# The Real Estate Law Review

Eighth Edition

**Editor**
John Nevin

The Law Reviews

# THE REAL ESTATE LAW REVIEW

EIGHTH EDITION



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THE LAWREVIEWS

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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 978-1-83862-009-7

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

# ACKNOWLEDGEMENTS

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

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO

ALLEN & OVERY SCS

AL TAMIMI & COMPANY

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# PREFACE

I am delighted to introduce the eighth edition of *The Real Estate Law Review*. The continued success of the *Review* confirms its relevance to real estate practitioners and their clients. Real estate is increasingly viewed on a global basis and readers can only benefit from a general understanding of how individual jurisdictions operate within the global real estate market.

This edition extends to 31 jurisdictions, and we are delighted to welcome new contributions from distinguished practitioners from around the world. I am very grateful to all contributors for their hard work and essential role in compiling this eighth edition. Each chapter provides an invaluable insight into key legal issues and market trends in the author's jurisdiction and, together, they offer an up-to-date synopsis of the global real estate market.

The *Review* seeks to identify distinctions in practice between the different jurisdictions by highlighting particular local issues. We believe that this offers investors and occupiers and their professional advisers an invaluable guide to real estate investment outside their own domestic market. Overseas investors are increasingly prepared to look beyond traditional markets and sectors to exploit international opportunities as and when they arise. Often, investors need to act quickly, and we hope that the *Review* provides an advantageous starting point to understanding cross-border transactions in the light of the reader's own domestic forum.

International economic and political instability continues to have a significant effect on the global real estate market. In the UK, Brexit-generated uncertainty remains as negotiations for leaving the EU are still ongoing as we approach the 29 March 2019 deadline. However, the continued attraction of UK real estate to overseas investors confirms that each event or development in a particular country must be seen in a global context to ascertain the bigger picture. It is no longer possible to ignore globalisation and view real estate markets in isolation. Brexit notwithstanding, the UK remains a safe haven for investors from around the world, and investment levels in London and the wider UK market remain buoyant.

In addition to all the distinguished authors, I would like to thank the members of the Law Review team for their tireless work in compiling this eighth edition of *The Real Estate Law Review*.

**John Nevin**
Slaughter and May
London
February 2019

**Chapter 10**

# ENGLAND AND WALES

*John Nevin*[1]

## I INTRODUCTION TO THE LEGAL FRAMEWORK

### i Ownership of real estate

The two main types of ownership of real estate in England and Wales are freehold and leasehold. Freehold is, in effect, absolute ownership for an indeterminate period, whereas leasehold is a right to possession and use of land for a limited period; the landlord retains its interest and grants the leasehold interest to the tenant for the term of the lease. Ownership of land also includes ownership of any buildings or other structures attached to the land and, as a general rule, includes the subsoil beneath and the airspace above the land.

Generally, freehold interests are more attractive to investors because they are not subject to termination and there are fewer restrictions on the owner, whereas a tenant is constrained by the terms of a lease. That said, long leasehold interests are often held for investment purposes. In central London in particular, properties may be owned by the Crown Estate, trusts, charities or other entities that may choose not to dispose of their freehold interests as a matter of policy, and will instead grant long leases. It is also common for leaseholds to be used when structuring joint ventures, and other arrangements and structures where owners wish to retain an element of control by imposing positive covenants.

A leasehold property held as an investment should be distinguished from an occupational lease, which is typically granted for between five and 20 years subject to a market rent, and therefore has a negligible capital value. An investment leasehold interest will most likely be granted for a term of between 99 and 250 years, at a premium. There are generally fewer onerous obligations on the tenant of a leasehold property held as an investment. The income generated from most investment properties is in the form of rent paid under occupational leases.

A relatively new form of land ownership called commonhold was introduced in England and Wales by the Commonhold and Leasehold Reform Act 2002. Commonhold comprises a freehold unit within a larger development and membership of the company that manages the common parts. As such, commonhold is suitable for residential flats as well as commercial developments such as shopping centres; however, its use has not been adopted by the property industry and it remains a rarity.

### ii System of registration

Most freehold and long leasehold titles are registered at the Land Registry; however, a number of unregistered titles remain, and these will generally only become registered once there has

1 John Nevin is a partner at Slaughter and May.

been a dealing with the land that triggers a requirement for 'first registration'. Trigger events include sales, mortgages and leases granted for more than seven years. Until a trigger event occurs, titles will usually remain unregistered. Registration fees are payable, calculated by reference to the type of transaction and the price paid.

Registration at the Land Registry provides a state guarantee of title. Compensation is payable if loss is suffered because of a mistake on the register. Therefore, there is no separate US-style title insurance regime. The registered title has a unique title number and identifies the extent of the land on a plan. The register also provides details of the property, including any rights that benefit it, and identifies the owner and any rights or matters adversely affecting the property, including financial charges. It also includes the purchase price at which the owner acquired the property and the purchase date, if done so through an asset as opposed to a share purchase. If the property is leasehold, brief details of the lease are included. Various short leases and rights of occupation are not, however, required to be registered in their own right. These and some other non-registrable interests will bind a purchaser, and should be uncovered by the purchaser's due diligence process. Accordingly, the information on the register cannot be treated as being comprehensive. Documents and other information held by the Land Registry are widely available to the public, although it may be possible to protect certain commercially confidential provisions for a limited period.

The government is proposing to introduce a register of the beneficial owners of overseas companies acquiring real estate in the UK. Draft legislation has been published and the new register is expected to become operational in 2021.

### iii Choice of law

Dealings with real estate in England and Wales will be covered by the law of England and Wales. Although a contract may include an express choice of governing law, which in general the courts will uphold, English law will still apply in relation to the transactional formalities that involve English and Welsh real estate.

Real estate law in England and Wales is different from real estate law in Scotland, Northern Ireland, the Channel Islands and the Isle of Man, and thus specialist advice is required where these jurisdictions are involved. Because of tax planning, property ownership vehicles are often incorporated in the Channel Islands, although the benefits of holding UK real estate through offshore vehicles will decline markedly following changes to the tax rules expected to take effect from April 2019, when non-residents will be brought fully within the scope of capital gains tax on disposals of UK real estate.

## II OVERVIEW OF THE MARKET

Brexit has continued to generate uncertainty in the real estate market as the negotiations for leaving the EU continue. However, the continued attraction of UK real estate to overseas investors confirms that Brexit must be considered in a global context to ascertain the bigger picture. To many overseas investors, the announcement in the 2017 Budget that gains made on direct and indirect disposals of UK commercial property by non-residents will from April 2019 be subject to tax is of far greater significance than Brexit. The proposed introduction of a new beneficial owners register for overseas entities owning UK real estate may also deter investment and will add a new administrative burden.

Indications are that whether the UK is within the EU or not seems unlikely to affect the attraction of the UK as a place to live and work and where investors wish to invest their capital. Last year saw record levels of investment in central London from overseas buyers, with investment from the Asia-Pacific region, and in particular Hong Kong, once again at the forefront. The effect of investment capital control measures on Chinese investment has been offset by interest from Malaysia, Singapore, South Korea and the long-awaited return of Japan. Japanese funds have begun to look further afield for healthy rates of return and UK real estate is expected to be a target. Brexit notwithstanding, the UK remains a safe haven for investors from around the world wishing to invest their capital. The continued weakness of the pound, historically low interest rates and the relatively robust state of the economy have helped ensure that the UK remains open as a place to do business.

The office market has seen a steady 2018 as lower investment levels have been offset by healthy occupier activity and a shortage of suitable available stock. Although take-up has softened as businesses evaluate their post-Brexit strategies and requirements, there have been some significant deals, with Deutsche Bank committing to nearly 46,000 m$^2$ of City space and Facebook confirming its requirement for up to 65,000 m$^2$ of new space. Overseas investors have been particularly active in London's midtown office market with the largest deal being the acquisition of Goldman Sachs' new London headquarters by Korea's National Pension Service. The rapid growth of the co-working office sector has seen the emergence of significant new operators such as WeWork, which acquired the 58,000 m$^2$ Devonshire Square estate. The demand for affordable, flexible and well-connected space with high levels of service provision has been fuelled by the new wave of tech and media occupiers and also by more traditional occupiers valuing the ability to expand and contract their requirements on a short-term basis. The office market is evolving rapidly and investors must know their customers if buildings are to meet the requirements of business occupiers. Tenants are seeking much more favourable terms and landlords need to differentiate their buildings with more thought given to communal space to secure the best tenants. Real estate is traditionally a slow-moving industry, but this is changing as the sector reacts to evolving demographics and new living and working practices. London is the leading European city for proptech and seems likely to remain so for the foreseeable future. The serviced office space boom has also extended to regional centres with a growing tech and media sector, such as Manchester, Glasgow, Birmingham, Milton Keynes, Cambridge and Oxford. Channel 4's new national headquarters in Leeds and its new creative hubs in Glasgow and Bristol should prove to be catalysts for creative industries in those cities.

The retail sector is going through a period of transition as traditional retailers re-evaluate their requirements for space and online retailers experiment with the use of physical space to showcase their products and lifestyle aspirations. The high street is changing as retail is being replaced by leisure and experience occupiers and surplus units are undergoing a change of use, mainly to residential. Shopping centres and retail parks are also evolving to offer a more general leisure experience. Well-known names in the mainstream retail and restaurant sectors continue to struggle, including Toys R Us, Maplin, New Look, Poundworld, House of Fraser, Carpetright, Mothercare, Jamie's Italian, Byron and Prezzo, while the luxury central London market continues to benefit from the enhanced spending power of overseas visitors. The use of company voluntary arrangements by insolvent occupiers to restructure their debt is facing increased hostility from landlords in the retail and restaurant sectors, where many have been forced to accept reduced rents and closed outlets. The industrial sector remains strong with demand for large, high-specification distribution centres particularly robust in the logistics sector. The total volume of industrial portfolio investment is expected to exceed that for 2017.

Activity outside the traditional office, retail and industrial sectors continues to grow as investors look to alternative assets for new opportunities. Institutional investors continue to increase their market share in the private rented sector as traditional 'buy-to-let' investors have been hit by a less favourable tax regime. The specialist retirement living market has developed, offering a wider product range to meet the growing demands of an ageing population. The hotel and leisure sector has benefited from high levels of overseas visitors and a growing 'staycation' domestic market. Investors have extended their interest beyond trophy hotels in the central London market and have been looking for value across the sector and outside London, with rental growth being strongest in Glasgow, Liverpool and Birmingham. Other alternative asset classes of interest to overseas investors include student accommodation, data centres, logistics, energy and infrastructure. Investors will continue to look for growth potential in less obvious assets and sub-markets, prompted by stiff competition for prime assets in the traditional sectors.

The residential property market has fared better in the regions, where house price growth can be contrasted with stagnant or falling prices in London. The slowdown in the prime central London residential property market has continued and has spread to the wider London market. Overseas and domestic buyers have been deterred by inflated prices, oversupply, punitive rates of tax and Brexit, all of which have contributed to weaker demand. The government's proposal to introduce an additional 1 per cent SDLT surcharge (see Section V.iii below) on non-residents acquiring residential property in England and Northern Ireland will not have helped. Outside London, the West Midlands has seen the fastest growth and Birmingham will benefit further from hosting the 2022 Commonwealth Games. Manchester has also been a particular hot spot, boosted by the relocation of both public and private sector jobs from London.

In financing, there has been a decline in loan originations for UK property, with banks in particular taking a noticeably more cautious approach. However, alternative lenders have continued to increase their funding activity and market share. Significant new entrants in the non-bank lending market have included fund managers and insurance companies looking for relatively safe long-term returns.

## III FOREIGN INVESTMENT

Overseas investors are able to own, sell and lease real estate in England and Wales without any legal restrictions. A legal opinion may be required to confirm that an overseas investor has legal power to enter into a transaction involving property in England and Wales, to deal with the property and to execute the relevant documents.

## IV STRUCTURING THE INVESTMENT

A number of alternative structures are available for direct or indirect investment in real estate in England and Wales. The decision how best to structure an investment is likely to be dictated by tax considerations, and it is important to ensure that appropriate tax advice is sought, taking into account both UK tax legislation and that of the investor's own jurisdiction. There are, however, a number of advantages and disadvantages to each structure, which may also prove critical depending on the investor's particular objectives.

### i Corporate entity

A company can hold assets in its own name and create floating charges. There is potential for flexibility in terms of share structure, and there can be the advantage of limited liability. More generally, corporate entities are widely recognised, and can promote a strong and legitimate identity. Nonetheless, there is a lack of confidentiality in comparison with other investment structures and the added administrative burden of complying with the relevant regulatory framework. There is also a lack of tax transparency, and it may be expedient to base the company offshore.

### ii General partnership

Whereas property co-ownership is not in itself sufficient, the active, joint management of property may constitute a partnership; it is a matter of substance rather than form. The main advantage is tax transparency, while the main disadvantage is the unlimited liability of the partners.

### iii Limited partnership

In a limited partnership, investors will be limited partners who are only liable to the extent of their investment. This limited liability is particularly advantageous when coupled with the tax transparency that, to an extent, is offered by a limited partnership. However, a limited partnership must comply with the Limited Partnerships Act 1907, and a limited partner should not become involved in the management of the partnership. This may prove to be unduly restrictive for investors looking to actively manage their real estate investments. The limited partnership regime has been modernised by the introduction of a new private fund limited partnership to help meet the needs of fund managers.

### iv Limited liability partnership (LLP)

LLPs are governed by the Limited Liability Partnerships Act 2000 and combine limited liability for members with the tax transparency of a partnership. LLPs are not subject to the same restrictions as limited partnerships, and partners are able to actively manage the business of the LLP. Furthermore, an LLP is a body corporate (having a legal entity separate from that of its members), so there are no issues as to the legitimacy of floating charges. If the LLP is a collective investment scheme, it must be operated by an authorised person in accordance with the Financial Services and Markets Act 2000 (FSMA).

### v Property unit trust

A property unit trust is an open-ended fund that allows pooled investment and is tax-efficient. A unit trust is governed by a trust deed, and as such may be an unfamiliar structure to certain overseas investors. One drawback may be the need for authorisation under FSMA. Offshore unit trusts are popular, and can provide further tax advantages because of their offshore status (albeit that such advantages will be largely curtailed from April 2019); Jersey property unit trusts in particular have been used extensively in recent years. However, there may still be local regulatory supervision, and the fact that the trust must be managed outside the UK may be undesirable for certain investors and difficult to achieve.

### vi Property authorised investment fund (PAIF)

PAIFs are open-ended investment schemes that invest in property and are authorised under FSMA. The PAIF regime allows gross dividends to be paid, and was introduced to make property attractive to tax-exempt investors. A number of conditions apply for entry into the PAIF regime, including the need to carry on a property investment business and the genuine diversity of ownership condition. PAIFs benefit from SDLT seeding relief.

### vii Offshore vehicle

Offshore vehicles can take advantage of lighter regulatory and tax regimes. As well as Jersey, popular offshore locations include Luxembourg, Guernsey, the Isle of Man, the British Virgin Islands and the Cayman Islands.

### viii Listed property company

Investing in a listed property company offers a popular means of investing in UK real estate. Listed property companies can benefit from a high profile and augmented credibility as well as greater liquidity. The drawbacks include stringent regulatory and filing obligations, and a general lack of confidentiality. In addition, listing may be costly and places extra pressure on the company management to perform. The investor also has limited control over the underlying real estate assets.

### ix Real estate investment trust (REIT)

Based on an investment structure first developed in the United States, REITs were introduced in the UK in 2007. REITs are tax-efficient, as they are exempt from tax on income and capital gains arising from property rental business; distributions of profits are treated as property income in the hands of the shareholders and are generally subject to withholding tax at 20 per cent. To gain REIT status, a company must comply with a number of conditions, including a requirement to be listed and either widely held or owned by specified types of 'institutional investor' (such as pension funds), and have property rental business as their predominant activity.

### x Property joint venture

Joint ventures allow parties to share risk, and therefore provide a particularly attractive investment structure while the availability of debt remains constricted and investors are keen to mitigate risk exposure. A property joint venture can be structured in whatever form the parties choose, and in many cases may involve more than two parties. Of course, as well as sharing risk, parties share gains and management, so joint venture provisions need to be considered carefully.

## V REAL ESTATE OWNERSHIP

### i Planning

The planning administration in England and Wales primarily consists of local planning authorities (LPAs) and the Secretary of State for Communities and Local Government. The Mayor of London is also able to exercise specific planning powers at a London-wide level, including the power to decide strategically important planning applications. Planning administration is governed by various statutes, the most important of which is the Town and

Country Planning Act 1990. In general, planning permission is required for development, including material changes of use, although certain restricted types of development are automatically granted planning permission under the Town and Country Planning (General Permitted Development) Order 2015. Particular planning requirements exist for conservation areas and listed buildings, as determined by the Planning (Listed Buildings and Conservation Areas) Act 1990. Third parties have a right to make representations about any planning application, which in turn must be considered by the relevant LPA. Applicants are able to appeal LPA planning decisions to the Secretary of State, in which case the Secretary of State will decide the application afresh and on its merits. Third parties have no such right of appeal but they (and applicants) may appeal decisions of the Secretary of State on the grounds of legal error. LPAs have enforcement powers to deal with development that is carried out without or in breach of planning permission. The Planning Act 2008 provides a streamlined decision-making process for nationally significant infrastructure projects, which are projects within the five general fields of energy, transport, water, wastewater and waste, as well as certain commercial and residential projects. A development consent order granted under the Planning Act 2008 provides a single consent for such projects, thereby removing the need for developers to seek planning permission and other related consents separately.

### ii Environment

The environmental issue of particular significance to investors is the contaminated land regime, which is set out in Part IIA of the Environmental Protection Act 1990, as amended by the Environment Act 1995. Contaminated land is land that is causing, or may cause, significant harm to the environment or human health, and the regime also applies to water pollution. Local authorities are obliged to inspect their land to identify areas of contamination. Where land is deemed to be contaminated and is not being remediated voluntarily, the local authority or the Environment Agency (in England) or Natural Resources Wales (in Wales) is obliged to serve a remediation notice on the relevant persons requiring the clean-up, investigation and monitoring of the contamination. It is a criminal offence to fail to comply with a remediation notice. In general, those who cause or knowingly permit land to become contaminated are responsible in the first instance; however, if no such person can be identified, the current owners and occupiers of the site may be liable for remediation costs. While regulators in the UK do not take enforcement action as readily as in other jurisdictions, remediation costs can be substantial, and it is often necessary to obtain specialist advice when dealing with land that is or may be contaminated.

### iii Tax

#### *VAT*

The starting point is that a supply of land (i.e., any sale, letting or licensing, or the grant or surrender of property rights such as rights of light) will be exempt from VAT. However, the seller or landlord can exercise the option to tax, which will generally make any sale or letting of the property by that seller or landlord a supply subject to VAT. The standard rate of VAT is currently 20 per cent. The landlord or seller can then recover the VAT charged on supplies of goods and services made to him or her in connection with the property concerned. In addition, supplies of land are generally subject to VAT if the sale involves a new commercial building completed within the past three years, or an incomplete industrial or commercial building.

***SDLT***

SDLT is a transactional tax payable by the buyer on the acquisition of a chargeable interest, and applies to any chargeable consideration payable by the buyer on a relevant transaction. The rate depends on the value of the transaction, and the highest rate for non-residential transactions is currently 5 per cent in respect of that part of consideration that exceeds £250,000. Residential properties are subject to rates ranging from 2 per cent up to 12 per cent for higher-value properties where the consideration exceeds £1.5 million, and there is an additional 3 per cent charge on second homes and most buy-to-let properties. The 2017 Budget introduced a new relief for first-time buyers to help boost home ownership, which was extended under the last Budget to those buying under approved shared ownership schemes. Where the buyer of a residential property costing more than £500,000 is a corporate vehicle, the rate of SDLT is 15 per cent and an additional annual charge may also apply. The government has announced that there will be a consultation on the introduction of an additional 1 per cent charge for non-residents buying residential property in England and Northern Ireland. A new land transaction tax replaced SDLT on property transactions in Wales with effect from April 2018. SDLT is also payable by the tenant on the rental element of a lease on grant, and is charged at banded rates of 1 and 2 per cent of the net present value of the rent payable for the term of the lease. Limited types of transactions are normally exempt from SDLT, including mortgages and personal licences to use or occupy land. A number of reliefs that may apply, including group relief, sale and leaseback relief, acquisition relief, reconstruction relief and charity relief. It is important to consider how best to structure a transaction for SDLT purposes, although the introduction of various anti-avoidance provisions has made it increasingly difficult to implement tax-saving schemes.

***Rates***

The occupier of a business property is responsible for the payment of business rates, which fund local government expenditure and are calculated by reference to the rateable value of the property. Rateable values are usually assessed every five years, and a revaluation took place in 2017 based on 2015 rateable values. This has resulted in a significant uplift, particularly for those businesses in property hot spots such as central London. Following a significant reduction in the relief available, business rates are generally payable on empty properties, and this has become a significant issue for owners in sectors with high vacancy rates.

### iv Finance and security

Lenders will generally require security over real estate, the best form of which is a charge by way of legal mortgage. It is necessary to register a mortgage over land at the Land Registry. If the company giving the security is registered at Companies House, the security must also be registered at Companies House within 21 days of creation. The mortgage will typically impose restrictions on the ability of the borrower to deal with the property and obligations on the borrower to preserve the value of the security. Security is also commonly taken over the rental income derived from occupational leases.

## VI LEASES OF BUSINESS PREMISES

In general, the landlord and tenant are free to agree the terms of a commercial lease. The law does not prescribe a particular form or contents of a lease and, subject to the tenant's security of tenure referred to below, there are relatively few statutory provisions affecting the landlord and tenant relationship under a commercial lease. The Code for Leasing of Business Premises seeks to encourage fairer and more flexible terms for tenants but, despite industry endorsement, remains voluntary. Traditionally, the industry has not enjoyed a reputation for being customer-driven, and leases have tended to be lengthy, complex and onerous for tenants. This is, however, changing as owners seek to meet the needs of their occupiers. The position for commercial leases should be contrasted with that for residential leases, where statute plays a significant role.

### i Term

Leases can be granted for a wide range of terms. Leasehold interests held for investment purposes are normally held on long leases for a term of between 99 and 250 years. Historically, occupational leases were granted for a term of 20 or 25 years; however, shorter terms of 15 years, 10 years or less have become more common recently. A tenant of an occupational lease may also require a right to determine the lease before the end of the term. For example, the tenant of a 10-year lease may have a contractual right to determine or break the lease at the end of the fifth year of the term.

### ii Rent increases

The property industry has traditionally required five-yearly upward-only rent reviews to the open market rental value of the property. This guarantees a minimum return of no less than the original rent for the remainder of the term of the lease, even if market rents have fallen. Although there has been some pressure on the property industry to offer leases on more flexible terms, it is still very rare to see rent review provisions that allow for the rent to go up or down in line with the market. An alternative form of rent review is indexation, for example in line with the retail price index or the consumer price index, but this, too, is often on an upward-only basis. Fixed uplifts in the rent are another possibility, and changes to the rent can also be restricted by agreed caps and collars. An element of the rent, particularly in large retail developments, may also be calculated by reference to turnover. VAT may be charged on the rent if the landlord has exercised the option to tax.

### iii Tenant's right to sell and change of control

There are likely to be restrictions on the tenant's ability to sell, charge, underlet or share occupation of the property without the landlord's consent. In a typical occupational lease, consent must not be unreasonably withheld. In considering applications for consent, the landlord will be keen to ensure that a tenant of good covenant strength is responsible for paying the rent. Provisions restricting a change of control of the tenant itself are, however, rare.

### iv Tenant liability and security for payment of rent and performance of covenants

The Landlord and Tenant (Covenants) Act 1995 (LT(C)A) introduced a regime whereby tenants of new leases (granted on or after 1 January 1996) are released from liability on an assignment of the lease. The tenant's guarantor is also released at this point. This is in contrast to the previous regime, whereby the tenant and its guarantor remained liable for the duration of the term of the lease under the doctrine of privity of contract, even after an assignment of the lease. The doctrine continues to apply to old leases (granted before 1 January 1996). The LT(C)A also introduced authorised guarantee agreements (AGAs), which provide the landlord with a guarantee from the outgoing tenant for the incoming assignee's obligations under a new lease. The AGA is for the duration of the assignee's term only, so that when the lease is assigned again, the original tenant is released from all liability. The decision in *K/S Victoria Street v. House of Fraser (Stores Management) Ltd and others*[2] confirmed that, although an existing tenant's guarantor cannot guarantee the liability of an incoming assignee, it can guarantee the outgoing tenant's obligations under an AGA given by that tenant in respect of the assignee. In *EMI Group Limited v. O&H Q1 Limited*,[3] the court confirmed that a purported assignment of a lease to the tenant's guarantor was void and of no effect. A landlord will also consider other security, including a rent deposit or bank guarantee.

### v Repair and insurance

A tenant of business premises will usually be expected to be responsible for all liabilities in respect of the property, including maintenance and repair costs. Where a property is multi-let, those costs are recovered through a service charge. The landlord generally insures the property, but recovers the cost of the premiums from the tenant. As a result, leases of business premises are often known as full repairing and insuring (FRI) leases. An FRI lease is important for the UK real estate investment market, as it allows the landlord to receive a clear income stream without incurring any expense itself in relation to the property.

### vi Collateral warranties

For investors in a property that has been recently constructed, collateral warranties provide investors, funders, tenants and other third parties with a contractual link that can be used to enforce the performance of the duties of the professional and construction teams. Third parties can also be given equivalent rights under the Contracts (Rights of Third Parties) Act 1999.

### vii Termination

If the tenant fails to pay the rent or is in breach of any of its other obligations, generally the landlord is entitled to bring the lease to an end by forfeiture; however, the tenant is given the opportunity to remedy the breach and can apply to the court for relief. The landlord's right to forfeit also normally applies if the tenant of an occupational lease becomes insolvent.

### viii Security of tenure

The Landlord and Tenant Act 1954 (LTA) provides security of tenure to tenants of commercial properties in England and Wales. If the property is occupied for business purposes, the tenant has the right to remain in occupation at the end of the term of the lease and is entitled to apply for the grant of a new lease on substantially the same terms; however, the landlord may be able to resist the grant of a new lease based on one of the grounds prescribed by the LTA. The most common ground relied on in practice is that the landlord plans to redevelop the property. This ground is not always easy to establish and, if the landlord is successful, the tenant may be entitled to compensation. Security of tenure can be a valuable statutory right for tenants, and can have a significant effect on a landlord's plans for dealing with its property, including future development. It is possible for the landlord and tenant to agree to contract

2 [2011] EWCA Civ 904.

3 [2016] EWHC 529 (Ch).

out of the security of tenure provisions of the LTA. To contract out, a notice must be served on the tenant explaining that security of tenure is to be excluded, and the tenant must make a declaration acknowledging this before the lease can be completed. Contracting out tends to be more common in relation to short-term leases. A recent reform ensures that tenants operating a business from home do not acquire security of tenure.

### ix Mixed-use developments

Mixed-use developments are generally permitted in England and Wales, and have become a facet of urban renewal. There are specific issues relating to mixed-use developments, including increased levels of statutory protection for residential tenants. Residential tenants' rights include collective enfranchisement and individual lease extension rights, as well as the right of first refusal and protection in relation to service charges and the management of the property.

## VII DEVELOPMENTS IN PRACTICE

### i Brexit and frustration

As far as the property industry is concerned, the effect of Brexit on market conditions has always been of far greater significance than the purely legal implications. However, a recent application to the High Court has raised the question of whether Brexit might frustrate existing leases. The European Medicines Agency (EMA) is responsible for approving drugs for the EU Member States. The EMA has made it clear that it will leave its London headquarters and relocate to a new European headquarters in Amsterdam when the UK leaves the EU. This means that its existing offices at 30 Churchill Place in Canary Wharf will become surplus to requirements. The EMA's landlord, Canary Wharf, has sought a declaration that Brexit will not frustrate the EMA's lease. If the court decides that the lease has been frustrated, the EMA will be able to walk away without any further liability for rent or other obligations under the lease. Such a decision could have far-reaching implications for a number of landlords and may also apply to a range of other contracts affected by Brexit. However, it seems likely that Canary Wharf will be successful. Frustration applies where an intervening event has made performance of a contract impossible, illegal or significantly different from that contemplated by the parties. The courts will not allow the doctrine to be used to avoid a contract that has simply become a bad bargain for one of the parties. Having headquarters outside the EU would undoubtedly be very inconvenient for the EMA, but it seems unlikely to be sufficient for a court to rule that it would be just for it to avoid its obligations as tenant.

### ii Electronic Communications Code

The new Electronic Communications Code came into force on 28 December 2017. The new Code provides telecommunications operators with Code rights to install, inspect, maintain, upgrade, operate and share telecommunications equipment on another person's land to provide network services. Landowners must comply with new procedures under the Code to terminate the Code agreement and for the removal of the operator's apparatus. The process is a lengthy one, which could cause problems for landowners seeking to redevelop. Telecommunications operators have new rights to assign Code agreements and to share equipment with other operators. The compensation payable to landowners is now calculated on the market value of the Code rights assessed on a 'no scheme' basis that excludes any value attributable to network use. This will mean that landowners are likely to receive lower rents from telecommunications operators. Code agreements with the primary purpose of conferring Code rights will no longer also enjoy security of tenure under the LTA.

### iii Energy efficiency

The minimum energy efficiency standards (MEES) came into force in April 2018. Landlords are not able to grant new leases unless the property meets the required energy efficiency rating. The rating for a property is set out in its energy performance certificate. From April 2023, MEES will apply to all existing lettings. A property must have an energy efficiency rating of band E or better to meet the minimum standard. If a property is sub-standard, the landlord must carry out energy efficiency improvement works unless one of the exemptions applies. Any relevant exemption must be registered and will normally last for five years. If the property is sold, the new landlord must register the exemption if it continues to apply. The main exemptions are:

*a* the seven-year payback exemption for commercial property, which applies where the cost of the relevant energy efficiency improvement cannot be recovered by way of energy savings over a seven-year period;

*b* the all-improvements-made exemption, where all the relevant energy efficiency improvements have been made and the property is still sub-standard;

*c* the third-party consent exemption, where a third-party consent is required for the improvement works, such as planning permission or the consent of a superior landlord, mortgagee or tenant, if the landlord has sought to obtain the consent and it was refused or granted subject to a condition that the landlord could not reasonably comply with; and

*d* the devaluation exemption, which is available where an independent surveyor has provided a report indicating that the energy efficiency improvement measures would result in a reduction in the value of the property or building it forms part of by more than 5 per cent.

A temporary six-month exemption may apply in certain circumstances where the relevant person has suddenly become the landlord of a property, including where the grant of the lease is down to a contractual obligation, the lease has come into effect by operation of law and the new lease has been granted under the Landlord and Tenant Act 1954. With effect from April 2023, the landlord will have a temporary six-month exemption when it becomes the landlord of an existing lease as the result of a purchase of the property.

### iv Empty property rates relief

The High Court has confirmed that a scheme designed to reduce business rates liability was effective. Empty shops and offices receive empty property rates relief for three months. If a property is re-occupied for at least six weeks, the occupier becomes liable for the business rates and the owner can claim a further three months' relief when the property becomes vacant again. A number of schemes involving short-term occupation have been used to help owners to reduce their rates liability. Typically, a short-term tenancy is granted for storage purposes at a nominal rent with the tenant receiving a fee calculated by reference to the business rates saved by the owner.

In *R (Principled Offsite Logistics Ltd) v. Trafford Council and others*,[4] the High Court ruled that such a short-term tenancy arrangement was not a sham and the tenant had been in beneficial occupation for business rates purposes. The case means that empty property rates relief schemes involving short-term lettings are likely to be effective. Business rates liability for empty properties is a significant issue particularly in the struggling retail sector where vacancy rates remain stubbornly high.

### v Capital gains

A significant change to the taxation of offshore investors in UK real estate was announced as part of the 2017 Budget. With effect from April 2019, non-resident companies will be taxable on gains arising from disposing of UK real estate in the same way as UK resident companies. Currently, although disposals of residential property by non-residents have been subject to capital gains tax since 2015, the new tax charge will cover all forms of UK property. A more surprising part of this package is that non-residents that dispose of indirect interests in UK property (e.g., shareholdings in 'property-rich' companies) will also be subject to UK tax on any gain. The current proposal is that a company will be 'property-rich' if more than 75 per cent of its gross asset value is attributable to UK real estate (whether held directly or via subsidiaries). A non-resident will be subject to tax on any gain if it holds a 25 per cent or greater interest in the company, or has done so within the preceding two years and with interests held by connected parties being aggregated.

## VIII OUTLOOK AND CONCLUSIONS

Brexit will remain the dominant political, economic and legal issue for the foreseeable future. The Prime Minister has confirmed that the UK will leave the EU on 29 March 2019. After months of negotiation, a deal has been struck with the EU and she now has the unenviable task of convincing members of her own party and the opposition that it is the right deal for the country. This will not be an easy matter, especially with the future of the Irish border remaining such a highly contentious political issue. Considerable uncertainty remains, and real estate activity will continue to be affected in the build up to the UK's separation from the EU. In particular, any prospect of a change in government will have a negative effect on business confidence. Although there will continue to be risks along the way, there will also be buying opportunities that will boost the market, some of which may arise because of exchange rate movements.

The uncertainty surrounding Brexit needs to be considered in the light of global economic and political concerns. Overseas investors will continue to look for attractive assets and income streams and UK real estate has remained a global investment hot spot. Concerns about Brexit and how the UK will fare outside the EU have been offset by a number of factors, including the ongoing weakness of the pound, low unemployment, historically low interest rates and positive economic data. Continuing global political and economic uncertainty, including concerns about North Korea, Chinese and other emerging market economies, the Trump administration, trade tariffs, oil prices, tensions in the Middle East and political instability in Europe, all mean that UK real estate will retain its appeal for investors.

4 [2018] EWHC 1687.

Although it is impossible to predict what the next 12 months have in store, the outlook for the real estate market is generally more positive than the prevailing mood following the initial effect of the 2016 EU referendum result. Demand has held up well and the vacancy rate is better than expected. However, this cautious optimism is not shared by all sectors and the outlook for retail, particularly on the high street, remains negative. The government must work hard to ensure that the UK remains competitive and investment in infrastructure is essential. A new runway at Heathrow has finally been confirmed as the preferred option for expanding the UK's aviation capacity. As Crossrail (now known as the Elizabeth Line) approaches a delayed completion, government backing for Crossrail 2 and the Northern Powerhouse Rail network is still awaited. Domestic and global connectivity will be even more important once the UK is out of the EU. The government must also tackle the UK's chronic housing shortage. The continued availability of both a skilled and an unskilled workforce is of fundamental importance to the UK economy and will be a key factor for businesses considering whether to retain a substantive presence in the UK. In addition, the construction industry has been reliant on labour from Europe for a number of years. In short, any tightening of restrictions on immigration will affect the UK's ability to both construct and staff new buildings and also to attract businesses to occupy them. Competition from other countries should not be underestimated; Germany is likely to be the biggest European beneficiary of any movement of the financial services sector away from London. Strong competition also comes from further afield and London's true rivals remain global cities such as Hong Kong, New York and Singapore.

Although risks and challenges remain, UK real estate will retain its appeal for overseas investors and maintain its key role in the global market. There will be plenty of opportunities for overseas investors looking for value and higher rates of return across the full range of real estate asset classes.

**Appendix 1**

# ABOUT THE AUTHORS


**JOHN NEVIN**

*Slaughter and May*


John Nevin is a partner in the real estate group at Slaughter and May. He has considerable experience in a wide range of real estate work. He has acted extensively on acquisitions and disposals of all types of property interests, on significant development projects and on major lettings. His clients include investors, occupiers, developers, livery companies, hotel owners, housebuilders and banks. He is listed as a leading individual in the real estate section of *Chambers UK 2019*, as a notable practitioner in *IFLR1000 2019* and is also listed in *Who's Who Legal: Real Estate 2018*.


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ISBN 978-1-83862-009-7