Maples Teesdale LLP
solicitors

Specialists in commercial property & construction law

Spring 2012

Community Infrastructure Levy… Current proposals

The Community Infrastructure Levy, a new planning charge, came into force on the 6th April 2010 through the Community Infrastructure Levy (Amendment Regulations) 2011.

Local Authorities can choose to charge the Levy on new developments in their area. It has been created in a bid to support important local development and infrastructure such as health centres, schools or safe road schemes, which councils and communities deem beneficial. The Levy is thought a fair compromise. The Government hopes that the Levy will raise around an extra £1 billion for local infrastructure by 2016.

The Levy will be charged on most new developments of over 100m2 internal floor space or any extension or redevelopment involving an increase in floor space. No increase in floor space incurs no charge. It does not apply to structures or buildings only used for plant and machinery maintenance.

Implementation is by a Charging Authority producing a Charging Schedule, setting out the Levy's rates in their area. The rates vary depending on the local community infrastructure improvements required and the value of the land. A Draft Charging Schedule is published for representations by anyone wishing to challenge it. The Schedule is then examined by an independent person, appointed by the Charging Authority, who recommends whether the Draft Schedule should be approved, giving reasons for their recommendations. Examiners' recommendations are binding, but can be corrected for up to 6 months.

The Levy must be paid by an individual or organisation who assumes responsibility for paying it. It is payable as soon as development works start. It can be paid as a cash contribution or by transferring interests in the land to the Charging Authority.

There are limited exemptions, such as Charitable Relief for premises used wholly or mainly for charitable purposes where the land is owned by a charity. There is also an Exceptional Circumstances Relief from the Levy where paying it would render a development not economically viable.

As a result of the Levy, large-scale commercial developers are likely to be hit hard and the impact of the CIL will need to be considered carefully at the planning stage.

Case Study: Energy centres on mixed-use schemes

A recent project involved one of our clients developing a large site for various uses, including a hotel, car showroom, self storage units, and a number of small business units.

Some plots were sold and some were let on occupational leases.

The site-wide planning consent required construction of an energy centre and communal network heating system to serve the park as a whole, providing electricity from sustainable sources.

The common parts of the park were owned by an estate management company with shares in it being owned by the plot owners.

The following legal issues had to be accommodated as a result of the requirement for the energy centre:-

- The management company was required to own and operate the energy centre and so appointed a specialist contractor to do so.
- Each plot owner was required to pay for the cost of operating/maintaining the energy centre via an estate service charge.
- Plot owners had to pay a reasonable price for the heat and electricity produced by the energy centre.
- Excess energy produced was to be sold to the National Grid and the proceeds credited to the estate service charge.
- Plot owners were given the necessary legal rights over the common parts to connect to the energy centre.
- Some plot owners wanted the ability to step in and carry out the maintenance and operation of the energy centre if the estate management company failed to do so.

WELCOME TO THE SPRING 2012 EDITION OF OUR NEWSLETTER

IN THIS ISSUE

LATEST NEWS

MIPIM

We sent a four man team to MIPIM in March… 3 by plane and one cycled!

Paul Burke, who cycled, was taking part in the annual Aedas Cycle to Cannes. Paul covered more than 1,000 miles to raise funds for the children's charity, Coram.

There is still time to sponsor Paul – please visit www.bmycharity.com/PaulBurke2012

The Team

Jon Blackburn has joined our corporate and commercial group as a Senior Associate. Jon was previously at Taylor Wessing and has over 8 years' experience acting on corporate transactions, with an emphasis on both private equity deals and M&A in the real estate sector.

Seminars

We are hosting a series of seminars for clients at our offices. In January David Tomback, Development Director at English Heritage spoke about development issues and the listed building regime. We have speakers from Gerald Eve coming to talk about the Community Infrastructure Levy and its likely impact on development, and the lead Barrister in the Heaney Case will be talking to us about rights of light issues and the law going forward. Dates will be circulated shortly.

PROPOSED CHANGES TO THE EXISTING REIT REGIME

A brief reminder – what is a REIT?

In simple terms, a REIT is:

- A company, or a group of companies the top company of which is tax resident in the UK and which is fully listed on a stock exchange recognised by HMRC (for example on the main market of the London Stock Exchange or the Channel Islands Stock Exchange); and
- At least 75% of whose business is in property investment.

If these and certain other conditions are met, the REIT status of the relevant company or group means that such company or group will be exempt from paying corporation tax on the profits that it derives from the property investment part of its business.

Why have REITS not been as popular as intended in the UK?

- At present, a company or group entering into the REIT regime is required to pay a one off entry charge of two per cent of the market value of the properties forming part of the company's/group's property investment business. While this may be considered a reasonable sacrifice for those with property portfolios nursing substantial latent gains (on the basis that a company's carried capital gains will disappear upon conversion into a REIT), the same cannot be said for investors holding properties with limited or no gains. To date, this has been a major disincentive for smaller property companies.
- As already noted, the REIT regime is only currently accessible to companies that are listed on the main market of the London Stock Exchange (or an equivalent exchange recognised by HMRC), which itself brings with it additional compliance and cost restrictions.
- In order to qualify as a REIT, a company must presently be seen to be diversely owned and therefore not effectively a private investment (or 'close') company. In practice, this means that companies must be owned by more than five persons. This has been a source of frustration for companies owned by institutions which themselves have a diverse investor base but which would not technically satisfy the 'close' company test.

What is the purpose of the changes?

According to HMRC, the aim is to address these restrictions to entry and investment in the regime, as well as to lower the costs of complying with the regime's requirements.

What are the key changes to the REIT regime?

- The two per cent charge on entry is to be abolished, which should make conversion into a REIT, as well as start ups, more attractive, especially for smaller groups.
- It will be possible for companies whose shares are traded on the AIM or PLUS (or equivalent non-UK) markets to also qualify for REIT status, providing considerable cost and compliance savings.
- The rules relating to diversity of ownership are to be relaxed so that:
  - there will be a three year 'grace period' for companies to demonstrate that they are not ' close'; and
  - certain institutional investors, such as pension funds and authorised unit trusts, will not be included when working out whether or not a company is close.

What will the changes mean in practice?

The most obvious beneficiaries of the upcoming changes will be owners holding, by way of corporate structures, properties with sizeable inherent capital gains, on the basis that the gains would effectively disappear upon the company or group becoming a REIT; in turn, this will mean that the REIT would be in a position to sell the shares in the relevant company without having to factor in inherent gain valuation issues.

Further, as and when a REIT looks to acquire additional properties held in corporate vehicles, the REIT would not only benefit from SDLT savings (incurring only a 0.5% stamp duty charge in relation to the acquisition of the shares in those vehicles) but would also not be required to pay the two per cent entry charge.

When will the changes to the REIT regime come into effect?

The changes are to form part of the Finance Act 2012, once it has received Royal Assent (expected in the summer of 2012).

Tenant's break notices and pre-conditions

In the present economic climate landlords may be keen to take a technical point to challenge the validity of a tenant's break notice and thereby hang on to their tenants. Tenants must ensure that they comply fully with any pre-conditions to the valid exercise of their right to break, such as ensuring they deliver up vacant possession on the due date and ensuring that all payments due have been made.

These issues were addressed recently by the Courts in two cases Ibrand Estates BV v NYK Logistics UK and Avocet Industrial Estates LLP v Merol Ltd (I) Tudor Rose International Ltd.

VACANT POSSESSION

Ibrand Estates BV v NYK Logistics UK

Facts of the case

- The tenant wanted to exercise the break clause in its lease. Delivery up of vacant possession on the break date was a pre-condition to the validity of the break;
- The tenant wanted to comply fully with its repairing obligations prior to lease expiry in order to avoid a subsequent dilapidations claim;
- The tenant sought to agree with the landlord that it could remain in occupation for a few days after the break date in order to complete the works, but this was never formally agreed by the landlord. Nevertheless the tenant's contractors remained on site for a couple of days after the break date to complete the works.

Despite the tenant paying the rent in full and attempting to return the keys, the landlord subsequently challenged the validity of the break on the basis that the presence of the contractors after the break date, together with a small amount of the tenant's equipment and vehicles, meant that vacant possession had not been given by the break date.

The Court of Appeal agreed with the landlord that, in the absence of a formal agreement to let the tenant remain in occupation to complete the works, the presence of the contractors and equipment beyond the break date meant that vacant possession had not been given at the break date and that therefore the lease continued to subsist.

The Court clarified the definition of vacant possession to mean:

- The landlord must be able to enjoy immediate possession, as of the break date; and
- The property must be empty of any chattels which could interfere with the landlord's enjoyment of the right of possession.

PAYMENT OF DEFAULT INTEREST

Avocet Industrial Estates LLP v Merol Ltd (I) Tudor Rose International Ltd

Another reminder to tenants of the court's strict interpretation of pre-conditions arose in the recent High Court case of Avocet. In that case the pre-condition to the break right was that the tenant had paid all rent and "other sums" due under the lease. The Court reluctantly held that the break notice had not been effective because of outstanding default interest of approximately £130, which had never been demanded by the landlord. Under the lease the default interest accruing on late payment of rent was payable whether or not the landlord made a formal demand.

Both cases provide illustrations of the opportunities available to landlords to hold on to their tenants and are a stark warning to tenants when exercising break rights. Tenants must strictly observe any pre-conditions to the valid exercise of their right to break.

Tenant's repair obligations and dilapidations

If a Landlord does substantial works to a building following lease termination does this mean that there is no claim for dilapidations from the outgoing tenant?

The answer to this question depends on what the landlord's intention was at lease termination and whether or not any hypothetical purchaser would inevitably have carried out such works.

A landlord's damages for breaches of a tenant's repairing covenants are usually calculated by reference to the cost of the works necessary to remedy the breaches of the tenant repairing covenants together with any loss of rent which may have been suffered. However, section 18(1) of the Landlord and Tenant Act 1927 places a cap on the landlord's damages. They should not exceed the amount by which the value of the reversion is diminished owing to the breach of the tenant's repairing covenant. The damages are assessed as at the date of termination of the lease which means that events occurring after the end of the lease cannot reduce or extinguish the damages.

Section 18(1) also provides that no damages shall be recovered for a breach of any tenant's repairing covenant if it is shown that the premises would at or shortly after the termination of the tenancy be pulled down, or structural alterations made which would render valueless the repairs made by the tenant.

Accordingly, if prior to lease expiry a landlord has decided to demolish the premises (or carry out major structural work which would render the repairs valueless) regardless of its state of repair, that landlord will have no dilapidations claim against its tenant. However, if the landlord does not make the decision until after lease expiry or alternatively can demonstrate that it would not have carried out the demolition if the premises had been yielded up in repair then, even if it subsequently demolishes the premises after lease expiry, it may still have a dilapidations claim against the tenant. (For an example of this see the recent case of *PGF II SA and PGF II (LIME) SA v (1) Royal and Sun Alliance Insurance Plc and (2) London and Edinburgh Insurance Company Limited [2010] in which Maples Teesdale LLP acted for the first defendant).*

Issues...

A GREEN UPDATE

- **CRC Energy Efficiency Scheme** – There is still no consensus as to how CRC costs should be shared between landlords and tenants. In a few cases landlords have managed to include CRC recovery within the service charge mechanism and in a few more cases tenants have managed to exclude liability for any CRC costs incurred by their landlord. But in most cases leases remain silent (with the result that each party pays their own CRC costs).
- **Feed In Tariffs** – In December 2011 the High Court held that the government's proposal to cut FITs for new smaller scale solar photovoltaic (PVs) installed after 12 December 2011 was unlawful. In January 2012 the Court of Appeal refused the government's appeal. The government is seeking permission to appeal to the Supreme Court.
- **Renewable Heat Incentive** – The purpose of this scheme is to encourage heating to come from renewable sources. Tariff levels are intended to compensate the owner for the additional cost of installing and using renewable technologies over and above that of conventional heating system. It is therefore intended to be cost-neutral to the owner. RHI payments will be made quarterly over a 20 year period and are available for a range of technologies and fuel uses. Phase 1, which targets the industrial, business and public sectors, had been planned to start on 30 September 2011 but has been postponed for legislative reasons. The second phase (expected to be introduced in October 2012) will expand the scheme to include additional technologies.
- **Green Deal** – The idea of this scheme is that consumers pay a "green deal charge" for energy efficiency improvements to their domestic or commercial property in their regular bills, so there are no upfront costs. The scheme's "golden rule" means that the green deal charge should never exceed the expected savings generated by the energy efficiency improvements. However there is no guarantee of the savings. If the building owner sells the building the financial obligation stays with the building.
- **Green Investment Bank** – From April 2012 the government will set up the Green Investment Bank with £3 billion of public money to fund £15 billion worth of energy improvement projects.

Changes to the law regarding payment provisions in construction contracts

Construction contracts completed in England and Wales after 1 October 2011 are subject to changes in the law regarding payment provisions.

Where employers use published standard forms of building contracts or appointments they should obtain the relevant updates or use the latest updated versions. The Joint Contracts Tribunal has published new editions of its building contracts which take in the changes.

Where employers use bespoke forms of building contracts or appointments they should ensure that they comply with the changes.

One major change to the payment provisions relates to the issuing of notices in respect of payments.

Failure to properly follow the provisions could result in claims being made against employers, for example, for failure to pay sums due and as the rules will be implied if not adequately covered in a contract employers cannot avoid the amended provisions.

Construction contracts must now require the employer or the contractor to issue "a payment notice" stating the sum considered to be due on the payment due date. If the employer is required to issue the notice and does not do so the contractor may issue a "default payment notice" to the employer.

Where the employer intends to pay less than the requested sum then he must serve a "pay less notice". Pay less notices have replaced withholding notices although the details to be included in the notice remain largely the same. In a pay less notice the employer must state how much it considers to be due. The employer does not need to detail the grounds for paying less or the amount attributable to those grounds (as was required in withholding notices) but it does need to state the basis for the calculation of the sum considered to be due.

The employer will be required to pay, by the final date for payment, any sum stated to be due in the relevant notice. Where the employer does not do so the new rules give the contractor additional rights. The contractor will be entitled to suspend some or all of its obligations under the contract (under the old rules the contractor could only suspend all of its obligations under the contract) and recover a reasonable amount in respect of its costs and expenses reasonably incurred as a result of the suspension. Additionally extensions of time may be awarded for any period to reflect the period of suspension.

Construction contracts completed before 1 October 2011 are still governed by the old rules therefore employers should ensure that payments are processed in accordance with those procedures.

The new rules also provide for the timing of the issuing of payment notices.

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