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Real Estate

UK

Colin Rodrigues, Harminder Sandhu and Davinder Sanghera
Hawkins Hatton Corporate Lawyers Ltd

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Contributed by:

Colin Rodrigues, Harminder Sandhu and Davinder Sanghera

Hawkins Hatton Corporate Lawyers Ltd see p.16



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1. General

1.1 Main Sources of Law

UK real estate law is derived from common law and statutory legislation. In relation to the latter, the primary legislation comprises:

- the Law of Property Act 1925, which reduced the number of legal estates to two and streamlined the transfer of interests in land for purchasers;
- the Land Charges Act 1972, which updated the process for registering charges against unregistered land; and
- the Land Registration Act 2002, which updated the law of land registration and stipulated the registration of shorter leases.

1.2 Main Market Trends and Deals

Brexit

In the last 12 months the UK economy has been dominated by the uncertainty associated with Brexit. However, despite this uncertainty, transactional activity has been consistent in the real estate sector across the UK. Why have business owners had the confidence to continue to invest in business premises or lease more units? The answer lies in the opportunities that arise in uncertain times. The UK saw a record number of real estate transactions (save for in retail) in 2019, primarily due to the reduced cost of finance. Investors are also optimistic that once the Brexit uncertainty passes (now there is a majority Conservative government led by Boris Johnson), the real estate market will bounce back with a vengeance.

Key Transactions

Some of the key transactions of 2019 included the sale of a plot of land by the owner of Newcastle United FC for GBP9 million to make way for a regeneration programme valued at GBP120 million; the purchase of Stockport's iconic Pyramid building for GBP4.5 million by a Saudi Arabian investor; and the purchase of Cardiff's historical post office and county court building (dating back to 1897) by a London-based investor funded by Legal & General for development as a hotel. In addition, Aviva Investors agreed to a GBP45 million multi-storey car park at a hotel complex in Manchester's new Circle Square which is due to be completed in August 2020; there's been expansion by Cofresh (Leicester-based snack company) following its GBP20 million investment in a new site in Leicester; a multimillion-pound investment by a Singapore-based Fragrance Group in a new 115-bed hotel in Torquay and the acquisition by Tristan Capital Partners (London-based real estate investors) of 103 Colmore Row in the heart of Birmingham, an office development set for completion in 2021. The expectation is that commercial real estate will stay strong in 2020. The weakness of sterling continues to attract overseas investors from the Middle East, Japan and

Korea, etc. Foreign capital in London yields higher income than in other EU countries. There have also not yet been relocations of large organisations to other EU countries.

Retail Sector

Brexit aside, online shopping has continued the demise of the retail sector with 2019 being the worst year on record (total sales slipped by 0.1%), according to the British Retail Consortium and KPMG. Around 16 stores closed each day in the first half of 2019 with the decline of 1,234 chain stores on Britain's high street according to PwC and Local Data Company, faster than any preceding year. Chain stores such as Karen Millen, Jack Wills and Bathstore went into administration while retailers including Top Shop, Monsoon, Carpetright and New Look closed stores and terminated lease agreements to avoid insolvency. Major retailers (Tesco, Sainsbury's, Harrods) continue to lobby the government regarding business rates reductions. Fixed overheads associated with retail units and the change in shopping habits have made retail space less relevant, while in retail there has been increased demand for self-storage space (without long-term commitment) by online retailers, which presents a new investment opportunity in real estate.

Leases and Letting

The buy-to-let market in 2019 continued to be less attractive than in previous years due to tax changes such as a 3% increase in SDLT for additional properties, abolition of tax relief for mortgage repayments, and a stricter health-and-safety regime for landlords.

Staying with the letting market, 2019 showed that, on average, the length of commercial property leases has been reduced by five months to 6.3 years. This has been the theme since 2016 following the Brexit referendum. The issue is lack of space and not demand, which of late has been driven by tech businesses. Industrial space continues to be strong for commercial lettings.

Coronavirus

The unexpected economic challenge for the year ahead is Coronavirus, which has already significantly impacted economies and growth around the world. Closer to home, until the UK's relationship with the EU and the rest of the world is determined, the UK economy will continue to face some uncertainty, including in the real estate sector.

1.3 Impact of Disruptive Technologies

Real estate investors, developers and lenders have started to increase investment in technology to keep abreast of technological advancements in real estate, whether that be proptech or blockchain or DeFi. The pace of change is significant, with these disruptive technologies both speeding up real estate processes and making them more efficient. However, it will be some time

before disruptive technologies replace convention in the real estate market in the UK.

1.4 Proposals for Reform

The new Code for Leasing Business Premises will come into force in September 2020 and is aimed at assisting negotiations to produce comprehensive heads of terms to make the legal drafting process more effective. From April 2020, new legislation will mean that a landlord will only be allowed a 20% tax credit for mortgage interest paid. This has two main implications for landlords:

- if the landlord is a higher-rate tax payer, only a 20% tax refund will be given (not the higher rate of tax paid); and
- it may force landlords into a higher tax bracket, as they will have to declare the monies paid on the tax return.

This change will no doubt impact on investment by landlords in buy-to-let properties.

Capital Gains

Individuals pay “non-resident” CGT (NRCGT) at 28% on any (post-April 2015) gains made on UK residential property if they are non-resident for tax purposes.

From 6 April 2019, NRCGT was extended to (post-April 2019) gains in respect of commercial property, albeit with certain exemptions.

2. Sale and Purchase

2.1 Categories of Property Rights

The Law of Property Act 1925 creates two categories of property rights within England and Wales:

- freehold rights, where a proprietor has absolute control of the property and any dealings with it as he/she owns it in its entirety; and
- leasehold rights, where a proprietor does not own the property but is granted exclusive use of it subject to terms (including period of occupation) agreed in a lease.

2.2 Laws Applicable to Transfer of Title

Title to real estate is transferred by virtue of what is called a sale contract and transfer. There are no special laws which apply to transfer of any specific types of real estate.

2.3 Effecting Lawful and Proper Transfer of Title

A lawful and proper transfer of title is effected by submitting a duly executed transfer deed to HM Land Registry under cover of an AP1 form. This transfers the legal interest in the property

from the seller to the purchaser. On receipt of the deed, the Land Registry will register the legal interest of the new proprietor and generate an electronic register of the property showing the purchaser as the new owner of the property. This registration process is stipulated by the Land Registration Act 2002.

It is possible to obtain title insurance. However, it is not common, as the expectation is that a purchaser will fully interrogate and investigate title.

2.4 Real Estate Due Diligence

Real estate due diligence is carried out at all stages of a transaction. This is usually undertaken as follows:

- The purchaser’s conveyancer will interrogate the title to the property being purchased and raise enquiries of the seller in order to:
 - (a) understand what rights the property has the benefit of and is subject to;
 - (b) identify any covenants or restrictive covenants to which the property is subject that may affect use of the property (eg, it would not be advisable to complete the sale of a property which has a complete restriction on the property being used as an office, if it is your client’s intention to make this use of the property); and
 - (c) highlight any security registered against the property which will need to be discharged prior to completion of the transaction.
- The purchaser’s conveyancer also undertakes searches against the property, namely:
 - (a) a contaminated land search to identify any contamination issues;
 - (b) a drainage and water search to identify if the property is connected to the mains water and drainage system;
 - (c) a coal and mining search to identify if the property is located on or close to a mining area;
 - (d) a chancel repair search to identify any chancel repair liability; and
 - (e) a local authority search to identify any planning permissions or building regulation approvals/issues.

The purchaser’s conveyancer also raises standard enquiries in respect of the property for the seller to reply to (see **2.5 Typical Representations and Warranties**).

2.5 Typical Representations and Warranties

In commercial property transactions, the seller is asked to provide replies to commercial property standard enquiries (CPS-Es). These raise, by way of example, questions regarding:

- boundary disputes and maintenance;

- compliance with statutory obligations and planning permissions;
- environmental issues;
- VAT position; and
- capital allowances.

The answers provided in the replies to CPSEs constitute warranties provided by the seller to the buyer.

The buyer's remedies for misrepresentation are rescission and/or damages, depending on whether the misrepresentation was fraudulent, negligent or innocent.

2.6 Important Areas of Law for Investors

As detailed in **1.4 Proposals for Reform**, an investor must consider proposed changes in legislation (including tax) which may impact the financial viability of the transaction, given that an investor's objective is to derive capital growth and/or secure income.

2.7 Soil Pollution or Environmental Contamination

Land is considered to be contaminated where substances are either causing or could cause:

- significant harm to people, property or protected species;
- significant pollution of surface waters or groundwater; or
- harm to people as a result of radioactivity.

Generally, the person who caused or allowed the contamination to occur is liable for it unless they cannot be identified or the local council/environmental agency determines them exempt. The council may decide that the landowner or the person who occupies the land is liable for the contamination. Owners or occupiers who cause contamination remain liable after the disposition of the land, whereas an owner/occupier who is not a polluter has no liability when their ownership or occupation of the property ceases.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A local authority search will identify the permitted use of a parcel of land and whether this use has planning permission.

Where the property does not have planning permission for the permitted use, a seller/occupier of a commercial property can obtain a lawful development certificate for an existing use or development, provided it can be shown that the property has been used for that purpose for a continuous period of ten years or more. No enforcement action can be taken by a local authority once ten years have elapsed from the date of the breach (ie, the date on which the unlawful use of the property started).

An indemnity policy is usually readily available to provide cover to protect against the risk of any enforcement action.

In relation to a building that was completed more than four years ago and the building has been used as a dwelling for more than four years, a lawful development certificate can be obtained.

It is possible to obtain authorisation from the local authority in respect of change of use and it is always recommended that, prior to any development work, clients obtain the relevant planning permission from the local authority. This planning permission will include the permission required to undertake the planned works and use the property following completion of those works.

2.9 Condemnation, Expropriation or Compulsory Purchase

A compulsory purchase order (CPO) of property enables councils, central government, utility companies, etc, to purchase land if it is in the public interest to do so. "Public interest" could include:

- town-centre regeneration;
- housing developments;
- road-building projects;
- rail-building projects; and
- airport expansions.

If a CPO is granted, the landowner is paid compensation for the loss of the property.

Notice is served on the landowner of a proposed CPO and approval from government/parliament is then obtained. This notice will set a time limit for the landowner to lodge any objections. These are considered by the relevant authority, which then decides whether the CPO should be granted.

If a CPO is granted, then the purchase will proceed and the landowner will be compensated. The compensation is usually equivalent to the market value of the property together with reasonable moving costs, stamp duty land tax for buying an equivalent home and reasonable legal and lender's fees.

2.10 Taxes Applicable to a Transaction

SDLT is payable by the buyer on all property transactions in the UK. The rates of SDLT are determined by the price of the property and the designated use of the property (ie, whether it is commercial or residential).

Residential Property Rates

SDLT is payable on property prices above GBP125,000 in the following rates:

- GBP0–125,000 – 0%
- GBP125,001–250,000 – 2%
- GBP250,001–925,000 – 5%
- GBP925,001–1.5 million – 10%
- >GBP1.5 million – 12%

Relief for First-Time Buyers

No SDLT is paid by first-time buyers on properties worth up to GBP300,000 and only 5% SDLT is paid on the portion of the purchase price between GBP300,001 and GBP500,000.

Any purchase above GBP500,000 will attract the rates detailed here.

Residential Leasehold Sales and Transfers

If a new residential leasehold property is purchased, then SDLT is payable on the purchase price of the lease in the rates detailed here. In the event the total rent of the lease is GBP125,000 over the duration of the lease, then SDLT at a rate of 1% is payable on the amount over GBP125,000.

Higher Rates of SDLT

A 3% penal rate of SDLT applies on top of the standard rate for each subsequent purchase by a purchaser who owns one or more dwellings.

Non-residential and mixed-use land and property rates SDLT is payable on increasing portions where non-residential or mixed-use land is purchased for more than GBP150,000.

Non-residential property includes:

- commercial property, eg, shops or offices;
- agricultural land;
- forests;
- any other land or property which is not used as a residence; and
- six or more residential properties bought in a single transaction.

A “mixed use” property is one that has both a residential and non-residential element (such as a flat above a shop).

Non-residential and mixed-use land rates

- GBP0–150,000 – 0%
- GBP150,001–250,000 – 2%
- >GBP250,001 – 5%

Non-residential Leasehold Sales and Transfers

If a new non-residential leasehold property is purchased, then SDLT is payable on the purchase price of the lease in the rates detailed above. In the event the total rent of the lease is GBP150,000 over the duration of the lease, then SDLT at a rate of 1% is payable above GBP150,000.

- GBP0–150,000 – 0%
- GBP150,001–5 million – 1%
- >GBP5 million – 2%

SDLT Reliefs and Exemptions

Reliefs

The following reliefs can be applied for:

- first-time buyers;
- multiple dwellings;
- a building company buying an individual's home;
- employers buying an employee's house;
- local authorities making compulsory purchases;
- property developers providing amenities to communities;
- companies transferring property to another company;
- charities;
- right-to-buy properties; and
- registered social landlords.

Exemptions

SDLT is not payable and no SDLT return needs to be filed if:

- no money or other payment changes hands for a land or property transfer;
- property is left in a will;
- property is transferred because of divorce or dissolution of a civil partnership;
- freehold property is purchased for less than GBP40,000;
- a new lease of more than seven years is purchased or assigned provided the premium is less than GBP40,000 and the annual rent is less than GBP1,000;
- a new lease of less than seven years is bought or assigned, provided that the amount paid is less than the residential or non-residential SDLT threshold; and/or
- an alternative property financial arrangement is used.

SDLT on Residential Property Owned by a Corporate Vehicle

- SDLT is charged at 15% on residential properties costing more than GBP500,000 bought by certain corporate entities. The 15% rate does not apply to property bought by a company that is acting as a trustee of a settlement or bought by a company to be used for a property rental business;
- property developers and traders;
- property made available to the public;

- financial institutions acquiring property in the course of lending;
- property occupied by employees; and
- farmhouses.

In addition, there is a 3% surcharge on residential properties bought by companies.

SDLT on Shares in a Company

SDLT is payable at a rate of 0.5% of the entire transaction. SDLT will be payable on transactions including a change of control of a company if shares are sold.

Value-Added Tax

The sale of real estate is exempt from VAT unless the seller has opted to tax the land and buildings. Most new build commercial properties will attract standard-rate VAT at 20%. If, however, a property is acquired with a sitting tenant, the “transfer as a going concern” exemption will apply, provided both parties are VAT registered and hence no VAT will be payable on the purchase price. This exemption only applies where the buyer opts to tax the property before transfer.

Capital Gains Tax (CGT)

CGT is payable by an individual on the disposal of residential real estate in the UK (other than the individual’s main residence) in respect of the gain (profit) made at a rate of 28% for a higher-rate tax payer or a lower rate for a basic-rate tax payer. A 20% CGT rate applies for commercial property.

A UK-based company will pay corporation tax at a rate of 19% on the investment gain (subject to any indexation allowance, which now only accrues up to 31 December 2017) on the disposal of a commercial or residential property.

The CGT exemption for non-resident investors in respect of non-residential property was removed from April 2019, albeit with exemptions.

“Non-resident” CGT (NRCGT) is payable at 28% on any (post-April 2015) gains made on UK residential property by individuals who are non-resident for tax purposes.

From 6 April 2019, NRCGT was extended to (post-April 2019) gains in respect of commercial property, albeit with certain exemptions.

2.11 Legal Restrictions on Foreign Investors

There are currently no restrictions on foreign investors acquiring property in the UK.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial property are generally financed by borrowing from institutional banks/lenders. However, many companies are also able to purchase property from their own available resources without the need for any finance.

There are also a number of private companies that offer finance to developers in order to assist with projects and development opportunities.

3.2 Typical Security Created by Commercial Investors

A lender will require the first legal charge to be registered against the property as security for the loan which is advanced.

If the purchaser of a property is a company, then the lender will usually also require a debenture over the company’s assets. If a holding company (ie, a company which does not trade) purchases a property then a lender will usually require a lease between the holding company and its trading company so that the monthly repayments under the mortgage can be secured.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

The UK does not currently have a domestic legal framework that specifically governs inward foreign direct investment (FDI).

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

A modest fee is payable to register a security over a property or a company. This fee is payable to either the Land Registry in respect of a legal charge/mortgage or Companies House in relation to a debenture or charge over shares. Additionally, enforcement of security would attract court fees and legal fees.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Before an entity can give valid security over its real estate assets, a private company director will need to have regard to their director’s duties and whether any transaction is for the company’s benefit. They also need to confirm that the company is solvent in accordance with the Companies Act 2006. If corporate benefit to giving security cannot be established, a director could be in breach of their duties to the company. Directors are encouraged to record the basis of their decisions in board minutes and to identify the corporate benefit. It is also advisable to ask the company’s auditor to confirm the company’s solvency.

3.6 Formalities When a Borrower Is in Default

Provided the lender has secured its mortgage through registration of a legal charge against the property asset with the Land Registry, there are usually no obstacles to enforcing its security in the case of a default. A lender will usually enforce the security by the appointment of an LPA receiver who will manage the disposal of the property asset and repayment of the debt (together with cost of realisation) from the sale proceeds.

At the point of enforcement, no further steps can be taken to give priority to the lender's security above that of other creditors. Priority of security is a matter to be addressed at the time of making the loan, by virtue of a deed of priority.

3.7 Subordinating Existing Debt to Newly Created Debt

The rules governing the priority between two different security interests over the same asset vary for different types of assets.

In order for a particular security interest to take priority over an earlier security interest, one or a combination of the following circumstances must usually apply:

- the later security is a "better" type of security (legal rather than equitable; fixed rather than floating);
- the holder of the later security was not aware or is deemed to have been unaware of the earlier security; and/or
- the later security has been better perfected, or was perfected first.

Secured creditors will usually agree priority of their respective secured interests contractually by virtue of a deed of priority, which will rank the priority of the secured interests on enforcement.

3.8 Lenders' Liability Under Environmental Laws

A lender cannot generally be liable for environmental damage unless it is responsible for the cause or knowingly permits the damage. A lender does, however, need to be mindful if, at enforcement of its security, it takes possession of the property, as it may then have a liability relating to any environmental issues as an owner of the contaminated land or a knowing permitter.

3.9 Effects of Borrower Becoming Insolvent

Secured interests of a lender are not affected by the insolvency of a borrower. However, during an administration a lender may not start or continue legal proceedings against the company and/or enforce security without leave of the court.

3.10 Consequences of LIBOR Index Expiry

The London Interbank Offered Rate (LIBOR) is to be replaced by the end of 2021 with "a more reliable alternative" according to

the head of the Financial Conduct Authority (FCA). Movement away from this deep-rooted mechanism is likely to cause disturbance to a broad range of individuals and companies around the world that base their finances on LIBOR. Current contracts may maintain LIBOR in the short term, whereas it seems new contracts will adopt the Sterling Overnight Index Average (SONIA).

Borrowers must start to consider the effects new benchmark rates could have on their property portfolios/investments to secure a smooth transition from LIBOR. The landscape is somewhat uncertain at this stage but as the deadline approaches, borrowers will be better equipped to manage the risks.

4. Planning and Zoning

4.1 Legislative and Government Controls Applicable to Strategic Planning and Zoning

Government plans and development aspirations are contained in policy statements including in the National Planning Policy Framework (NPPF), which applies only to England. This provides the programme for generating local plans for housing and other development. It is against the background of these local plans that applications for planning permission are determined.

Local planning authorities (LPAs) are also motivated to prepare a local plan which sets planning policies in a local authority area. If there is no local plan, LPAs will be deemed to adopt a "presumption in favour of sustainable development".

4.2 Legislative and Government Controls Applicable to Design, Appearance and Method of Construction

The LPA will decide if a proposed development of a property should be permitted.

The developer seeking to obtain planning permission will submit plans and specifications of the intended work to be undertaken to the relevant LPA.

Planning permission is required in most new buildings, major alterations to existing buildings and significant changes to the use of a building or piece of land. When planning permission is granted, it is usually subject to strict conditions with which a developer must comply.

Building Regulations Approval

Building regulations are minimum standards for design, construction and alterations to almost every building. A landowner applies to its local authority building control department for building regulations approval. Examples of where building regulations approval is likely to be required include:

- erecting a new building;
- extending or altering an existing building; and
- providing services and/or fittings in a building such as washing and sanitary facilities, hot water cylinders, foul water and rainwater drainage, replacement windows and fuel-burning appliances of any type.

When the work is carried out it must meet the relevant technical requirements in the building regulations approval. In addition, the works must not make other fabric, services and fittings less compliant or dangerous than they were before.

4.3 Regulatory Authorities

The local authorities for regional areas regulate the use of individual parcels of real estate, subject to prevailing primary and secondary legislation.

4.4 Obtaining Entitlements to Develop a New Project

It is usual for LPAs to notify any neighbouring properties of a new development project or major refurbishment. Notices are displayed and the parish, town or community council is usually also notified. This enables third parties to provide their comments on the proposed planning permission.

The LPA will then consider any minor changes to the planning permission in light of these comments. Third parties have the right to apply for judicial review of an LPA decision if they have reason to believe that a decision has been reached unlawfully.

4.5 Right of Appeal Against an Authority's Decision

If the LPA refuses permission or imposes conditions, it must give written reasons. Appeals must be submitted within six months of the date of the application decision letter.

4.6 Agreements with Local or Government Authorities

It can be necessary to enter into agreements with local or government authorities or agencies or utility suppliers to facilitate a development project. These agreements range from the developer committing to payments towards local infrastructure improvement projects or the provision of new highways or drainage systems. The objective of such agreements being to mitigate the effects of development.

4.7 Enforcement of Restrictions on Development and Designated Use

If an LPA considers that planning has been carried out in breach of the terms of the planning permission then an enforcement notice will be issued. This notice will identify the breach and stipulate what steps the LPA intends to take. Failure to comply

with an enforcement notice could result in a fine. Alternatively, a breach of condition notice can be given as an alternative to an enforcement notice and the developer is required to remedy the breach of condition.

During the course of the development, the LPA will undertake site visits to inspect compliance with building regulations. Failure to comply can result in enforcement action in the form of either prosecution and/or an enforcement notice requiring the alteration or removal of work which contravenes the regulations. If the owner does not comply with the notice, the local authority has the power to undertake the work itself and recover the costs of doing so from the owner.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Entities available to investors to hold real estate assets include limited liability partnerships, private limited companies and public limited companies.

5.2 Main Features of the Constitution of Each Type of Entity

Limited Liability Partnerships

Limited liability partnerships are comprised of members who are in partnership with limited liability. The relationship between the members is usually governed by a members' agreement. An LLP is taxed in the same way as a partnership.

Private Limited Companies

Private limited companies are comprised of shareholders who own share capital of the company proportionally to their individual levels of capital investment. Directors (who may or may not include shareholders) are appointed to run the company. The shareholders have personal liability protection, and their relationship is governed by a shareholders' agreement. This entity is liable for corporation tax and shareholders only pay tax on dividends.

Public Limited Companies

A public limited company is a limited liability company whose shares may be sold and traded to the public and listed on a stock exchange. It can therefore raise money by the sale of shares to the general public.

5.3 Minimum Capital Requirement

In the case of limited liability partnerships and private limited companies, no minimum capital requirement applies. A public limited company must have a minimum issued share capital of

GBP50,000, with at least 25% (GBP12,500) of this being paid up in full.

5.4 Applicable Governance Requirements

Limited liability partnerships are governed by UK company law but, unlike in the case of limited companies, members of an LLP can manage their own interests without forming a board.

Private limited companies are governed by the Companies Act 2006 and have a constitution (articles of association) to assist the shareholders and directors with regulating their relationship with the company and each other.

Unlike private limited companies, public limited companies require at least two directors and a company secretary. They are otherwise governed by UK company law. If a public limited company is trading on a stock exchange it will also be subject to the regulations of that exchange.

5.5 Annual Entity Maintenance and Accounting Compliance

The costs of annual entity maintenance and accounting compliance vary subject to the extent of the portfolio of properties owned by each entity.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The law recognises the following arrangements which allow a person, company or other organisation to occupy and use real estate for a limited period of time without buying it outright:

- a lease, which grants exclusive occupation of the property for an agreed period of time; and
- a licence, which grants occupation of a property without exclusive possession of it.

6.2 Types of Commercial Leases

There are no specific different types of commercial leases. The nature of any lease, in terms of its duration, is a matter of negotiation and agreement between the parties.

6.3 Regulation of Rents or Lease Terms

The new Code for Leasing Business Premises provides a code of practice to govern the negotiation of leases between landlords and tenants.

6.4 Typical Terms of a Lease

There is no typical length of a lease.

A tenant will generally covenant to maintain and repair the property in a long lease. A tenant will limit its liability by recording the state of repair of the property at the commencement of the lease with a schedule of condition.

It is usual for lease rents to be paid quarterly, namely on 25 March, 24 June, 29 September and 25 December.

6.5 Rent Variation

The rent payable under a lease will remain the same for the duration of the lease term unless there is a rent review clause.

6.6 Determination of New Rent

New rent under an existing lease will be determined in accordance with the rent review clause, if such a clause exists. It is usual for the rent review clause to be “upwards only”. The revised rent will be the greater of the rent payable at the time of the rent review and the market rent determined by a surveyor.

Less common rent review clauses provide that the rent will be reviewed in line with inflation.

6.7 Payment of VAT

VAT is only payable on rent at the current rate of 20% if the landlord has opted to tax the property.

6.8 Costs Payable by Tenant at Start of Lease

A deposit may be payable under a rent deposit deed at the start of a lease. In addition, a tenant will be responsible for registration of the lease (if it is for more than seven years), as well as payment of the modest registration fee. SDLT is also payable for a commercial lease as detailed in **2.10 Taxes Applicable to a Transaction**. Subject to negotiation, insurance rent and service charge may also be payable at the outset.

6.9 Payment of Maintenance and Repair of Communal Areas

The landlord is responsible for the maintenance and repair of the common areas used by tenants. The landlord will usually undertake to provide these services on the estate and recoup the cost from tenants via a service charge.

6.10 Payment of Utilities and Telecommunications

A tenant will be responsible for the utilities it consumes and these will be apportioned according to the space occupied by the tenant, unless the supply is segregated.

6.11 Insuring the Real Estate that is Subject to the Lease

The landlord usually insures the property and passes this cost on to the tenant.

The typical risks insured against include:

- fire;
- explosion;
- lightning;
- earthquake;
- storm;
- flood;
- bursting and overflowing of water tanks, apparatus or pipes;
- impact by aircraft and articles dropped from them;
- impact by vehicles;
- subsidence;
- ground slip;
- heave;
- riot; and
- civil commotion.

6.12 Restrictions on Use of Real Estate

The tenant is under an obligation to use the property in accordance with the legal permitted use (ie, within use classes B1, B2 and B8 of Town and Country Planning (Use Classes) 1987). In addition, a lease will usually specify that a tenant cannot use the property for any illegal or immoral purpose. Further restrictions on use can be agreed as part of the lease negotiations. A landlord is also able to restrict the use of the property by agreement with the tenant. For example, if one tenant on an estate has entered into an exclusivity agreement for a specific type of use of a property (eg, an Indian restaurant) then the landlord will be able to restrict the use of other properties on the estate within this area to enable the exclusivity agreement to be complied with.

6.13 Tenant's Ability to Alter and Improve Real Estate

A lease will prohibit the tenant from undertaking any external or internal structural works to the property without the landlord's consent. Even internal, non-structural alterations to the property usually require the landlord's consent in the form of a licence to alter.

6.14 Specific Regulations

One of the key statutory regulations which applies to commercial leases is the Landlord and Tenant Act 1954. This legislation provides business tenants with security of tenure unless the statutory provisions are formally contacted out.

As for residential leases and agricultural tenancies, these have an abundance of statutory regulation on which specific advice should always be sought.

6.15 Effect of Tenant's Insolvency

A lease usually provides that the landlord can end the lease (forfeit) and regain the property in the event the tenant becomes

insolvent. In the event a tenant goes into administration, the moratorium imposed would mean that any forfeiture action is placed on hold.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

If a landlord is concerned about a tenant's ability to meet its obligations under a lease, it can require a rent deposit for particular rental payments. This usually comprises the payment of up to three months' rent up-front, which can be used in the event of default. The landlord can also insist on a personal guarantor.

6.17 Right to Occupy After Termination or Expiry of a Lease

A business tenant is able to remain in occupation after the expiry of the term of a lease if the lease is not contracted out of the security of tenure provisions of the Landlord and Tenant Act 1954.

If the lease is protected then the landlord is only able to bring the lease to an end on the expiry date by providing the tenant with formal notice (of not less than six months and not more than 12 months) that one of the following are applicable to the property:

- the tenant has breached a repairing covenant;
- the tenant has persistently delayed paying the rent;
- the tenant has breached other obligations;
- the landlord has offered the tenant the availability of alternative accommodation;
- a sub-tenant is in place at the property and possession is required for letting or disposing of whole of property;
- the landlord intends to demolish or reconstruct the property; and/or
- the landlord intends to occupy the building for its own business.

6.18 Right to Assign Leasehold Interest

Most commercial leases will include the right for a tenant to assign its interest or to sublease. This is subject to obtaining the landlord's consent by virtue of a licence to assign/sublease. A landlord will permit an assignment subject to conditions including the new tenant (Assignee) providing a rent deposit to the landlord (pursuant to a rent deposit deed) as security for performance of the obligations under the lease and an Authorised Guarantee Agreement (AGA) whereby the tenant (Assignor) will guarantee the performance by the Assignee of the obligations under the lease.

With regards to a sublease this is a contract between the tenant and a new tenant (Subleasee) whereby the Subtenant takes over the rented premises and pays rental directly to the first tenant and the first tenant remains directly liable to the land-

lord. Landlord's consent to sublease should be obtained and the usual condition for consent is that the subtenant can only use the property for the purposes that have been approved by the landlord in the lease and subject to the sublease terms mirroring those of the headlease.

6.19 Right to Terminate Lease

The landlord is typically able to forfeit the lease if one of the following events occurs:

- any rent is unpaid 14 days after becoming payable, whether it has been formally demanded or not;
- any breach of any condition or tenant covenant in the lease; and/or
- the tenant becomes insolvent.

Additionally, both parties may have a contractual right to break the lease or negotiate a surrender of the lease.

6.20 Registration Requirements

Commercial leases granted for a period of more than seven years are required to be registered at the Land Registry and registration needs to be completed within two months of the completion of the lease. The responsibility for registration lies with the tenant, as it protects the tenant if the property should change ownership.

A lease for seven years or less can be noted on the landlord's title. Any land registry fees are to be paid by the tenant and prior to registration, any SDLT which is payable (see **2.10 Taxes Applicable to a Transaction**) will need to be paid and a certificate obtained for filing at the Land Registry.

6.21 Forced Eviction

A landlord can commence forfeiture proceedings to end the lease prior to the expiry date on the grounds of the tenant's default. How long the process takes is dependent upon various factors, including whether the tenant seeks relief from forfeiture.

6.22 Termination by Third Party

It is possible that a lease could be terminated by a third party, eg, the government, if the public interest so required. For such a process to take place, the requisite public law requirements/criteria would need to be met and, where relevant, compensation would be payable.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Lump-sum or fixed-price contracts comprise a total fixed price for all construction work. They are the most commonly used form of contract.

Cost-plus contracts comprise payment of the actual costs, consumptions or other expenses relating directly to the construction work.

Measured contracts define the buildings that will be covered by the work, the period over which work may be required and an estimate of the likely total value of the work.

7.2 Assigning Responsibility for the Design and Construction of a Project

The "traditional" procurement method, often referred to as "design bid build" is the most commonly used method of procuring construction work. This is where design consultants are appointed to design the project in detail and the contractors are invited to tender for the construction of the designed project. The design consultants are responsible for design and the contractor is responsible for the construction work.

The "design and build" procurement method, as its name suggests, is where the contractor is appointed to design and construct, as opposed to a traditional contract where the client appoints design consultants to design the development and then a contractor is appointed to construct the project.

7.3 Management of Construction Risk

This is where a percentage (often 5%) of the amount certified as due to the contractor on an interim certificate is deducted from the amount due and retained by the client. The reason for the retention is to encourage the contractor to discharge its duties fully under the contract.

Limitations and Exclusion of Liability

The three most common forms of limiting liability are:

- caps on liability, where the amount payable in the event of a breach is capped;
- net contribution clauses, where a claimant must pursue a claim against all parties responsible for damage to seek full recovery of loss; and
- exclusion clauses, which if agreed and upheld, would negate any liability for loss or damage (liability for death or personal injury cannot be excluded).

Collateral Warranties

Collateral warranties are agreements which are related to another “primary” contract. They extend the duty of care by one of the contracting parties to a third party who is not party to the primary contract. By way of example, an architect of a new development owes a duty of care to an occupier of the development despite the fact there is no contractual relationship between the architect and subsequent occupier.

7.4 Management of Schedule-Related Risk

Schedule-related risk is the risk that the construction work takes longer than scheduled. Delay can lead to cost risk, hence this is usually managed by the contract including a clause for liquidated and ascertained damages (LADs) to the client in the event that the contract is delayed. LADs are not penalties; they are pre-determined damages at the outset of the contract based on a genuine calculation of the actual loss the client is likely to incur if the completion date is delayed.

7.5 Additional Forms of Security to Guarantee a Contractor’s Performance**Performance Bonds**

A performance bond is used in relation to construction projects as a means of insuring a client against the risk of a contractor defaulting on the contract obligations. A performance bond is provided by a third party up to an agreed amount.

Parent Company Guarantees

A parent company guarantee (PCG) is also a form of security that can protect in the event of default on a contract by a contractor that is controlled by a parent company (or holding company). These are particularly helpful when a small contractor is retained who is part of a more financially viable parent company.

Escrow Accounts

Escrow accounts are also used as holding accounts for construction project funds. They are usually set up by a solicitor acting on behalf of one of the parties. The terms of the agreement will specify that the payments must be protected, so as to provide security should a party default on payment.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and/or designers are permitted, subject to an express agreement, to exercise a lien or otherwise encumber a property in the event of non-payment and this can only be removed upon payment of the outstanding fees.

7.7 Requirements Before Use or Inhabitation

At the commencement of a construction project, a number of consents and approvals are required, whether in relation to

planning or building regulations. During the course of the work, various inspections are undertaken to ensure compliance with the requisite consents/approvals prior to obtaining a completion certificate from the local authority, and also in relation to health and safety in accordance with the Construction (Design and Management) (CDM) Regulations 2015. The requisite insurance policies must also be in place prior to inhabitation.

8. Tax**8.1 VAT**

Sale of real estate is exempt from VAT unless the seller has opted to tax the land and buildings. Most new-build commercial properties will attract standard-rate VAT at 20%.

If, however, a property is acquired with a sitting tenant, the “transfer as a going concern” exception will apply, provided both parties are VAT registered, and hence no VAT will be payable on the purchase price. However, this exemption only applies where the buyer opts to tax the property before transfer. See **6.7 Payment of VAT**.

8.2 Mitigation of Tax Liability

Business rates will be payable on the occupation of a business premises, examples of which include:

- shops;
- offices;
- pubs;
- warehouses;
- factories; and
- holiday rental homes or guest houses.

The domestic rates will be payable to the local council in March of each year in respect of the amount required in the following tax year.

The following reliefs from business rates are available:

- small business rate relief;
- rural rate relief;
- charitable rate relief;
- enterprise zone relief;
- hardship relief;
- exempted buildings and empty buildings relief;
- transitional relief if your rates change by more than a certain amount at revaluation; and
- relief for pubs.

8.3 Municipal Taxes

Tax is payable on rental income from property as outlined below.

Property Owned by UK-Resident Individuals

An individual must pay tax on any profit made from renting out property. The amount paid depends on how much profit is made and the individual's personal circumstances.

Property Owned by a UK Company

A company must pay corporation tax (at the current rate of 19%) on the profit it makes from renting out a property.

Deductions

Allowable expenses are items which need to be spent in the day-to-day running of the property (eg, letting agents' fees, council tax, etc).

Allowable expenses do not include "capital expenditure", such as in buying a property and renovating it. Repairs for wear and tear are allowable, however.

In addition, tax relief can be claimed on money spent on replacing domestic items (eg, beds, sofas, etc). Such items must have been bought for use by the tenants and the item replaced must no longer be used.

The Non-resident Landlord Scheme

A landlord who resides abroad for more than six months of the year must pay tax on any rental income received from a property in the UK. If the landlord is a company or trustee, the rules relating to their usual place of abode apply. The tax is collected using the Non-resident Landlord (NRL) Scheme. The tax can be paid by either the letting agent or tenant.

Capital Gains Tax

CGT is payable by an individual on the disposal of residential real estate in the UK (other than an individual's main residence) in respect of the gain (profit) made at a rate of 28% for a higher-rate tax payer, or a lower rate for a basic-rate tax payer. A 20% CGT rate applies for commercial property.

A UK-based company will pay corporation tax at a rate of 19% on the investment gain (subject to any indexation allowance, which now only accrues up to 31 December 2017) on the disposal of a commercial or residential property.

Individuals pay "non-resident" CGT (NRCGT) at 28% on any (post-April 2015) gains made on UK residential property if they are non-resident for tax purposes.

From 6 April 2019, NRCGT was extended to (post-April 2019) gains in respect of commercial property, albeit with certain exemptions.

8.4 Income Tax Withholding for Foreign Investors

The Tax Cuts and Jobs Bill was signed into law on 22 December 2017. This is intended to bolster real estate development and commercial real estate transactions.

Corporations will see a significant tax saving as the top rate of corporate tax has been reduced from 35% to a flat 21%.

Developers can deduct interest expenses for a variety of real estate activities.

Owners of property can make a large capital gain but defer any tax as long as they use the proceeds to buy some other property. Owners of commercial real estate could therefore flip the properties without ever paying any capital gains tax.

Carried interest allows for taxation at lower capital gains rates, rather than ordinary income rates, for assets held for at least three years (as opposed to one year).

8.5 Tax Benefits

There are tax benefits to owning real estate, but these require specialist tax advice/input.

Hawkins Hatton Corporate Lawyers Ltd was formed in December 2005 and is a niche corporate law firm based in London and Dudley. It deals primarily with corporate and commercial work, together with commercial property and litigation, and its client base includes European and Anglo-US companies, regional and national clients, as well as individuals. The firm's real estate department is best known for secured lending work on behalf of HSBC, Lloyds Bank, Santander and RBS, as well as all aspects of commercial property work on behalf of its SME client base, which spans a number of key industry sectors in-

cluding pharmaceutical and healthcare, manufacturing, engineering and pension funds. It advises on a wide range of property-related matters, including commercial acquisitions and disposals, commercial leases, secured lending and corporate support. Hawkins Hatton also offers advice on a broad range of specialist areas such as property investment and finance, development schemes, compulsory purchase issues, construction and commercial leases for clients, including landlords and tenants, public companies, banks, private companies, developers and investors.

Authors



Colin Rodrigues is head of commercial property at Hawkins Hatton, with partner-level experience of real estate work spanning over 20 years. He not only founded the firm but also single-handedly developed its real estate department, winning panel membership with four

mainstream lenders, namely RBS, Lloyds Bank, Santander and HSBC. His main focus is secured lending in relation to multimillion-pound loans. Colin manages the department on a day-to-day basis and is responsible for business development. In addition to banking, he undertakes corporate support and all aspects of commercial property work for the firm's SME client base. He regularly contributes comment pieces to the local and legal press.



Harminder Sandhu is managing director of the firm and heads its dispute resolution department. Her experience of real estate is in the context of property disputes ranging from forfeiture of leases, Landlord and Tenant Act 1954 disputes and dilapidations claims, to land tribunal

claims relating to rights of way, breach of covenants and beneficial interests. In addition, Harminder has over 20 years of experience in conducting high-value and complex litigation claims, including in construction. She adopts a commercial and pragmatic approach to dispute resolution, seeking out innovative solutions for clients rather than following a set process. Harminder is a keen advocate of mediation.



Davinder Sanghera is an associate partner of the firm. Having worked as a solicitor for over ten years, including in managerial and business development positions, Davinder brings a wealth of skills and experience to her current role in the real estate department. She is involved in a

variety of transactions, including the acquisition and disposal of commercial property, drafting of commercial leases and corporate support. Commerciality is at the forefront of Davinder's advice to business clients and she delivers advice in a transparent and comprehensive manner.

UK LAW AND PRACTICE

Contributed by: Colin Rodrigues, Harminder Sandhu and Davinder Sanghera, Hawkins Hatton Corporate Lawyers Ltd

Hawkins Hatton Corporate Lawyers Ltd

Suite 402
16 High Holborn
London
WC1V 6BX

Tel: +44 020 8191 7893
Email: crodrigues@hawkinshatton.co.uk
Web: www.hawkinshatton.co.uk

HawkinsHatton
—CORPORATE LAWYERS—