clauses, which also generally apply in commercial landlord-tenant law, do not apply (decision of 26 November 2014 – XII ZR 120/13):

5.2.1 Individual agreements

A tenant can principally be obligated to carry out repairs and maintenance work to a large extent on the basis of an individual agreement even if this ultimately leads to a strict liability of the tenant. However, this option often fails because the landlord is unable to successfully prove the existence of an individual agreement and refute prima facie evidence of general terms and conditions of business.

5.2.2 Real estate leasing

The object, purpose and particular nature of the respective contract can lead to typical interests of the contracting parties, which speak in favour of the validity of otherwise invalid clauses on maintaining the condition of the leased premises, as the Federal Court of Justice decided in the case of real estate leasing agreements.

This type of agreement represents a special form of financial leasing with the purpose of financing the acquisition of real estate or the construction of buildings and structures. This situation is characterized by the following:

- The lessor provides the lessee with real estate against payment of remuneration in instalments for the use of the real estate for a contractually agreed fixed period of time, whereby a purchase right of the lessee is not required by definition;
- The lessee is thereby solely responsible for the risk and liability with regard to maintenance, material defects, destruction and damage of the real estate; and
- The payment instalments of the lessee fully cover the acquisition and construction costs as well as all ancillary costs including the financing of the lessor (if applicable, supplemented by a tenant loan).

Due to the fact that the lessee acquires a legal position, which is more comparable to the legal position of an owner than of a tenant, and due to the specific interests of the lessor in maintaining the value and security of the real estate, the lessee can also be assigned the responsibility for maintaining the condition of the property in general terms and conditions of business to a greater extent in the case of a real estate leasing agreement than would be possible in the case of a commercial lease agreement.

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