K&L GATES

Overriding Interest

Highlighting developments and issues in the real estate industry

Spring 2013

In this issue:

The Green Deal - Impact on Commercial Real Estate

Introduction

The Energy Act 2011 introduced a funding mechanism for energy efficiency improvements to property, known in the industry as the "Green Deal". The Green Deal regulations have been in force since January 2013, and are essentially designed to help the government meet its carbon reduction targets without the need for consumers to pay for energy efficiency measures up-front. A Green Deal Provider will carry out the necessary improvement works and then, over a period of time, the occupier pays for the works under a Green Deal Plan, through payments made under their energy bill.

The expected financial savings resulting from installing measures must be equal to or greater than the cost of repayment over the term of the Green Deal Plan. The repayment period can be for a specified "pay-back" period, or over the lifetime. If the estimated annual saving is expected to be equal to or greater than the expected annual repayment costs, the Green Deal Plan works and is therefore permitted (known as the "Golden Rule").

The Green Deal process has four stages, which include an assessment by a Green Deal Adviser/Assessor, using specific software to identify improvements and savings, and outline how repayments will work etc. The next stage is the financing, which is provided by Green Deal providers. The works are then carried out, with the fourth stage being the "repayment part". The electricity supplier will pass repayments on to the Green Deal Provider. There is no cap on the amount of finance a customer can receive through the Green Deal, but the total amount available will be limited by the Golden Rule.

The government has formed a Green Deal Finance Company (GDFC) which will supply money in the form of loans to the general public. The intention is that the members of GDFC (which includes British Gas and Carillion) will supply the bulk of the cash to enable the scheme to work. The government will supply the initial money for the scheme, currently around £200/500 million, while the private sector will provide approximately £14 billion which will form the majority of the finance.

Continued on page 2

K&L Gates LLP
One New Change
London EC4M 9AF
www.klgates.com
T: +44 (0)20 7648 9000
F: +44 (0)20 7648 9001

The Green Deal (cont')

Commercial Real Estate Issues

Some issues/concerns as to how the Green Deal impacts on commercial property have been raised by landlords. A common query has been as to the payback period, and whether this would fall within the period of a tenant's lease. Landlords have also been concerned that the freehold value of a property may be affected if the property is subject to a Green Deal Plan, and the issue of voids has been raised too. A tenant could find it hard to take out a Green Deal Plan and undertake works within a short term lease since, due to the shorter lease term, the Golden Rule may not be satisfied. The landlord is unlikely to want to be responsible as payer of the electricity bill once the lease ends.

Disclosure

The Green Deal regulations oblige a seller or landlord to disclose any Green Deal Plan attaching to the property.

EPCs - new commercial leases

By no later than 1 April 2018, the Energy Act sets out that properties with an EPC rating below a set level (widely reported to be an "E" rating) cannot be let until landlords have made "such relevant energy efficiency improvements as are provided by the regulations". This could mean that energy efficient buildings will attract a "premium", with discounts being applied to buildings which are less energy efficient. Tenants will no doubt be looking at the service charge provisions in their leases to see if the landlord can pass on charges associated with Green Deal works to the common areas. Similarly if tenants wish to carry out Green Deal improvement works they will need to get consent, and ensure that such works are disregarded on rent review and that the works do not have to be removed at the end of the term.

Lease Drafting

Landlords negotiating leases now, may wish to impose an obligation on the tenant to ensure that the energy efficiency of the property does not fall below a specific rating, in anticipation of the 2018 date looming. However this could be perceived as being onerous if the rating is currently substantially lower. Landlords could also be concerned that marketing the property will be difficult if a Green Deal Plan exceeds the term of the existing lease. In summary, the response of the commercial real estate market has been luke warm to the provisions. However the Green Deal looks to be here to stay, and we highlight the importance of sustainability elsewhere in this issue. ■

High Value Residential Property Tax

Residential properties valued at over £2m are to be subject to three new tax charges:

- The Annual Residential Property Tax
- A new Capital Gains Tax charge
- Increased rate of SDLT

The Annual Residential Property Tax

This came into force on 1 April. Its chief characteristics are:

- It only applies to non-natural persons, ie companies, partnerships that have a company as a partner and collective investment schemes. Settlements will not therefore be caught.
- Tax will be payable according to the value of the property, which will be self-assessed. The rate of tax ranges from £15,000 for properties within the £2m to £5m band, rising to £140,000 for properties worth over £20m. The annual amounts of tax will be index linked. The first valuation date is 1 April 2012 (or the date of acquisition if later). Properties will need to be valued every 5 years thereafter.
- Various reliefs are available such as for properties held for property development purposes or let on a commercial basis. Generally such properties must not be occupied by a connected person for the relief to apply.

A new Capital Gains Tax charge

Disposals of residential property for more than £2m on or after 6 April 2013 will attract a new capital gains tax charge. It will only affect non-natural persons and will only be chargeable if none of the ARPT reliefs apply. The rate of tax will be 28%.

The tax will affect non-resident persons (although only non-natural persons) for the first time, so in their case only the gain relating to the period after 6 April 2013 will be liable to the charge.

Stamp Duty Land Tax

SDLT at the rate of 15% is payable by non-natural persons in respect of residential properties valued at over £2m. There will be a set of reliefs to mirror those for the ARPT whereby the 7% rate will apply provided the relief remains applicable for 3 years after the purchase and the property is not occupied by a non-qualifying person during that period. These amendments are to apply from the Royal Assent to the Finance Bill, which is expected to be in June or July 2013. ■

Announcements and Events

Sustainability: Going Beyond Data Collection - upcoming event

Sebastian Charles, a Partner in our Planning and Zoning practice, and part of the European Sustainability Team, will shortly be participating in the following joint event with CBRE and IPD.

The impact of sustainability in the UK commercial property market: a review of IPD's EcoPAS Measurement Service and a look forward to what practical steps investors are taking in 2013.

CBRE together with IPD and K&L Gates invites you to a breakfast seminar led by a panel of key decision makers from the property investment industry. The event will reflect on developments in environmental performance measurement in 2012 and discuss how real estate assets and portfolios will be influenced by sustainability in 2013.

Tuesday 14 May 2013, 08:30 - 10:30 (registration and coffee from 08:00). Henrietta House, Henrietta Place, London W1G 0NB

To register and for more information about this event, or any other of our real estate sustainability initiatives, please contact any of the editors.

Sustainability

Bonny Hedderly, Senior Real Estate Associate at K&L Gates, recently participated in a round table Property Week debate on the burning issues affecting owners, investors and occupiers in the area of sustainability. The panel of participants included: Giles Barrie (former editor-in-chief, Property Week (chair)), Patricia Brown (Director, Central), Patrick Brown (Assistant director (sustainability), British Property Federation), Keith Bugden (Programme director, Better Buildings Partnership), Bill Hughes (Managing director, Legal & General Property and chairman of the Green Property Alliance), Debbie Hobbs (Sustainability manager, Legal & General Property), Simon Wilkes (Head of business space development, Legal & General Property), Miles Keeping (Head of responsible property investment, Drivers Jonas Deloitte) , Dr Paul McNamara (Consultant, Investment Property Forum), Andrew Renshaw (Lead director, professional advisory group, Jones Lang LaSalle), John Alker (Director of policy and communications, UK Green Building Council), Ben Elder (Global director of valuation, RICS), Munish Datta (Head of property "plan A", Marks & Spencer), John Rhodes (Founder and director, Quod) and Joe Montgomery (Chief executive, Urban Land Institute).

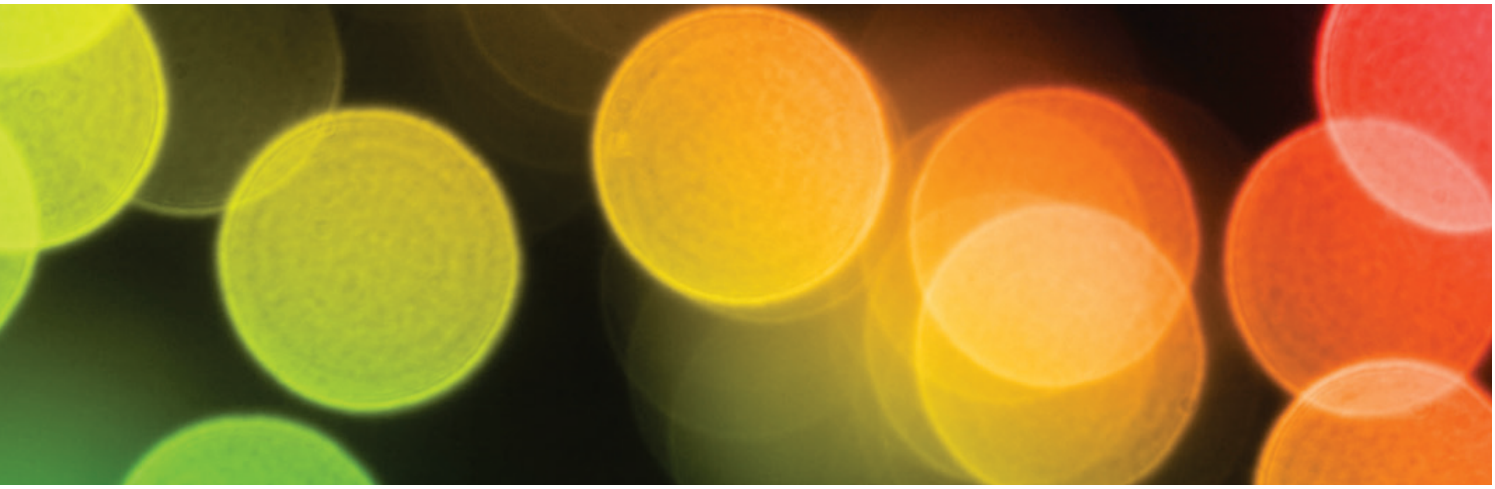
The full write-up of the debate features in the early March issue of Property Week, but the debate addressed how sustainability is now arguably one of the most critical agents of change in property. From a fund-management perspective, the key drivers are the protection of investment value over the medium to long term, while behaving in a socially responsible manner.

To read the full article please *click here*.

To see our European Sustainability team please *click here*.

RESI AWARDS - Property Week - 1 May 2013

Congratulations to our client **Akelius** which has been shortlisted in the category of Landlord of the Year (Privately Owned). To read more about our residential investment credentials, and our work for client Akelius please *click here* to see our previous issue of OI.



Diversity Update

Freehold is an LGBT networking organisation which specifically focuses on LGBT professionals working in the real estate, real estate finance and construction sectors. An event held at One New Change earlier this year attracted over 100 people which included a mixture of lawyers, real estate agents, architects and local government employees. The event also featured a fundraising appeal by the charity The Albert Kennedy Trust, which works hard to provide support, counselling and if necessary accommodation to LGBT youths who are rejected by their families and forced to live elsewhere. The Albert Kennedy Trust raised £950 to aid their cause at the event.

Finally, the network met again out in the real estate trade fair MIPIM.

New Joiners

We are delighted to welcome into the department Sarah Lockwood, Rupeena Purewal and Jane Burgess.

Sarah Lockwood

Sarah Lockwood is an associate in the firm's London office. She concentrates her practice on real estate matters. Sarah has experience in a range of transactions including portfolio management for public and commercial entities, retail lettings and landlord and tenant matters. She has experience acting for a wide range of clients including institutional investors, landlords, tenants, individuals, lenders and registered providers of social housing.

Rupeena Purewal

Rupeena Purewal is an associate in the Real Estate practice group. During her time in the group she has assisted with a variety of commercial property matters including acting on lease negotiations and renewals, sale of commercial properties and advising both landlords and tenants on management matters.

Jane Burgess

Jane Burgess is Special Counsel in the Real Estate Land Use, Planning and Zoning practice group. Jane has advised on major development schemes across the country, been responsible for the conduct of a number of high profile planning inquiries into development schemes including the preparation and co-ordination of evidence, and the management of multi-disciplinary teams. ■

Transaction Profile - Focus on Henderson Global Investors

This issue of OI profiles the sale of the Mercury Portfolio for our client Henderson Global Investors. The Mercury Portfolio was the largest UK multi-sector portfolio sale in over three years, and constituted the remaining assets held in the Henderson Caspar Property Fund. The portfolio comprised 24 commercial assets split evenly across the retail, office and industrial sectors, with 60% of the assets in London and the South East and the balance stretching from Plymouth to Scotland. The portfolio produced a total income of around £17.75m per annum secured by 68 tenants on 87 tenancies.

History of Client Relationship/ Transaction Background

We have acted on what became the Henderson entities since 1986, and Wayne Smith (joint global head of real estate) has managed that relationship for many years. The work we undertake for Henderson supports the complete range of real estate and real estate associated services undertaken by Henderson operating out of London. We advise a range of property funds covering retail, industrial and office asset classes. We undertake complex tax driven structure work and we are very familiar with, and advise upon the Jersey Property Unit Trust, and other structures which Henderson utilises. We have advised Henderson upon a number of high value complex unit swap/cash for units transactions in recent times and, in 2011, we advised Henderson Central London Office Fund on the acquisition of the Leadenhall Triangle site in the City of London for £190m. Last year we were shortlisted by the Lawyer referencing this deal.

Due to our existing relationship, and our in depth knowledge of the Fund, we were instructed to act on the sale of the Mercury Portfolio, which marked the end of a long journey for the closed ended Henderson Caspar Fund (first launched in 2004).

Following various strategic disposals earlier in the Fund's life, coupled with the completion of an extensive programme of asset management, the sale of the portfolio initially began by identifying new sources of equity which could recapitalise the vehicle ahead of an October 2012 CMBS debt maturity deadline. Whilst a recapitalisation/ re-financing solution for the Fund had been identified the decision by the investors was taken to sell the assets, and the sale of the remaining assets of the Caspar Fund known as the "Mercury Portfolio" was launched in May 2012.

Terms for the sale were agreed following a bidding process and given the far-reaching appeal for the portfolio it demonstrated there is a considerable weight of capital in the market place for portfolios of scale and quality, principally driven by private equity, with 16 bids received.

The Fund achieved a price of £184m for a corporate sale of the four JPUTs held within the Caspar Property Fund. The purchaser was a new JV formed between Mountgrange Investment Management (represented by BLP) and Patron Capital Partners, with a portion of the assets being immediately sub-sold to CBRE Global Investors, F&C Reit and Royal London Asset Management.

The K&L Gates real estate team had therefore to project-manage a tense and challenging process between managing the CMBS debt expiry whilst at the same time seeking to conclude a complex disposal transaction of four JPUTs.

Key team members included Melanie Curtis and Wayne Smith (property partner, who led and project managed the team, and Henderson client relationship partner respectively), Howard Kleiman (corporate partner), Sebastian Charles (planning partner), and a team of finance, construction, employment and corporate lawyers at K&L Gates. The real estate team needed to be innovative in:

- Managing the expiry of the Fund, together with the loan arrangements for the CMBS Loan. It was unusual to sell off a whole portfolio, whilst at the same time negotiating with the bank, and agreeing the undertakings was a technical and tricky process. Henderson needed to avoid putting the equity at risk, and the team had to work to tight timescales, and negotiate with a range of parties, both external and internal, to ensure the process ran smoothly and the legal challenges were dealt with.
- Project managing a team of internal cross disciplinary lawyers (circa 21 at K&L Gates), whilst also being responsible for managing the external Henderson Lawyers. Project management skills were fundamental.

Commenting on the deal Martin Payne, the Fund's manager says, "This transaction marked a tense and challenging process between managing the debt expiry at the same time as trying to conclude a very complex disposal transaction. We were delighted to have concluded a satisfactory outcome allowing us to return equity to investors from a Fund whose LTV had gone well above 100 per cent. The key to that was identifying the right purchasers and working together to find solutions. K&L Gates project-managed multidisciplinary teams at several law firms, including English, Scottish and Jersey lawyers. They were proactive, commercial and innovative and worked together with us to find solutions." ■

Case Summaries

Recovery of costs from residential tenants via service charge

In 2008, the freehold of a holiday park in Cornwall, containing 150 chalets let on 999 year leases, was bought by a new owner with the intention of redeveloping it. The new owner informed the lessees that the service charge of £3,120 per chalet would rise to £9,600. The landlord did not consult prior to carrying out the redevelopment works.

The lessees argued that the works should be considered as a whole and under the Landlord and Tenant Act 1985 (the "LTA 1985") if a landlord intends to carry out qualifying works costing a lessee over £250, then he must consult with those lessees. If the landlord does not consult, the amount recoverable from any lessee is capped at £250. The landlord argued that each set of works should be examined, not the works globally, and if the contribution for a particular set of works was under £250 there was no need to consult.

The High Court decided that qualifying works under the LTA 1985 must be considered as a whole when seeking recovery of the cost from the tenants via the service charge. Following amendments made to the LTA 1985, it not appropriate to divide the qualifying works into sets of works. If the costs in any one service charge year are to exceed a contribution of £250 per tenant, then the section 20 consultation procedure must be carried out on all works.

Comment: This case has changed the way in which qualifying works need to be assessed under the LTA 1985 as amended. Previously, it was thought that that the cap applied to each set of works and if further works were required, the landlord would only consult again if the contribution towards the further works was over £250. The position now seems to have changed, requiring landlords to consult where any tenant is required to contribute more than £250 in any one service charge year, which most managing agents regard as unworkable. However, we understand that the landlord is appealing against the decision.

Phillips & Goddard v Francis & Francis [2012] HC

Continuity of use for a prescriptive right of way

A right was claimed over a track on the burdened land leading to a farm (the benefited land). A public highway was situated at one end of the track, with the burdened property on the other. The owner of the farm claimed the benefit of a vehicular right of way over the track based on regular use. The period of use relied on was between 1971 and 1991.

The court found that, until 1988, the owner of the farm used the track at least once a month. In 1988 the farm was sold and the new owners drove over the track only occasionally. It was held that the occasional use of the track by the new owners was enough for a claim in prescription, even though the use was more infrequent than their predecessors.

Furthermore, the burdened owner could have been expected to be alerted to use by the farm owner as the ruts in the track suggested vehicular use, and it was difficult for a burdened owner to envisage the vehicles going anywhere other than to the farm.

Comment: This case highlights the need for landowners to be attentive to the possibility of neighbouring properties acquiring rights over their land despite what seems to be infrequent use. Each case will be assessed on its facts and it is not necessary for an access to be used daily, weekly or monthly for there to be a prescription claim.

Orme v Lyons [2012] HC

Damages for loss caused by decrease in the value of the property not too remote

A developer obtained planning permission to develop a field for residential purposes. In September 2006, the developer reached an agreement with an engineering company, JGP, to design a road within the site and to obtain approval for the road to be adopted by the local authority. It was an express oral term of the contract that JGP would complete the work by March 2007. The work was not completed by this date and the developer engaged another engineer, who obtained the approval in June 2008.

The developer successfully sought damages from JGP, claiming that the delay had resulted in loss because of the reduction in market value of the property.

Applying the test in *Hadley v Baxendale*, the appeal court dismissed JGP's appeal that the loss was too remote as it was

Case Summaries (cont')

not reasonably foreseeable as a serious possibility if there was delay. The court held that there was nothing to suggest an understanding in the property industry that someone in JGP's position would not be taken to assume responsibility for changes in the property market, arising from a delay from breach of contract. JPG knew what the developer intended to do and the intended to start date. They also knew that delay resulted in risk that the property market may change. Therefore, this was not loss that JGP could not reasonably foresee.

Comment: This case emphasises that for parties to ensure they are not held liable for particular types of loss, they should expressly exclude them in the contract. If not, then to avoid liability, they will need to show circumstances that make the implied assumption of responsibility inappropriate for the type of loss in issue.

John Grimes Partnership Ltd v Gubbins [2013] CA

Prescribed information needed for tenancy deposit schemes

The tenant paid a deposit and the landlord put the deposit in a Tenancy Deposit Scheme. The tenant fell into arrears and as a result the landlord sought possession.

The tenant argued that the landlord had not complied with paragraphs 2(1)(c) to (f) of the Housing (Tenancy Deposits) Prescribed Information Order 2007. The landlord admitted non-compliance but argued that the requirement was mainly procedural and that the purpose of the Order was to protect deposits, which had been done. Furthermore, the landlord contended that as the information was available, the tenant could easily have found out any further information that was required from the TDS website.

The Court of Appeal held that the Landlord was in breach of the Order. As a result, the Landlord was required to return the deposit to the Tenant and additionally pay a penalty equal to three times the deposit.

Comment: This case emphasises that it is imperative that landlords comply with the Order and they must also be meticulous in providing the prescribed information to their tenants.

Ayannuga v Swindells [2012] CA

Law Commission publishes consultation on rights to light

A "right to light" is an easement which provides the benefiting landowner with the right to receive light to their land through defined apertures across another owners land. The servient landowner cannot interfere with this access to light on the dominant land.

On 18 February 2013, the Law Commission published its Consultation Paper in relation to reforms to the rights to light. The consultation period will run until 16 May 2013.

The Paper responds to the continuing debate as to whether the law of rights to light has become unduly burdensome and as a result negatively impacts the potential for development and redevelopment.

The report contains the following four main proposals when constructing new buildings:

- to abolish the ability to acquire a right to light through prescription (long use);
- to introduce a statutory test to clarify when the court can order payment of damages instead of granting an injunction to stop the construction of a building interfering with a right to light;
- to introduce a statutory notice procedure, requiring a person with the benefit of a right to light to make clear that they intend to apply to court for an injunction stopping development that interferes with their right to light; and
- to enable the Lands Chamber of the Upper Tribunal to extinguish obsolete rights to light that have no practical benefit and also to award compensation, as it can currently do with restrictive covenants.

Comment: The law on rights to light is extremely difficult to apply and a number of recent cases have triggered calls for reform. The consultation follows on from the High Court decision in *HKRUK II (CHC) Ltd v Heaney* which highlighted the risk of developers being required to demolish buildings that obstruct rights to light, in circumstances where it would have previously been expected that the court would order payment of damages.

The consultation paper examines a number of difficult issues in this area and attempts to resolve the surrounding uncertainty. ■

For further information contact:

Steven Cox	steven.cox@klgates.com	T: +44 (0)20 7360 8213
Bonny Hedderly	bonny.hedderly@klgates.com	T: +44 (0)20 7360 8192
Rupeena Purewal	rupeena.purewal@klgates.com	T: +44 (0)20 7360 8184

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Diego San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates practices out of 48 fully integrated offices located in the United States, Asia, Australia, Europe, the Middle East and South America and represents leading global corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.