K&L GATES

Overriding Interest

Highlighting developments and issues in the real estate industry

February 2014

In this issue:

Permitted Development Rights — Change of Use from Office to Residential

New permitted development rights were announced by Eric Pickles in January 2013 as one of the measures promoted by the government last year to increase the national housing supply. They came into effect in May 2013 and permit the change of use of a building from Class B1(a) (office) to Class C3 (residential). Since the introduction of these rights, there has been a significant increase in the number of prior approval applications for the conversion of office buildings into residential use being submitted to local planning authorities (LPAs). The benefit for developers is clear, as the ability of LPAs to seek substantial obligations by way of section 106 agreements for affordable housing and education contributions is effectively removed.

However the approach of LPAs to these types of applications appears, particularly in London, to be hardening. Faced with the loss of valuable employment floor space and the loss of associated business rates, LPAs are considering a range of options to restrict the number of these applications coming forward, for example by actively seeking unilateral undertakings from developers to mitigate the impacts of such development particularly in relation to highways and transport issues.

The recent High Court challenge by the London Boroughs of Islington, Camden, Lambeth and Richmond upon Thames to the procedure and criteria used by the government to determine which areas should be exempted from these permitted development rights, was dismissed in December last year. This now leaves Article 4 Directions to withdraw permitted development rights in certain areas as the most likely tool to be used by LPAs to stop developers exercising these permitted development rights.

To date Islington, Richmond, Merton and Sutton have issued Article 4 Directions whilst others including Camden and Bromley are considering using these powers. Once in force, these Directions will require a developer to submit an application for planning permission in the usual way for the conversion of office to residential. No compensation is payable to developers where 12 months' notice of the Article 4 Direction has been given.

The government are closely monitoring the growing number of Article 4 directions being made by LPAs and recently issued a Ministerial Statement in respect of the "disproportionate" use of Article 4 directions made by the London Borough of Islington and Broxbourne Borough Council to restrict the operation of these permitted development rights. The Statement sends a clear warning to all LPAs that Ministers are minded to cancel any Article 4 direction which in their view imposes an unjustified blanket restriction on the operation of these permitted development rights.

In addition, following recent attempts by LPAs to secure wide-ranging s106 obligations on matters unrelated to the prior approval application procedure, further planning guidance is to be issued to LPAs to prevent "unjustified state levies" being applied

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Chancel Repairs

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by LPAs to frustrate the exercise of these permitted development rights.

What was advocated by Nick Boles, Planning Minister, as "an important step in improving the planning system" is fast becoming the next battle ground in planning, particularly as the first set of refusals for prior approval applications are now emerging from LPAs. It will be up to the Planning Inspectors in determining appeals from these refusals and the High Court in hearing any legal challenges to appeal decisions and Article 4 Directions, to determine how many of these schemes are granted and implemented before the deadline of 30 May 2016, when the 3 year time limit for these powers expires.

Should you require further information about any of the matters contained within this alert or any advice on how these reforms may impact on your development proposals please contact Sebastian Charles, Jane Burgess or your usual K&L Gates contacts.

Chancel Repairs

Some third party rights in land can bind a purchaser or chargee of that land, even though the rights are not mentioned in the register of title of registered land or in the deeds of unregistered land. The Land Registration Act 2002 provided that from 13 October 2013, certain interests would lose this overriding status and these included chancel repair liability.

Chancel repair liability is the liability of an owner of land to pay for repairs to the chancel of a parish church.

The new position in relation to registered land

1. Chancel repair liability can be protected by a notice in the register. Notices can be entered after 12 October 2013, but only if there has been no change in land ownership since 12 October 2013.
2. The right will continue to bind the owner of land purchased or voluntarily registered before 13 October 2013 until that land is sold to a third party, even if the right has not been protected by notice in the register.
3. Where a notice has not been entered, liability for chancel repair will continue until the first transaction for value after 13 October 2013. From 13 October 2013, a purchaser of land for valuable consideration will take free of any liability if it has not been protected by notice in the register.

The new position in relation to unregistered land

1. Chancel repair liability can be protected by lodging a caution against first registration. Cautions can be registered after 12 October 2013, but only if there has been no change in ownership since 12 October 2013 and the land remains unregistered.
2. The right will continue to bind the owner of unregistered land, before and after 13 October 2013, until that land is conveyed to a third party or voluntarily registered. A conveyance will trigger compulsory first registration. If a caution has been lodged, the registrar will notify the cautioner, enabling it to object to the application and protect its interest by entering a notice in the register.
3. If any chancel repair liability is not protected by caution at the time of first registration, the new owner will take the estate free from this liability. ■

Flooding

Has your commercial property been affected by flooding this winter? Here are some simple steps for making the most of your insurance cover.

In a time of crisis, insurance may not necessarily be at the forefront of every commercial property owner or occupier's mind. However, if your business has been affected by the floods and storms you should be dusting off your insurance policies without delay to see what cover is available for damage to property and interruption to your business.

A proper analysis of the policy and the manner in which a claim is prepared and submitted can make a significant difference to the amount which insurers will pay, and the speed with which the claim will be resolved.

Whilst property damage can often be resolved by loss adjusters with relatively little scope for argument (other than betterment), in our experience the quantum of business interruption (BI) claims are often a matter of dispute and delay. This can be reduced if the policyholder has a clear understanding of the operation of its policy and collates its supporting evidence in a way which matches the cover thereby giving insurers fewer grounds to dispute coverage or quantum.

It may be that the breadth of cover in an insurance policy is wider than realised and goes beyond properties actually damaged. Some policies provide coverage where a business has been affected indirectly, for example where staff have been unable to gain access to the building or due to power outages. This is known as contingent BI cover and is not dependent on flood damage to the property itself.

We have compiled a brief list of key issues from an insurance perspective to consider when your business premises have been affected (directly or indirectly) by the floods and storms:

1. Is there insured damage to property at any premises specified in the policy schedule?
2. Inspect the loss to determine the extent of the damage, taking steps to salvage damaged property, and to mitigate further losses where possible.
3. Take photographs of the damage and make a daily diary entry of events.
4. What is the time specified in the policy for notifying insurers? All policies contain notification requirements. Failure to comply may mean insurers can legitimately deny an otherwise valid claim.
5. Does a proof of loss need to be submitted to insurers: if so, by when? Late submission may invalidate the claim. It will also be necessary to consider what needs to be included.
6. Is there contingent BI cover that might respond to the circumstances of the particular loss? Consider - loss of attraction, loss of public utilities, denial of access, or damage to customers' or suppliers' premises.
7. In relation to any BI claim specifically, consider what steps are required to record and document losses. For example, this may mean setting up separate or sub accounts to maintain a record of extra expenses and disrupted revenues.
8. It may be possible to make a recovery under your policy for management time. This is where there has been a genuine diversion of individual staff to deal with the circumstances of the claim. Such additional staff time should be logged carefully.
9. Write down your business plan if alternative trading arrangements need to be set up and discuss this with any adjusters appointed by insurers. Policyholders are under a duty to mitigate their losses and so

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documenting the steps taken in response to a business interruption event can only help in demonstrating that reasonable action has been taken (see also points 2 & 3).

10. You may also want to check how long your BI policy provides coverage for and whether there is a limit to the cover that is likely to be exceeded.

Should you wish to discuss the application of your property policy, and related business interruption cover, to the recent floods and storms or the presentation of a claim to insurers, the Insurance Coverage team in our London office can be contacted using the details below.

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Changes to the Green Deal

Background

On 2 December 2013, the Department of Energy and Climate Change (DECC) proposed changes to the government's flagship energy efficiency scheme, the Green Deal, as part of the government's wider action to help consumers with their energy bills.

Take up of the Green Deal has been very low since it was launched, mainly because relatively high interest rates (approximately 7% per annum) have been charged on Green Deal loans. The new measures are intended to increase the popularity of the scheme.

The proposed changes

DECC has yet to publish much of the detail relating to these changes. However the main changes can be broadly summarised as follows:

1. Adjusting the "golden rule"

DECC will look at relaxing the "golden rule" which limits the amount that can be spent on energy saving measures under the Green Deal. Broadly, the golden rule provides that:

1. The cost of repayment should not exceed the estimated financial savings resulting from the installation of energy saving measures; and
2. The length of the repayment period should not exceed the expected lifetime of the improvements.

The proposed adjustment could enable consumers to borrow more than is currently possible.

2. Improving Green Deal finance

DECC will consult with the Green Deal Finance Company (GDFC) to improve the finance available by:

- Seeking Parliament's approval to amend the Green Deal legislation to make it clearer that landlords and tenants can benefit from the Green Deal and to encourage industry to offer finance in the rented sector; and
- Increasing the range and availability of top-up loans that customers can put alongside Green Deal finance if they wish.

3. Helping companies providing services under the Green Deal

DECC proposes to help companies providing services under the Green Deal by:

- Opening up access to energy performance certificate (EPC) data, so that companies can more easily identify properties which will benefit most from energy efficiency improvements.
- Adding more Green Deal measures to the list of those that can be supported under the Green Deal, and allowing more flexibility over the exact specification to which companies install.
- Finding ways to reduce the cost of insurance requirements attached to Green Deal measures.

4. Simplifying the Green Deal for consumers

DECC intends to make the Green Deal more user-friendly by:

- Minimising the number of visits to a home for assessments, work and inspections. DECC hopes that in future consumers will be able to receive a quotation and begin a Green Deal Plan in a single day.
- Integrating Green Deal loans with the Energy Company Obligation (ECO), another Government initiative to improve household energy efficiency, to ensure that consumers receive the best deal possible.
- Improving the Green Deal advice available online and raising awareness of the steps consumers can take to improve the energy efficiency of their homes.
- Improving customer support and ensuring information made available to consumers is as clear as possible.

Implementation

- DECC is currently consulting with the GDFC and companies involved in providing the Green Deal.
- It is proposed that many of the new changes will be rolled out throughout the first half of 2014.
- The Green Deal has mainly been implemented by statutory instrument so most of the changes will not require parliamentary approval.

Proposals in the Autumn Statement

Background

On 5 December 2013, the Government announced new proposals intended to improve domestic energy efficiency. Full details have yet to be announced so it remains to be seen how these proposals will be enacted.

The proposals

1. Energy efficiency grants for future home buyers over 3 years

Future home buyers will receive a grant of up to £1,000 to spend on important energy saving measures or up to £4,000 for particularly expensive measures.

2. A scheme to help private landlords to increase the energy efficiency of their properties

The Government has yet to announce full details of this scheme but it is envisaged that around 45,000 of the least energy efficient rental properties in the UK will be improved over the next three years.

The Government has pledged £450 million over 3 years towards these first two schemes.

3. A rebate for domestic electricity customers

Households will receive a rebate of £12 on their bill for the next 2 years.

4. A reduction in the cost of the Energy Companies Obligation (ECO)

Precise details have yet to be announced but the Government envisages that the overall result will be £30-£35 off energy bills, on average, in 2014. ■

Announcements and Events

New Joiners

Chiara Del Frate - The Italian Desk in London

Chiara is Special Counsel in K&L Gates' London office. With a practice focussed on real estate investment, development and finance she has a wide range of experience, advising on commercial and residential property matters both in the United Kingdom and Italy, including property investment, landlord and tenant matters and property finance. She also has extensive experience representing Italian clients on cross-border property investment deals, in particular for owners, purchasers, lenders, landlords and tenants.

Takahiro Tsumagari - Tokyo

Takahiro is a partner resident in our Tokyo office, and he joins from Atsui & Sakai. Although trained and still maintaining a practice in real estate finance, Takahiro is relied upon by his clients for a range of services including mergers and acquisitions and some contentious matters. With his arrival, our growing Tokyo office takes another step forward.

Recent Events

Investment Opportunities in the Caribbean Real Estate and Hospitality Markets

In November 2013 we hosted a seminar on opportunities in the Caribbean in the resort, hospitality and leisure sector.

Topics included:

- Where are the investment opportunities in the Caribbean real estate and hospitality markets?
- Obtaining Citizenship by Investment in St. Kitts and Nevis and other Caribbean nations

We were joined by Matt Norton, Partner (Charleston), K&L Gates LLP; Charles P. "Buddy" Darby, III, CEO, Christophe Harbour Development Partners; and Mohammed Asaria, Managing Director, Range Capital Partners. For those of you who missed the seminar and would be interested in exploring these opportunities further, please get in touch with any of the editors, who would be delighted to put you in touch with the appropriate contacts.

IPD EcoPAS Q3 Results

As our regular readers will know, K&L Gates, together with CBRE, sponsors and supports the IPD EcoPAS initiative. In November 2013 the Q3 Results were launched. The seminar was chaired by Ian Cullen, Advisory Director at IPD and included the latest results from IPD's EcoPAS measurement service, together with an analysis and panel discussion by key investment and valuation professionals.

Topics included:

- IPD EcoPAS Q3 Results, Jess Stevens, Associate and Head of Sustainability, IPD
- The impact of sustainability on lending, James Bretten, Director, Strategy and Research, Real Estate Finance, Corporate & Institutional Banking, Royal Bank of Scotland

Panellists / Speakers:

Sebastian Charles, Partner, K&L Gates

Justin Snoxall, Head of the Business Group, British Land

John Symes-Thompson, Senior Director, CBRE

Jess Stevens, Associate and Head of Sustainability, IPD

James Bretten, Director, Strategy and Research, Real Estate Finance, Corporate & Institutional Banking, Royal Bank of Scotland

Please contact the editors for further information. The next EcoPAS event will take place at the offices of CBRE and information will be posted on our website shortly. ■

MIPIM 2014

GLOBAL REAL ESTATE TEAM MIPIM 2014

Members of the Real Estate, Construction and Finance teams will be attending MIPIM 2014 and hope to meet you there.

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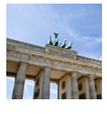

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MIPIM Express

On **Tuesday, 11th March 2014**, lawyers from the K&L Gates MIPIM Team are travelling to Cannes in a sustainable fashion. We would be delighted if you could join us for drinks and light refreshments on our journey.

Eurostar: London St Pancras to Paris Gare du Nord **08:31 a.m., coach 011.**

TGV: Paris Gare de Lyon to Cannes **12:49 p.m., coach 001.**

For more information please contact sabina.joseph@klgates.com.

Rent & Mortgages

New Commercial Rent Arrears Recovery Process to be Introduced In April 2014

Under new regulations, the ancient remedy of distress for rent will be removed for business premises and replaced by Commercial Rent Arrears Recovery (CRAR).

The regulations aim to impose a CRAR process that strikes a balance between landlord and tenant. The main changes are in relation to the procedure that bailiffs must follow when taking control of a tenant's goods and are as follows:

- The regulations introduce a minimum period of notice before an enforcement agent can seize the tenant's goods. Landlords are now required to give the tenant seven clear days' written notice before taking any goods;
- "Controlled goods agreements" replace the present "walking possession" procedure. Also, there are detailed rules for selling and dealing with a tenant's goods after the enforcement agent has removed them;
- Landlords will not be able to use the CRAR process in order to enforce payment of service charges or other sums, even if they are reserved as "Rent" within the relevant lease. CRAR can only be used to recover principal rent (in addition to VAT and interest);
- Enforcement agents are unable to exercise CRAR where the premises include a part that is used for residential purposes;
- The regulations have confirmed the category of goods that are exempt from seizure by an enforcement agent. Goods that are necessary for a tenant's business up to the value of £1,350 and goods that are owned by third parties (including sub-tenants) will not be subject to CRAR;
- A number of rules regulating how enforcement agents can enter and secure a tenant's property are also laid out in the regulations;
- Finally, if a landlord serves a notice on a sub-tenant to redirect any outstanding rent, it will now take effect 14 clear days after the notice is served on that sub-tenant. ■

Protocol for Discharging Mortgages of Commercial Property

A new Protocol produced by the City of London Law Society Land Law Committee, with input from the Association of Property Lenders and the CLLS Financial Law Committee has been issued in relation to discharging mortgages of commercial property.

To view the Protocol itself please ***click here.***

To access the Committee's documents on the Land Law Committee's webpage please ***click here***.

Unlike residential conveyancing, there is no Law Society endorsed code for completion that relates to commercial property, so the Protocol will act as a guide as to steps and procedures that solicitors (and their clients) might adopt and which the Committee regards as being appropriate and fair to all parties. The Protocol is not compulsory and parties can decide whether to adopt it on a case by case basis, with or without variations.

Case Summaries

Rent and Break Clauses

Marks & Spencer Plc was the tenant and BNP Paribas was the landlord of four floors in an office building in Paddington, London.

The tenant had a lease with a right to serve a break notice, allowing the lease to determine on 24 January 2012. Under the lease, the rent was paid in equal instalments in advance on the usual quarter days. The break was conditional on the tenant having paid full quarter's rent for the December quarter.

Six months before the break date, the tenant served notice on the landlord to exercise the break. On the December 2011 quarter day, the tenant paid the rent for the full quarter up to 24 March 2012. The lease ended on 24 January 2012, in accordance with the break clause.

In February 2012, the tenant requested that the landlord refunded rent paid from the break date up to 24 March 2012, amounting to £15,000. The Landlord refused. The lease did not contain any express clause entitling the tenant to a refund of the rent from the break date to the end of the quarter. The lease only said that rent was payable "proportionately for any fraction of a year".

The High Court found, in the absence of express terms to that effect, the lease contained an implied term that if a full quarter's rent had been paid on the last quarter day before the break date, then the landlord is obliged to pay back the part of the rent which exceeds the apportioned rent to the break date. Accordingly, it was held that the tenant was entitled to a refund.

Comment: Previously, it was widely accepted that without express provisions in a lease to the contrary, a tenant is not entitled to a refund of rent paid that relates to the period after a break date. However, this recent decision confirms there are circumstances in which an entitlement to a refund can be implied into the lease.

Marks and Spencer Plc v BNP Paribas Securities Trust Company (Jersey) Ltd [2013] EWHC 1279 (Ch)

Break Notices: Complying with the Requirements of a Lease

Siemens Hearing Instruments Ltd were the tenants and Friends Life was the landlord under a lease dated 27 January 1999.

The lease contained a tenant's break option at clause 19 effective on 23 August 2013 subject to compliance with specified pre-conditions. The dispute concerned clause 19.2 which stated:

"19.2 [Subject to the pre-conditions being complied with]…the Tenant may determine the Term on the Termination Date by giving the Landlord not more than 12 months' notice and not less than 6 months' notice which notice must be expressed to be given under section 24(2) of the Landlord and Tenant Act 1954…"

The landlord served a break notice to terminate the lease. However, the notice failed to refer to the Landlord and Tenant Act 1954. As a result, the tenant challenged the validity of the break notice.

The High Court held that the notice was valid even though it did not comply with a requirement in the lease. The reasons provided by the court are as follows:

Case Summaries (cont')

- The lease was well drafted. The break clause states that the break will fail for non-compliance with certain conditions. If failure to refer to section 24(2) was intended to be fatal, this would have been expressly stated.
- Failing to use the words had no effect on the tenant.
- The missing words were not necessary information and could not sensibly be construed as mandatory.

Comment: The key point from this case for landlords is to ensure that if their intention is to make non-compliance with the terms of a break clause fatal, then they should expressly incorporate this in the lease.

Siemens Hearing Instruments Ltd v Friends Life Ltd [2013] All ER (D) 188 (Jul).

Mediation: The Consequences of Refusal

The landlord, PFG, sought damages for dilapidations in relation to three floors let to the tenant under separate leases. The landlord served a schedule of dilapidations valuing the dilapidations at £1.8m. The tenant did not pay.

The tenant made a Part 36 offer of £700,000 to settle the claim in April 2011. The landlord did not accept the offer but proposed mediation instead. The tenant failed to reply to the mediation proposal despite being chased and the claim proceeded to trial. As a Part 36 offer remains open for acceptance until withdrawn, the day before the trial the landlord accepted the tenant's Part 36 offer.

Ordinarily, the landlord would have been expected to be liable for costs from 21 days from the date of the offer up to the date of acceptance. However, the landlord argued that this rule should not apply because the tenant had refused to mediate.

The Court of Appeal, upholding the first instance decision, decided that the absence of a reply to the request for mediation amounted to refusal. The court also held that the refusal was unreasonable, rejecting the tenant's argument that acceptance of the £700,000 offer indicated that the refusal was reasonable. Consequently, the tenant was ordered to pay their own costs from May 2011. The court considered that this was the time when mediation was likely to have taken place and there was a reasonable prospect that such mediation would have been successful.

Comment: This case serves as a timely reminder of the court's discretion regarding costs following acceptance of a Part 36 offer and the implications of refusing.

PGF II SA v OMFS Company 1 Ltd [2013] EWCA Civ 1288

Absence of Covenant

The tenant had a lease of the ground floor of a commercial property. The lease did not have a provision requiring the landlord to repair the upper parts of the building. The only duty was for the landlord to insure and lay out insurance proceeds in reinstatement. The premises were damaged on several occasions by sewerage coming from the retained parts.

The damage was repaired using the insurance proceeds. When the tenant fell behind on rent the landlord re-entered the property. The tenant claimed damages and relief from forfeiture, alleging that it was entitled to set-off rent against compensation payable by the landlord for damage caused by the leaks. The tenant also argued that in the absence of an express repairing obligation for the structure of the building, the landlord was impliedly responsible for keeping the retained parts in repair.

At first instance, the judge found that the landlord was under a duty in tort to take reasonable care to remedy defects once it knew or should have known that defects had caused or were likely to cause damage to the demised premises.

The Court of Appeal, disagreeing with this decision, held that, where the lease was silent, a landlord was not responsible for repairs to the retained parts. The court highlighted that the lease contained a scheme to cover repairs in the insurance clause and this had been complied with. There was no basis to imply a further term. The award for damages was overruled as the landlord had complied with its obligations.

Comment: This case highlights that a tenant can only claim for breach of covenant if there is an express (or implied) covenant covering the point. Accordingly, it is imperative that a tenant taking a lease where the landlord retains parts of the building ensures that it clarifies who is responsible for repairing various parts of the building.

Gavin v Community Housing Association [2013] EWCA Civ 580

Holding Over: The Risk for Tenants

The landlord, Barclays Wealth Trustees, had granted a five year lease to Erimus. Erimus remained in occupation and the parties began negotiating a renewal lease on similar terms. After almost two years' of negotiations, heads of terms were agreed. However, before documentation was put in place, Erimus decided that it needed larger premises. In August 2011 it proposed that it be permitted to remain in occupation until its new premises were ready, which it expected would be in six months' time. Erimus kept paying rent, which was accepted. Nine months' later it gave three months' notice of its intention to leave.

Barclays argued that three months' notice was insufficient as a yearly periodic tenancy had arisen and the court agreed. It held that the parties' behaviour was not consistent with a tenancy at will: it was clear that the parties did not intend that Erimus could be asked to leave without notice. As Erimus was unclear on how long it intended to stay, a fixed term tenancy could not be implied. As Erimus had continued to pay annual rent (although on a quarterly basis) it was found to be a yearly periodic tenancy, meaning that a full year's notice was required, expiring on the day before the anniversary of the start date. This meant that Erimus remained liable for a further 13 months' rent, amounting to around £185,000.

Comment: Although usually landlords are aware of the risk of allowing negotiations to stall, and the importance of putting a tenancy at will in place, this is usually not a major concern for tenants. This case serves as a warning of the risk for tenants of delaying negotiations.

Barclays Wealth Trustees (Jersey) Ltd v Erimus Housing Ltd [2013] EWHC 2699 (Ch).

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