Room with a view

Birketts

Welcome to the July 2016 issue of *Room with a view*

I'm going to refrain from making any further comment on Brexit because:

- in truth, the direct impact on property law (as opposed to the property market) is likely to be pretty modest as there is relatively little directly applicable European legislation which affects us. The bits that do are largely in our domestic legislation already and will be pretty far down the list of subjects up for negotiation when (if) that process starts; and
- because whatever we say today is likely to be overtaken by events tomorrow.

Instead in our summer edition we focus on the here and now, something we can have some influence over. Certainly the world will continue to turn and to a greater or lesser degree people will continue to invest in bricks and mortar. With that in mind, this edition is (broadly) about being good neighbours (with not a hint of irony) and looks at a range of tricky commercial property subjects.

- Property transactions and charities - To commercial property owners charities can present an opportunity, especially as they can take certain advantages not available to the wider market. However, an understanding of the reasons why they can appear 'slow' to settle commercial discussions is a good way of avoiding tensions, as Louisa Saunders explains.
- Redevelopment of property can be a source of tension with neighbours at any time. But what happens when the neighbours are actually tenants in the building being redeveloped? Stuart Raven discusses a recent case as well as offering top tips on how to handle the process.
- Mixed use properties are increasingly prevalent (especially in urban areas) and can represent a different kind of investment opportunity... if you know what you're doing. Charlotte Wormstone gives a brief overview of some of the bear-traps associated with dealing in such properties.
- Neighbourhood planning – not quite social engineering but a real and growing force affecting development. Sue Chadwick explains some of the issues and the latest legislation which is going to bring this subject increasingly to the fore.

And if you ever wanted to know how to go about using a pension fund as a vehicle for direct investment in property, we might just have the people you need to talk to.

In this issue

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Speedread: what you need to know when doing property deals with charities

Buying from and selling land to charities is a fact of life for many commercial property investors, and in some instances leasing to a charity at a modest rent can even provide a cost-effective alternative to having voids in a property portfolio. However, before doing so it is worth having an understanding of some of the particular 'quirks' of dealing with charitable organisations which can seem odd (or an attempt to slow down the transaction) to others. In this article Louisa Saunders covers some of the key issues to bear in mind.

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Who owns or will own the property?

- Establish the ownership structures of the charity at an early stage.
- A charity can only hold land in its own right if it is 'incorporated', e.g. a company or Charitable Incorporated Organisation.
- If the charity is not incorporated then individuals will need to hold title on trust for the charity.
- Individual trustees will usually seek to limit their personal liability by reference to the charity's assets – this is quite common as the trustees are frequently unpaid officeholders who have no wish to expose their personal assets on behalf of the charity.
- If buying/leasing from a charity establish early on who holds title as there can be a 'lag' between the day-to-day decision makers and the trustees in whom the title is actually vested. In this area at least it can be the case that the decision makers will have to have meetings to obtain formal sanction to the acts which they undertake on behalf of the charity.

Charities Act 2011 (the Act) - requirements

- The default position is that a charity may not dispose of an interest in land without obtaining an Order of the Charity Commission or the Court – these can take considerable time to obtain.
- In most cases charities can proceed without an Order - provided they follow the procedures set out in the Act.
- The aim of these provisions is to ensure that the terms of the deal are the best that can reasonably be achieved for the charity.
- For sales or grants of leases in excess of seven years a specialist surveyor's report is usually required.
- Shorter leases attract less stringent requirements, hence why charities are more reluctant to take on long lease commitments.
- A buyer from a charity could find the transaction is void if the charity has not followed the correct procedures. Simply relying on the prescribed charity statements in the contract documents may not be enough.
- Acquisitions by charities do not have the same restrictions but charity trustees still have the same overriding duty to obtain the best terms possible – depending on the circumstances that duty may still require a surveyor's report to be obtained.

Business rates

- Charities benefit from 80% mandatory relief from business rates which can represent considerable saving on the void rates bill to a landlord investor.
- A further 20% discretionary relief is available from the local authority provided the property is used wholly or mainly for 'charitable purposes' but this can vary from authority to authority.

Key tax issues on property deals involving charities

- SDLT – charitable relief is usually available to a charity provided the criteria are fulfilled and this may represent an opportunity to negotiate on price, particularly where the SDLT liability is substantial.
- VAT – charities are not generally exempt from VAT. VAT may still be payable by a charity on the purchase price or on rent if the seller has opted to tax. Establish the tax implications of the transaction early on as the lack of availability of relief can seriously impact the financial viability of some lettings and sales.

"...in some instances leasing to a charity at a modest rent can even provide a cost-effective alternative to having voids in a property portfolio."

Seeing the bigger picture

In circumstances where it is often more desirable (or cost effective) to repurpose parts of a building or development, how should the courts try to balance the potentially conflicting positions of landlords and tenants? Many modern leases expressly reserve the right for the landlord to redevelop the whole or part of the building, notwithstanding the occupation of sitting tenants in other parts. How can this be reconciled with a landlord's covenant to give 'quiet enjoyment' to those self-same tenants?

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The issue has recently been considered in the High Court. The property in question was a mixed use block across the street from the Connaught Hotel in central London. The ground floor of the property was originally let in 2007 on a twenty year lease to an art gallery, Timothy Taylor Limited. At the time of the dispute the passing rent of this lease was in the order of £500,000 per annum. The remainder of the building (a further five storeys) was divided into residential apartments. In around 2012 the landlord obtained planning permission to add a further mansard roof and virtually rebuild the whole of the interior of the building above ground floor level. The tenant did not dispute the landlord's right to carry out the works (by and large) but was upset about the manner in which the landlord tried to carry them out. In the end, the court largely sided with the tenant's arguments and awarded damages equivalent to a 20% reduction in the rent for the whole of the period of the landlord's works (which are currently ongoing and likely to take two years to complete). Further, the court also ordered certain restrictions on particularly noisy works and/or the duration that such works should be carried out for.

So what does the decision tell us?

In reaching his decision, the Judge considered both previous case law, and its particular application in this case. Key themes included the following:

- Regardless of the precise wording used, the landlord must take 'all reasonable steps' to minimise disturbance to its tenants. Clearly this is not the same as saying there can be no disturbance, but nonetheless the landlord must take account of the tenants' continuing occupation during the carrying out of the works.
- It is relevant whether the tenant knew at the date of the lease that the landlord had redevelopment proposals in mind. Merely inserting the necessary permissive wording to allow redevelopment in a lease does not constitute 'knowledge'. In this case the landlord was unable to persuade the court that it had set out the likely timescale and extent of the proposed redevelopment, or that this had been reflected in the lease terms negotiated.
- An offer of compensation to the tenant can be taken into consideration in assessing the overall reasonableness of the steps taken by the landlord. In effect this is what the court ordered through the rent reduction – a self-help solution the landlord had not shown any interest in pursuing.
- The nature of the property can also be relevant. Here the premises were operated as a high class art gallery at a substantial rent, and the bar for what constituted 'reasonable steps' was set appropriately higher.
- There is an element of 'say what you do and do what you say'. Apart from the noise issues, the tenant's main complaint related to the way in which scaffolding was erected at the property. Having been shown indicative plans which would leave most of the shop front visible to passers-by, what was constructed ultimately was a series of hoardings giving the impression that "the Gallery had entirely disappeared and was now part of what was a building site". The tenant had apparently received numerous comments asking whether or not the gallery was closed and when it would reopen.

> "Many modern leases expressly reserve the right for the landlord to redevelop the whole or part of the building..."

Practical pointers

So what are the practical lessons to be learned from the case? Ultimately, in spite of what the lease wording enabled the landlord to do in theory, trying to achieve that outcome ended in expensive litigation and a hefty rent reduction. That said, 'quiet enjoyment' is not the same as 'nearly silent', so there is food for thought on both sides. Things to think about when considering works being undertaken (whether landlord or tenant) include:

- Ensuring tenants are aware of any proposed plans for development works prior to the grant of leases so far as possible.
- Consulting early with tenants on any proposed works to reassure them that all reasonable steps will be taken to minimise interference.
- Instructing contractors to specifically take into account the use and enjoyment of other parts of the premises during construction works. This will go beyond essential health and safety issues to considering wider concerns such as scaffolding design, arrangements for delivery of materials and regular communication with all affected parties about the progress of the works.
- Timetable noisy works and liaise with tenants over their duration and noise levels. Consider also keeping acoustic records of noise levels to prevent disputes arising subsequently.
- Consider offering compensation by way of discounted rent. The landlord's refusal to do so in this case appears to have weighed heavily against it. This is particularly so as the landlord had paid a substantial sum to a neighbouring owner in order to secure licence to oversail their property with a crane during the construction period!

Perhaps unsurprisingly, the moral of this case is all about engaging pro-actively and seeking to manage tenant relations in a sensible manner. Failure to do so can have expensive consequences.

"Timetable noisy works and liaise with tenants over their duration and noise levels."

Mixed up in mixed use

Pressure to increase density of development in urban areas and the rise of commercial (typically office) buildings being changed into residential developments, have led to an increase in mixed use developments. Typically these comprise ground floor retail/office uses with residential units above, and possibly even additional income derived from mobile phone masts or other roof mounted equipment. Mixed use can provide potentially lucrative income streams to investors and developers alike. However proper consideration can mean the difference between ending up with a smart investment and taking on a problem lying in wait.

You first

Our first wrinkle is the Landlord and Tenant Act 1987 (the 1987 Act). Originally designed to give long leaseholders of flats a right of first refusal to buy the freehold of their buildings, it has far-reaching (and we would argue unintended) consequences. The 1987 Act applies where there are at least two flats let to qualifying tenants (which is based on there being a long lease, rather than simply a tenant's actual occupation of a flat).

In addition, for the 1987 Act to apply the floor area of the commercial space in the building, excluding common parts, must be less than 50% of the overall total. This is particularly worth bearing in mind if the owner plans to reduce the commercial space by converting it to residential as a building which was previously outside the 1987 Act may come within it.

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If the conditions are met, then the landlord must first offer the tenants the opportunity to buy the property comprised in a 'relevant disposal'. The 1987 Act lays down a prescribed timetable for service of notices, for the tenants to respond (and, if they wish to proceed, to nominate a purchaser/purchasing vehicle), and for the sale to either proceed under the pre-emption arrangements or for the pre-emption to lapse. During all of this process the seller cannot negotiate with another buyer (even on a conditional basis), until after the expiry of the statutory pre-emption period. Failure to comply with the relevant procedures gives rise to both:

- criminal sanctions against the seller including substantial fines; and
- the ability of the flat leaseholders to effectively undo the transaction by compelling the third party to convey the relevant interest to them on the same terms as it was sold to that third party. It should be noted in particular that there is, in effect, no limitation period on the tenants' right to exercise that compulsory purchase power which means they can secure any uplift in value, between the date of the original transaction and the date they exercise their rights, for free.

"If the conditions are met, then the landlord must first offer the tenants the opportunity to buy the property comprised in a 'relevant disposal'."

What makes the 1987 Act particularly difficult for landowners is that, as well as there being no ability to 'contract out' of its effect, the meaning of the phrase 'relevant disposal' has been interpreted as extending not only to an outright sale of the building but also to:

- the grant of a long lease of the building as a whole
- a lease of the air space above the building. This could be to erect a mobile phone mast (something which the new electronic communications code proposes to remedy for the benefit of mobile phone operators) but could equally apply to allowing a third party to develop the air space for additional residential units
- a lease of common parts which are to be converted to residential use
- arguably, the grant of the lease of a commercial unit in the mixed use building. We say arguably as, so far as we are aware, the point is actually untested in the courts. It is unclear in practice how a right of first refusal under the 1987 Act can sit with the rights of an occupying commercial tenant who has rights to renew their commercial lease under the provisions of the Landlord and Tenant Act 1954.

Sold?!

Even if a landowner has no plans to sell, it may well be manoeuvred into having to do so under another piece of legislation, the Leasehold Reform, Housing and Urban Development Act 1993 (the 1993 Act). This gives qualifying tenants (and here the rules are different and additionally the qualifying residential floor areas must comprise at least 75% of the total area of the building) the right to come together and serve notice on the landlord requiring it to dispose of the freehold of the property to the tenants. Again there is an involved statutory process to be negotiated, as well as procedures to enable the value to be determined where it cannot be agreed between the parties themselves.

"Even if a landowner has no plans to sell, it may well be manoeuvred into having to do so..."

In practice, where the commercial units are let at full rack rentals, it is unlikely flat owners will exercise the right to buy, on the basis that they will have to pay full market value for the building which may well prove beyond their individual or collective means.

As well as being able to buy the building outright, under the same legislation qualifying tenants also have the right to seek a statutory extension to their leases, a right usually exercised before the lease length falls below certain thresholds that affect its mortgageability. From an investment perspective this can be lucrative, as the tenants will have to pay a premium for that extension. Nonetheless, the negotiation process, and the statutory fall-back of applying to the First Tier Tribunal (previously known as the Leasehold Valuation Tribunal) to determine disputes, are different from a negotiation on an investment/commercial lease type basis.

Are you managing?

Another provision introduced by the 1993 Act (and for practical purposes largely the same qualifying criteria apply) is the collective right for tenants to take over the management of the building from the freehold owner. There are some important points to bear in mind.

- Mismanagement is not a pre-requisite of the tenants being able to exercise the right. Provided they meet the qualifying criteria and follow the (slightly involved) statutory procedure, then they can apply to have the management vested in a tenant management company (RTM) at any time.
- The management rights only extend to those areas of the building let to the relevant qualifying tenants; the remainder continue under the control of the building owner. In other words, the commercial areas and any residential apartments not let on a long lease basis remain the responsibility of the freeholder of the building or its managing agents / management company. In effect this can lead to a duplication of management and problems with practical issues over who manages what.
- The right to collect residential service charges vests automatically in the RTM and the owner will have to hand over any on account sums that the owner or its agent is holding. Furthermore, there are no automatic rights requiring the parties to jointly agree on managing agents or to deliver services in a co-ordinated fashion.

> "Sanctions for failure to follow procedure can be serious (at least in financial terms)..."

At your service

As if the situation were not complicated enough, a final piece of legislation, the Landlord and Tenant Act 1985, also imposes statutory controls on residential service charges. There are wide ranging restrictions on matters such as levels of service charge, provision of information, duties to consult before agreeing any long term (defined as an agreement lasting more than 12 months) arrangements or incurring costs above a (quite low, particularly in smaller developments) financial limit, all of which will be new to those used to dealing with commercial properties. Sanctions for failure to follow procedure can be serious (at least in financial terms) with cost recovery from tenants being either severely capped or even disallowed completely.

Conclusion

When considering buying or developing a site for mixed use, great thought should be given to the possible impact of the issues outlined above. In some circumstances, careful planning at an early stage can mitigate many of the adverse effects. However, generally this can only be done before a development is up and running or at least has reached certain critical points in its development. Otherwise, a detailed analysis of the risk issues is key, both operationally and financially, as part of a review of the overall viability of any given project.

Independence Day for Neighbourhood Planning???

In the brave new post-Brexit world, with traditional power structures disintegrating and previously overlooked sectors of the population making themselves heard, the context is ripe for the rise and rise of the neighbourhood plan.

Developers hoping to build in an area where a new planning forum is proposed or a neighbourhood plan is in the pipeline ignore these local voices at their peril.

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What is neighbourhood planning?

Neighbourhood planning was introduced by the Localism Act 2011. The most significant local plan powers are the ability for a local community to:

- create a neighbourhood planning forum
- get a local area designated as a local planning area
- facilitate certain types of development through a Development Order
- designate land for development in the area through neighbourhood plans.

Why is it important?

Neighbourhood planning enables local communities to have genuine and increasingly significant control over what can and cannot be built in their areas. The most serious impacts will be felt where there is an emerging neighbourhood plan close to adoption or a neighbourhood plan is in place and more up to date than the local authority one. However, if current plans to allow CIL funding to be reserved for and diverted to local areas are formally approved, then neighbourhood planning forums – and parish councils - could have a significant financial role in new developments too.

"Neighbourhood planning enables local communities to have genuine and increasingly significant control over what can and cannot be built in their areas."

Neighbourhood plans

It is important to remember that a neighbourhood plan, once adopted, becomes part of the formal 'development plan' for the area – and must be taken into account when any application is determined. Even an emerging plan will be a significant material consideration in such determinations. At a time when councils are still struggling to adopt sound and compliant area-wide plans it is wise to pay attention to both emerging and adopted versions of neighbourhood plans as they may well represent the most up to date and therefore influential local planning policies affecting development proposals in a given local area.

It is even more important to be aware that where there is conflict between a development proposal and a neighbourhood site designation, the neighbourhood plan, if up to date, is likely to be highly significant and may give the local council a good reason for refusal of that proposal.

"Even an emerging plan will be a significant material consideration in such determinations."

The increasing significance of neighbourhood plans is demonstrated by a significant increase in case law on this topic in the last few years. The three summarised here are both recent and significant in different ways.

- In the 'Crownhall Estates' case[1] the developer challenged the decision of Chichester District Council to allow a vote on adoption of the Lowood Neighbourhood Plan. The developer claimed that the council's site selection exercise was defective and should in particular have allocated more land for housing development than it did. The court disagreed, supporting the approach taken by the independent examiner to site selection. The plan remained in place, frustrating Crownhall's development ambitions.

- In the 'Larkfleet Homes'[2] case the developer asserted that it was not legitimate for specific site allocations to be set out in a neighbourhood plan. The Court of Appeal rejected this assertion and confirmed the view taken in the previous High Court decision: "The provisions relating specifically to neighbourhood development plans are plainly wide enough...to allow site allocation policies to be included".

- In the 'DLA Delivery" case[3] the High Court considered, among other matters, the role of an adopted Neighbourhood Development Plan (NDP) where there was no general development plan in place, so that it was impossible, practically, for the NDP to be 'in conformity with' the superior plan. In these circumstances, Justice Foskett ruled that the NDP would still be a material consideration, and might be useful in "unlocking for development a site that has general planning merit".

1 *R(Crownhall Estates Ltd) v Chichester District Council* [2016] EWHC 73 (Admin)
2 R (Larkfleet Homes) v Rutland County Council [2015] EWCA Civ 597
3 R(DLA Delivery Ltd) v Lewes DC [2015] EWHC 2311 (Admin)

Neighbourhood portions

As well as having significant impact in terms of strategic plan policies, neighbourhood forums could also have significant amounts of infrastructure spending money – often referred to as the 'neighbourhood portion'.

Under the Community Infrastructure Levy (Amendment) Regulations 2013, 15% of all money received from Community Infrastructure Levy (CIL) must be transferred to the local area but this proportion increases to 25% where there is a neighbourhood plan in place.

While a charging authority is required to apply CIL to funding 'infrastructure' – and to define what that means, the neighbourhood portion can either be applied to infrastructure or to anything else that 'supports the development of an area[4] including affordable housing. Although guidance advises local councils to work closely with the charging authority[5], the councils are not required to follow the charging authority's priorities.

"... there are clear indications that their powers will increase rather than diminish."

Future implications

Parish councils and planning forums have not traditionally been seen as significant players in the development process but their potential to frustrate - or positively influence development has increased and is unlikely to diminish in the near future. Indeed there are clear indications that their powers will increase rather than diminish.

- The Housing and Planning Act 2016 includes:
    - o powers for the Secretary of State to prescribe time periods within which local planning authorities must undertake key neighbourhood planning functions, and to intervene in some local authority decision making in relation to local referenda
    - o a new duty for all local authorities to notify the forum of planning applications in the neighbourhood area in which the forum is designated
    - o the power for the Secretary of State to amend the definition of 'planning authority' and 'relevant planning function' in relation to the new duty to promote the supply of starter homes.
- The Government has already published draft regulations on the changes to referenda timetables, and these are due to come into force on 1 October.[6]They amend the existing regulations[7] by imposing shorter, specific, timetables on the referendum process involved in approving a neighbourhood plan.
- The Neighbourhood Planning and Infrastructure Bill is likely to be published in the summer and the notes to the Queen's Speech suggest that it will include measures to "Further empower local communities to plan the homes and infrastructure that they need" including strengthening neighbourhood planning by "making the local government duty to support groups more transparent and by improving the process for reviewing and updating plans."

4 Reg 59C
5 Paragraph: 079 Reference ID: 25-079-20140612
6 The Neighbourhood Planning (Referendums) (Amendment) Regulations 2016
7 Neighbourhood Planning (Referendums) Regulations 2012 (S.I. 2012/2031)

Conclusion

Local bodies such as parish councils and neighbourhood planning forums are sometimes seen as potentially problematic in development terms and they certainly have the power to restrict development through neighbourhood plan policies. On the other hand, they also have the potential to facilitate the implementation of a development where they can be persuaded to use CIL receipts towards the provision of complementary infrastructure.

If you are planning development in an area with an existing parish council or neighbourhood plan, or there is an emerging planning forum in the area engaged in promoting formal designation of its area or in the early stages of plan formation, it makes sense to find out as much as possible about their ambitions for the area.

> "Local bodies such as parish councils and neighbourhood planning forums are sometimes seen as potentially problematic in development terms..."

I didn't know you did that!

Whatever the political climate at any given time, investing in commercial property can make it a good long-term bet. The ability to do so through a self-invested pension fund (SIPP) or small self-administered scheme (SSAS) can also be a particularly tax-efficient way to do so, but it is not without its complications.

Birketts has tackled this by establishing its own specialist team advising SIPP and SSAS administrators (including some of the largest in the UK), financial advisers, pensioneer trustees and investors on the acquisition, management and disposal of commercial property against a backdrop of a highly regulated investment industry.

The head of team was previously property director at leading SIPP provider, Suffolk Life. The team is eight strong, collectively has over 30 years' experience working within the SIPP industry and its industry knowledge and can-do attitude is second to none.

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