



REAL NEWS

AUTUMN/WINTER 2017

Welcome to the autumn/winter 2017 edition of Real News, DLA Piper's quarterly real estate publication. In this edition we cover a range of issues that are currently affecting the Real Estate sector.

Starting in the digital world, **Andrew Gray** and **Rob Shaw** tell us about blockchain and its applicability in the real estate sector. Next, **Andrew Walker** takes a look at opportunities for investors and developers in the private rented sector and **Mark Beardwood** and **Helen McLoughlin** address the question of whether the sale of residential leaseholds is a feudal scandal or just misunderstood.

Dean Peachey takes us through the recent case of Co-operative *Bank Plc v Deutsche Bank AG* and considers whether a tenant can surrender its lease in the absence of its landlord's lender's consent.

Moving onto planning and development, **Hayley Gore** considers neighbourhood planning and the interplay with development sites. Finally, addressing the often lengthy process of negotiating construction and engineering contracts, **Jennifer Price** has produced an invaluable guide to writing letters of intent.

I hope you find these articles useful, if there's a topic that you'd like us to address then please do get in touch.

Kind regards



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BLOCKCHAIN: OVER-HYPED FAD OR TRANSFORMATIONAL JUGGERNAUT?

INTRODUCTION

You may have heard about the digital currency known as “Bitcoin”, a system of electronic cash that can be traded peer-to-peer solely via the internet. Whilst Bitcoin’s wild price swings and internet success have been the subject of a number of headlines over the past few years, it is the backbone of Bitcoin’s protocol – a system known as the “blockchain” – which is really causing a stir in a number of industries throughout the world, including in the Real Estate sector.

Whilst blockchain seems to have become a bit of a buzzword amongst innovation-seeking professionals, it is often misunderstood by the public, who are often quick to write it off as unnecessary and over-hyped. Before being able to appreciate the transformational potential that blockchain technology offers, it is therefore useful to first have a basic understanding of the key facets of the technology. To this end, we will briefly look at the major features and benefits of the technology, before considering how it is being implemented in the real world and how it might affect the real estate sector in the future.

What is a blockchain?

At a basic level, a blockchain is a distributed, decentralised digital ledger of transactions, which is agreed upon by everyone who uses it.

Every day, the businesses we interact with use ledgers to record the state-of-play in respect of particular assets. Banks record what funds its customers have in their accounts and, between them, make the appropriate adjustments to evidence the transfer of money from one person to another. Stock-exchanges record the sale and purchase of shares for different companies. The Land Registry records the transfer of title from seller to buyer.

In each of these cases, we place a degree of trust in those institutions, who must expend considerable time and effort to ensure that their records are kept up to date and free from error. This brings with it a number of inherent risks. What if an incorrect entry is inputted into the ledger? What if a malicious actor intentionally changes the records for their own personal gain? What if the ledger, and its contents, are stolen (or hacked!) and come under the control of a third party?

Blockchain technology successfully deals these problems, allowing parties to transfer assets and value between themselves in a secure manner, whilst simultaneously recording and time-stamping these transactions in a publicly verifiable ledger. All of this takes place on a network where the users of the network can rely on pre-determined rules to agree a single version of the “truth” in respect of the history of an asset, with no need for a trusted intermediary in the middle.

How does this work?

There are a few key features of a blockchain:

■ Public

Every user of a blockchain has a copy of every transaction that has ever occurred on the network. If a person wishes to make a transaction, it will be visible to, and must be agreed by, everyone in the network.

This makes it incredibly difficult for any one person to falsify the ledger, because every other participant in the network would need to agree upon the change. This alone makes fraud much more difficult as clearly, it’s difficult to cheat the system if everybody is watching!

■ Secure

As a blockchain's digital ledger is shared between the users of the network, so too is the history of the particular asset being transferred on that ledger.

Transactions are grouped into "blocks" and then added to the network (by being appended to previous blocks of transactions) by "miners", who must solve a complex computational problem and expend considerable computing power to do so. This is where the name "blockchain" comes from and, depending on the type of blockchain used, transactions will be verified and added to the network in a matter of minutes, or even seconds.

In this way, the blocks of transactions that make up a blockchain are interconnected. As such, if a malicious user wished to change the agreed history of an asset on a blockchain, not only would it have to change the relevant block of transactions and re-solve the relevant computational problem, it would also have to re-solve the problem attaching to every subsequent block of transactions in the chain, all in the time it takes for the rest of the network to verify a single block.

All of this would also need to be done in a way that the network accepts and to do so would take an immense amount of computing power, so much so that it would likely remove any potential gain for a would-be fraudster.

■ Decentralised, Trustless and Persistent

The fact that an identical copy of the ledger is shared across every user in the network means that there is no single point of failure, unlike traditional web servers which are hosted by a particular provider.

Similarly, the process of sending assets via the network takes place without placing trust in any single party or authority, instead working on the basis of a consensus as to the pre-determined rules by which the network operates. This also means that there is no downtime – the network is always up and always available, allowing people to transact through it 24/7.

■ Programmable

Each digital "token" transferred via the network can represent an asset of some sort. There is the potential for each and every one of these tokens to be linked to electronic code (or "smart-contracts"), which may control how, and for what, the tokens can be used or which may specify particular circumstances in which those tokens will be automatically transferred to other parties.

■ Accessible

Whilst the processes behind blockchain technology may be complex, the networks can be made accessible to *anyone* who has an internet connection. With the implementation of easy-to-use interfaces, this raises the possibility that essentially anyone could transact using the network.

Bringing all of the above points together, you have a technology that is nothing short of revolutionary and which has the potential to completely change the way business is done in a number of arenas. Indeed, it has been said that blockchain technology has the potential to change the way we deal with value in much the same way that the internet transformed the way we publish and share information.

Applications to Real Estate

Ultimately, wherever a process or business model relies on trust, there is the potential for disruption via blockchain technology. This is clearly very much the case in the Real Estate sector, where people trust a whole raft of different players to ensure property dealings are carried out as quickly as possible. Throughout a property's lifecycle, property owners, construction professionals, banks, lawyers and even government bodies all place some degree of trust in each other to move deals along.

Through supplementing, or replacing, key transactional processes with solutions based on tamper-proof blockchain technology, the need for this trust is removed, opening the door to both cost and time-savings for everyone involved. Whilst there are a number of applications of the technology in the sector, and indeed these could form the basis of an entire stand-alone article, some of the key possibilities are set out below:

■ Tokenisation of Property

The starting point for much of the potential of blockchain is the ability for physical items to be "tokenised" – that is, reduced to a digital footprint on a blockchain. In a similar fashion to which physical bundles of title deeds have now been replaced, in a number of jurisdictions, by a single registration record at the relevant land registry, a property can also be reduced to an entry, or token, on the blockchain.

Ownership of the said token would be evidenced by the ownership of a “private key” that allows the relevant party to authorise a transfer of the token to another. The blockchain also permits control of these digital tokens to be split, requiring a digital “signature” from more than one party before the asset is transferred. This is important in a property context, where financial charges on assets will often mean a bank’s consent is required before transactions can be carried out.

Any transfer of the token from party-to-party would be recorded digitally, with the transfer chronologically imprinted upon a blockchain for all to see. This would allow the entire history of a property to be tracked via the blockchain, which could reduce cases of fraud.

Tokenising property and transacting with property in this manner will obviously require the buy-in of governments and regulatory bodies across the world. Whilst this is likely to take some time, a number of companies are already well under way with progressing this. For example Propy, a company which aims to use blockchain to enable international transfer of real estate ownership, has recently partnered with the Ukraine government to pilot a decentralised land registry.¹ These developments are also very clearly on the minds of HM Land Registry, who recently announced that they are looking to trial the use of blockchain as part of their “Digital Street” initiative.²

■ **Property and Market Information**

As part of this tokenisation, information relating to the property – such as records relating to the construction of the property, energy efficiency and evidence of regulatory compliance – could all be linked to the relevant token, essentially allowing the blockchain to act as a central database of all relevant information relating to that asset.

Various parties including surveyors, lawyers, funders and regulatory bodies might all input into this trusted public database. By opening up relevant property-related information to the market, blockchain has the potential to increase transparency and remove the premium currently placed on property analytics.

■ **Smart Contracts**

Perhaps the most interesting and exciting use of the blockchain is to enable smart-contracts, which draw upon a range of data sources to automate standard contract provisions. Indeed, once an asset has been tokenised on a blockchain, parties can implement a smart-contract to set out particular conditions which must be satisfied before the token is transferred.

For example, a simple smart-contract might require the transfer of digital currency (such as bitcoin) from one person to another in order to trigger the automatic transfer of a tokenised property asset.

On a more complicated level, processes set out in entire contracts could be automated through computer code and accompanying systems. A lease smart-contract might provide for regular automated payments to the landlord from the tenant and for interest clauses to be automatically invoked in the case of late payment (pulling interest rate data directly from the relevant reference bank). Such smart-contracts could be supplemented by online contract management platforms, whereby issues relating to maintenance of a property could be reported and recorded via the blockchain, with automated notifications then being sent to the relevant parties.

The automation of contracts in this way, based around secure and chronologically time-stamped records of events on the blockchain, could streamline the resolution of disputes in contracts and reduce the need (in certain cases) for intermediaries.

■ **Property Funding**

The ability to tokenise property assets on the blockchain also brings with it the potential for ownership of property assets to be split amongst hundreds, or even thousands, of individuals, all of whom would own a “share” in the property. Such shares would be recorded on a blockchain and would be easily transferrable between parties at any time.

¹ <https://www.wsj.com/articles/an-entire-real-estate-deal-takes-place-online-using-cryptocurrency-technology-1506462545>

² <https://www.gov.uk/government/news/hm-land-registry-signals-the-start-of-its-transformation>

This would enable the growth of fractional ownership in property developments, which could lower the barrier of entry into the property market for smaller investors, whilst opening up an entirely new pool of liquidity for developers wishing to fund the construction of new developments. In essence, blockchain could take the crowdfunding of such property developments to a new level, removing the need for dedicated third-parties to manage investment funds, whilst also allowing automatic distribution of returns to investors.

There are already a number of companies in this area looking to capitalise on this market, such as REAL (www.real.markets) which looks to offer a platform whereby cryptocurrency owners can crowdfund new property developments, and Atlant.io, which similarly seeks to “subdivide individual parcels of real estate into tokens” and offer them for sale.

Closing Remarks

The real estate sector is often criticised as being relatively slow to react to technological change and, whilst there are a large number of companies working on solutions involving blockchain technology, it is likely to be some time before these are cemented as an integral part of the real estate world. However, there are clearly marked opportunities for blockchain technology to disrupt and transform the real estate sector, reducing friction in transactions and introducing further transparency and cost-savings. To this end, the wide-spread use of blockchain seems to be a case of “when”, not “if”.

It is advisable for key stakeholders in the real estate sector to have a strategy in place to track, consider and, where possible, implement blockchain technology as it matures, to avoid being left behind and to ensure that they rank in file alongside the disruptors, rather than the disrupted. DLA Piper’s global blockchain group offers strategic regulatory and transactional guidance to companies in nearly every sector and can assist companies at every stage of the business life cycle. If you’d like to know more then please get in touch.



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BUILD TO RENT – RECENT MARKET TRENDS

AN INCREASE IN RENTAL DEMAND AND A LACK OF NEW HOUSING SUPPLY ACROSS THE UK IS ENCOURAGING INVESTORS AND DEVELOPERS TO LOOK AT NEW, PREVIOUSLY UNFANCIED, RENTAL DEVELOPMENT OPPORTUNITIES.

The well-publicised lack of new housing across the UK, which is driving house prices and rising rents, coupled with the increase in social acceptance of renting rather than buying, is spurring investors and developers into exploring less mature markets as potential opportunities to expand their private rented sector (PRS) portfolios arise.

Investors and institutional landlords seem to be gaining confidence from PRS schemes in more regional locations which are now appearing to provide similar stable rental incomes as have been experienced in established PRS markets such as London, Birmingham and Manchester. This is being viewed alongside lower land values and more affordable build costs as well as the fact that there is a gaping hole of an estimated 220,000 to 240,000 new homes required in the UK per year to cater for demand, which is only likely to continue to increase.

Since April of this year clear examples of such confidence can be seen in cities such as Leicester, Nottingham and Newcastle where funders have committed over £400 million to bring forward 650 residential units. These developments include gyms, dining rooms, rooftop gardens, shared communal space and ground floor retail units which adhere to the PRS mantra of generating placemaking and community building. Clearly, many developers are seeking to establish themselves as market leaders from the outset in such locations with a view to attracting tenants from existing outdated and rather mundane housing stock.

It is estimated that the prime PRS yield as at the end of 2016 was 4.25 per cent. The above locations are beginning to command yields of 5–5.25 per cent providing increased appetite to invest.

Further, these previously virgin PRS markets offer operators a blank canvas to create unique housing brands for their target demographic of 25–35 year olds. Similarities can be drawn with the student housing sector which have clear and targeted marketing strategies.

Where is the tipping point for PRS developments in terms of location? And will developers and investors continue to branch out over the coming years? Providing that urban locations have a demographic which is able to afford to live in such communities, there are strong public transport links and the UK's housing shortage continues there is every chance investment will pour into third and possibly fourth tier areas. Exciting times ahead in the residential market and we are looking forward to the next 10–15 years of development!

The real estate team at DLA Piper has a wealth of experience in acting on behalf of a variety of major clients on significant PRS schemes across the UK with a full service offering from our planning, funding, development and construction teams. If you would like more information on our PRS capabilities do not hesitate to contact us.



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LEASEHOLD HOUSES – A FEUDAL SCANDAL OR JUST MISUNDERSTOOD

The sale of new homes on long leases has become a popular practice. In 2015, 43 per cent of all new builds were leasehold, compared with 22 per cent in 1996. Of course, a great many of these will be flats where granting leases is the only sensible (and mortgageable) way to set out the rights and obligations of residents sharing a roof and foundations to avoid conflict. However, an increasing number of leasehold homes are houses. It is in relation to these homes in particular that MPs are debating about a “national scandal” and describing the “PPI of the house building industry”. Leasehold homes are nothing new so what has gone wrong?

SIGN OF THE FINANCIAL TIMES

Many developers have seen building leasehold homes in recent years as a way to extract added value from a development without reducing in any way the price they would charge for the house if sold as a freehold. By setting ground rents of a few hundred pounds, set to increase by RPI, the freehold of estates can then be packaged up and sold to investors and pension funds. The secure and steady nature of the income stream makes ground rents attractive. Failure to pay a ground rent could lead to forfeiture of the house and so defaulting tenants are rare. The yields are low but in a time when it is impossible to find a savings account that will keep up with inflation, the popularity of this investment has soared.

Whilst a ground rent linked to RPI is not inherently unfair, some developers have been tempted to go beyond that and set ground rents by reference to onerous formulas. In addition, some landlords have capitalised on their ability to require fees for consents, setting such requirements for anything from adding a conservatory to changing the colour of a front door. This practice again is not always unfair, it may benefit the residents to have controls in relation to further development. However, if the sole purpose of including controlling lease terms is the creation of a consent cottage industry then it would appear too much advantage is being taken by the mighty landowner over the individual resident.

WHY DO PEOPLE BUY LEASEHOLD HOMES?

Many tenants claim not to know the terms of the lease that they bought which has helped fuel cries of scandal. The response to these people is simple – your conveyancer is at fault if they did not adequately explain this to you. More likely, perhaps, is that the downside of a lease is forgotten in the passion to purchase their shiny new home. After all, who reads the standard terms and conditions when buying a new car on a lease purchase? Why should a house lease be any different?!

Market forces may also dictate that a leasehold home is the only home available in the area you need to live; or the only one you can afford – indeed the government’s “Help to Buy” scheme began life as funding for new homes only. This lack of choice coupled with the much stronger position of the house builders has the potential to create unfairness.

CAN HOME OWNERS EVER OWN THEIR OWN FREEHOLD?

Legislation has been in place since the 1960’s providing a process for a tenant of a leasehold house to acquire the freehold. This process is known as “enfranchisement”. A formula for the price of the freehold is set by statute and often results in a lower price than an investor would pay for it on the open market. However, the tenant must be prepared to pay their own legal and specialist surveyors’ fees as well as pick up those fees of the landlord. Often it is these additional costs, whilst not unfair, which put off most home owners pursuing this route. And the more onerous the lease terms in relation to rent, the higher the price which has to be paid. A combination of the fact that people are unaware of their rights combined with a lack of willingness or ability to find the cash to pursue these rights makes investing in ground rents all the more secure for investors.

ARE WE HEADED FOR AN OUTRIGHT BAN?

The government has issued a consultation paper “Tackling unfair practices in the leasehold market”. The consultation period ended on 19 September 2017. The first question set in the paper to consider is whether leasehold houses should be prohibited. Certain bad practices should indeed be stopped – aggressive ground rents and unnecessary lease terms requiring consent for minor domestic matters simply to generate money.

However, there are situations when creating leases rather than selling the freehold can be a better option. Often developments include roadways which local authorities do not want to adopt; or green spaces are required in the planning permission but the local authority does not want to be responsible for them. A leasehold arrangement with an active engaged landlord can result in better management of these assets than relying on freehold covenants. Even with a resident controlled management company, if the residents fall out a landlord can step back in to take back control.

On occasions there can be more altruistic motives for controlling what residents can and cannot do with their home. Preserving garden suburbs, aesthetic appearance and community character of a locality are best done on a leasehold basis. Landed estates were developed, operated and controlled in this way – and some still are. Cash strapped local authorities would not have the resources or the mandate to get involved in the management of the real estate in their areas in the same manner. It would be sad to lose this ability to create and preserve such attractive residential areas.

We agree with proposals to prevent developers taking advantage of their position but these can be addressed by caps on ground rents and management fees. However, we say please do not ban leaseholds entirely.



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A WARNING TO TENANTS –

SURRENDERING YOUR LEASE WITHOUT THE LANDLORD'S LENDER'S CONSENT; DON'T BANK ON IT!

The recent case of *Co-operative Bank Plc v Deutsche Bank AG* [2017] EWHC 1820 (Ch) considers whether a tenant can exercise a lease surrender without its landlord's lender's consent.

KEY FACTS

Deutsche Bank acquired a lease of a data centre known as Digiplex Megaplex Centre, Beaconsfield Road, Middlesex (“**Property**”) on 29 June 2001 for a term of 20 years (“**Headlease**”). In 2010, Deutsche Bank sublet the Property to Sentrum (Hayes) Limited (“**SHL**”) with Sentrum Holdings Limited (“**Sentrum Holdings**”) acting as guarantor (“**Underlease**”).

On 18 December 2012, the freehold interest in the Property was purchased by Hayes Freehold Limited (“**HFL**”), a group company of SHL (until June 2012 where SHL ceased to be a group company following a share sale). As part of the purchase Co-operative Bank Plc (“**Co-op**”) granted a lending facility of over £25million to HFL which was guaranteed by SHL. The terms of the charge stated that Co-op's consent was required to any dealing with either the Headlease or the Underlease.

In August 2015, HFL, Deutsche Bank, SHL and Sentrum Holdings entered into a deed of surrender which purported to effect:

- a surrender of the Headlease;
- a surrender of the Underlease; and
- a release of the Underlease guarantee.

However, the consent of Co-op was required for the surrender of the Headlease due to the existence of the charge. The absence of consent from Co-op meant that the surrender of the Headlease was not effective, with the result that Deutsche Bank was not released from its liability to pay the head-rent. Co-op issued proceedings seeking declarations that:

- the surrender was void; and
- Deutsche Bank and SHL remained liable under the Headlease and Underlease.

Deutsche Bank issued a Part 20 claim against SHL and Sentrum Holdings alleging that if the surrender of the Headlease was ineffective, then the surrender of the Underlease and the release of the Underlease guarantee was also ineffective. Deutsche Bank went further to allege that it was an implied condition precedent to the release of the Underlease guarantee that the surrender of the Headlease would be effective. In addition, Deutsche Bank argued fraudulent misrepresentation, common mistake, unilateral mistake and unjust enrichment.



DECISION

The High Court dismissed Deutsche Bank's claim on all counts and held that:

- it was not an implied condition precedent to the release of the Underlease guarantee that the surrender of the Headlease should be effective. The express provision releasing the Underlease guarantee was unambiguous and 'did what it set out to do', which was to unconditionally and irrevocably release the guarantor from its obligations;
- the surrender of the Underlease was not dependent on the surrender of the Headlease. The freehold interest was charged but Deutsche Bank's interest was not, therefore, it could accept a surrender of the Underlease independently;
- the surrender was not void for common mistake nor unilateral mistake; and
- Deutsche was not entitled to rescind the surrender on the ground that Sentrum Holdings had been unjustly enriched.

The High Court heard that the solicitor advising Deutsche Bank advised that there were no impediments to the surrender of the Headlease being effective, however, the solicitor has not checked the freehold title and was therefore not aware of Co-op's charge. The solicitor admitted that this action was negligent.

ANALYSIS

The decision here is a warning to all tenants – consent from your landlord's lender is (in most cases) required for a lease surrender to be effective. When seeking legal advice on surrenders, be sure to check with your solicitor that:

- no consent is required, be that from a superior landlord or a landlord's lender; and
- the documentation being entered into clearly reflects the parties commercial intentions. Here, Deutsche Bank had tried to argue that a condition precedent should be implied into the surrender. If it was the intention that the surrender of the Underlease was dependent on the surrender of the Headlease, it should have been expressly drafted into the surrender deed.



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NEIGHBOURHOOD PLANNING: NOT TO BE IGNORED WHEN ASSESSING DEVELOPMENT SITES

Neighbourhood planning is arguably not the most exciting element of planning law, but given its ability to limit development it is certainly worth bearing in mind when considering development proposals.

The Localism Act 2011 introduced neighbourhood planning as part of the government initiative to give more power to local people to determine how and where development takes place in their area. It is already a well-established part of the English planning system. However, recent case law, policy and legislative moves have given neighbourhood plans increased weight in the planning process.

Developers should not ignore the impact of a neighbourhood plan. Together with the local plan for an area it forms the development plan, directing where development should take place. It adds an extra layer of planning policy detail, so even when the local plan appears to be in favour of the proposed development, policies in a neighbourhood plan, or even a draft neighbourhood plan, may weigh against a grant of planning permission. Concerns have been expressed by developers that although neighbourhood plans should not cut down the amount of development in the local plan, policies can be informed by local opposition to effectively rule out viable development sites.

Planning applications which conflict with a neighbourhood plan will normally not be granted, and recent policy and legislation have limited developers' ability to argue that a lack of sufficient housing land supply should trigger a presumption in favour of their proposed sustainable development.

NEIGHBOURHOOD PLANS – WHAT ARE THEY?

A parish or town council, or a Neighbourhood Forum (21 or more local individuals) may apply to a Local Planning Authority (“LPA”) (usually the district or borough council) to have an area designated as a “neighbourhood”. If successful, the group may produce a draft neighbourhood plan which can set out how and where development takes place in a certain area, including allocating sites for development, or protecting sites from development. This draft plan must be consulted upon and independently reviewed. Once it comes through this examination, it is put to a referendum of local people. If it is accepted by a majority, it comes into force as part of the development plan.

Once a neighbourhood plan is in force, it is to be given full weight when considering whether to grant or refuse planning permission for developments as part of the development plan.

INCREASING WEIGHT NOW BEING GIVEN TO NEIGHBOURHOOD PLANS

The introduction of the National Planning Policy Framework in 2012 brought a requirement for LPAs to maintain a five-year supply of housing sites available for development. With this it introduced a presumption in favour of sustainable development where this housing land supply could not be demonstrated. This had the potential to undercut both local plans and neighbourhood plans where inadequate sites were allocated, by allowing developers to promote housing on unallocated sites.

As a consequence of concerns raised, a Ministerial Statement was issued in December 2016, which provided that where a neighbourhood plan is less than two years old, allocates land for housing, and the Local Planning Authority has a *three year* (rather than five year) housing land supply, the neighbourhood plan should be given full weight in planning decisions.

This Statement was shortly followed by the Neighbourhood Planning Act 2017, which also aimed to strengthen neighbourhood planning by increasing the weight to be given to neighbourhood plans.

New provisions in the Act brought forward the time when the neighbourhood plan should form part of the development plan by about 6 weeks, so that full weight applies from the point at which the plan is approved by referendum. In addition, the 2017 Act gives increased weight to draft neighbourhood plans, and sets out when a draft neighbourhood plan should be taken into account in planning decisions as a 'post-examination draft neighbourhood plan'.

Recent case-law indicates support for draft neighbourhood plans, and plans which are in slight conflict (but in 'general conformity') with local plans. To be in "general conformity", a neighbourhood plan must not propose less development or undermine the strategic policies of the local plan.

IMPACT OF NEIGHBOURHOOD PLANS ON PROPOSED DEVELOPMENTS

Case law has confirmed that neighbourhood plans can allocate specific sites for certain types of development. Clearly, if a proposed site is not allocated for that particular use, the development is less likely to be granted permission. This can be the case even where a local plan may appear generally in favour of a proposed type of development in the area.

Developers must make sure they are aware of what policies in any adopted or draft neighbourhood plan apply to a development site, and to ensure that its correct planning status is correctly assessed and priced in.

The neighbourhood planning process can also be a useful route to promote a development site, to comment on alternative sites, to provide evidence of deliverability to inform site allocation. In any event, it is important to be aware of the impact that a neighbourhood plan, or even a draft neighbourhood plan can have on development proposals.



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A GUIDE TO: LETTERS OF INTENT

I. INTRODUCTION

- 1.1 The negotiation of formal contracts in the construction and engineering sector can be a lengthy process. The employer and its prospective contractor often need considerable time to finalise a whole host of technical and practical matters alongside the negotiation of the legal terms. It is therefore commonplace in the industry that during these complex contractual negotiations, a letter of intent (“LOI”) is issued by the employer to encourage the contractor to mobilise, pending formalisation of the building contract, to minimise delay in commencing the work on site.
- 1.2 However, to maximise its commercial benefits, the use of a LOI requires careful consideration as to form and content and should never be seen as a substitute for a full, formal building contract. This article explores the form a LOI should take and offers guidance to both employers and contractors on the common pitfalls to be avoided.

2. LETTER OF INTENT – BINDING OR NON-BINDING?

- 2.1 The expression “letter of intent” is not a term of art; care must therefore be taken by both parties to ensure each party’s intentions are accurately represented. A LOI is normally either interpreted as:
 - 2.1.1 a “letter of comfort”, that is, a statement of one or both parties’ intention to enter into a contract in the future which is not intended to be legally binding. A letter of this nature neither instructs nor authorises the contractor to provide any works; or

- 2.1.2 a document which constitutes a “temporary contract”, i.e. it creates a set of binding contractual rights applicable for the period during which the LOI is intended to have effect; or
- 2.1.3 a fully binding contract which is deemed to incorporate the terms of the contract the parties intend to enter into at a future point but have not yet signed.

- 2.2 Every document described as a LOI must therefore be interpreted individually in the light of the circumstances of the case.
- 2.3 There are few advantages of a non-binding arrangement for all concerned. From the employer’s point of view, even if a letter of intent is non-binding, the employer will almost always be obliged to pay the contractor for any work it undertakes. Without clarity as to price the employer will have no certainty as to its financial exposure. From the contractor’s point of view, a non-binding arrangement does not offer the contractor any comfort as to the employer’s commitment to the works, nor does it give the contractor any certainty as to the sum it will be paid.
- 2.4 There are also few advantages in having a fully binding contract which is deemed to incorporate full contract terms. This scenario creates uncertainty for both parties, and relying on a short form LOI in place of a formal building contract will leave them both exposed.
- 2.5 If a LOI is to be used, a temporary binding arrangement is to be preferred. To achieve contractual status however, a LOI must satisfy the following requirements:
 - 2.5.1. There must be a clear offer by the employer.
 - 2.5.2. There must be an acceptance of that offer by the contractor.



- 2.5.3. There must be consideration (i.e. the contractor carries out the works in exchange for payment by the employer).
 - 2.5.4. There must be an intention to enter into a contractually binding arrangement.
 - 2.5.5. The terms of the legal arrangement must be clear.
- 2.6 These requirements, for the most part, tend to be easily satisfied. However, it is the requirement for certainty which parties tend to fall down on.

3. CLARITY IS KEY!

3.1 Establish the purpose of the LOI

- 3.1.1. Before drafting any LOI the parties must establish what they are looking to achieve. A LOI will often state that the employer intends to instruct the contractor to carry out the project but the terms of the building contract are still under discussion. The LOI therefore authorises the contractor to undertake certain limited works subject to the terms of the LOI.
- 3.1.2. The employer may wish to instruct the contractor to either commence the carrying out of the whole works under the terms of the LOI, or it may wish to define the scope of works the contractor is authorised to undertake pursuant to the LOI.

3.2 Identify the correct contractual parties

- 3.2.1. The LOI must ensure that the correct contractual parties are identified. LOIs are frequently issued by surveyors or project managers acting on behalf of an employer for the sake of expediency. This practice should be avoided and the LOI ought to be issued directly from the employer to the contractor.

3.3 Consider whether the duration of the LOI ought to be defined

- 3.3.1. In a bid to limit the scope of the LOI and to drive negotiations of the main building contract, the parties may wish to set a date for the LOI to expire.
- 3.3.2. In the event that such a provision is included it is essential that the expiry date is carefully monitored. If an expiry date is looming and the parties are not yet in a position to enter into the formal contract, the LOI will need to be extended and the extension must be recorded in writing. No further works should be carried out after an expiry date without a written extension to the LOI.
- 3.3.3. If the contractor continues to undertake works following the expiry of the LOI, the parties risk varying the terms of the LOI by conduct, causing contractual uncertainty as to what the contractor is entitled to be paid for the works it has undertaken. This is risky for both the employer and the contractor and ought to be avoided.

3.4 Payment provisions and caps on payment under a LOI

- 3.4.1. Certainty as to payment terms and the sums to be paid to the contractor are key matters that must be addressed in any LOI.
- 3.4.2. It is common for a LOI to incorporate payment terms by reference. For example, you will often see the payment terms of the intended building contract (subject to any bespoke contract amendments) being incorporated into the LOI. Whether this approach is adopted or whether a separate payment scheme is added to the LOI, particular care must be taken to ensure that Construction Act compliant terms are provided for in the event that the LOI is caught by the terms of the Act (as will often be the case).

- 3.4.3. It is also common for an employer to cap its liability under a LOI to a maximum sum. This will limit the scope of the LOI and, as with setting an expiry date for the LOI, should encourage the parties to advance contract negotiations in a more timely manner.
- 3.4.4. The sums paid under a LOI must be monitored to ensure that any monetary cap is not exceeded. From the contractor's perspective, any work undertaken over and above the maximum sum set out in the LOI will be done at his own risk with no guarantee of payment. Conversely, from the employer's perspective, an employer risks waiving a monetary cap by conduct if it continues to pay out sums to the contractor in excess of the cap.
- 3.4.5. One other point to mention – make sure your LOI deals with VAT. Failure to do this may lead to a dispute down the line as to whether the maximum sum is inclusive or exclusive of VAT.

4. ADDITIONAL “MUST HAVES” IN A LETTER OF INTENT

4.1 Insurance

- 4.1.1. Any insurance requirements being placed on the contractor ought to be addressed in the LOI. If the contractor is placing insurance for the works, the LOI must provide for this expressly. In the event that the contractor is undertaking design, it is advisable that the professional indemnity insurance requirements are also addressed in the LOI.

4.2 Quality and Programme

- 4.2.1. If a LOI contains no specific requirements in relation to quality and contract programme, the following terms will be implied:



- 4.2.1.1 The goods supplied will be of satisfactory quality.
 - 4.2.1.2 Goods supplied for a particular purpose (and that purpose has been made known to the contractor), will be fit for their intended purpose.
 - 4.2.1.3 The works will be undertaken within a reasonable period of time.
 - 4.2.2. For the sake of contractual certainty, it will often be preferable for express provisions to be made in relation to quality and time with reference to specifications and a contract programme.
 - 4.2.3. Additionally, it may also be preferable to specify the standard of skill and care the contractor is required to exercise in the undertaking of its works.
- 4.3 Copyright
- 4.3.1. In the event that the contractor is undertaking design under the LOI, from the employer's perspective, it is advisable to expressly incorporate an irrevocable copyright licence in favour of the employer in relation to any documents produced by or on the behalf of the contractor under the LOI.
- 4.4 Termination
- 4.4.1. It is in the interests of both the employer and contractor to address how a LOI arrangement can be brought to an end and to ensure that this is expressly dealt with in the drafting.

- 4.4.2. In the event that the parties proceed to enter into a building contract for the whole works, the LOI should provide that the terms and conditions of that contract will supersede the provisions of the LOI, with any works carried out/payments made under the LOI being treated as carried out/made under the building contract.
 - 4.4.3. Equally, the LOI must allow for the arrangement to come to an end with no obligation to enter into the formal building contract.
 - 4.4.4. In the event of termination, the LOI should deal with how much the contractor will be paid. The usual position is for the contractor to be paid its reasonable costs incurred to date together with its reasonable demobilisation costs. The contractor's ability to recover loss of profit is often expressly excluded. From the employer's perspective, such costs are an unknown and could potentially be considerable (particularly if a court concludes the contractor is also entitled to recover any loss of anticipated profit).
- 4.5 Dispute Resolution
- 4.5.1. As with payment, if the Construction Act applies to the LOI, the parties may refer any dispute to adjudication. Parties may wish to expressly provide for their own adjudication process. However, given the nature of a LOI, this is seen rarely and most employers and contractors are happy to rely on the statutory adjudication provisions set out in the Scheme for Construction Contracts 1998 (as amended).

5. TOP TIPS FOR A SUCCESSFUL LOI

- 5.1 Finally, here are a few top tips to ensure your LOI serves its purpose to get a project moving, without creating contractual uncertainty for both the employer and the contractor:
 - 5.1.1. Know what you want and ensure this is clearly reflected in the drafting! Clearly define your scope and any monetary limit on the sums to be paid to the contractor.
 - 5.1.2. Don't lose focus! Don't see your LOI as a substitute for a formal building contract and continue to negotiate your formal contract documents.
 - 5.1.3. Do your housekeeping! A well drafted letter of intent on its own is not enough; it needs to be monitored and operated properly. Employers should not allow work to continue when a letter of intent has expired. Equally, contractors should not incur costs in excess of any financial caps without first getting the employer's agreement to do so.



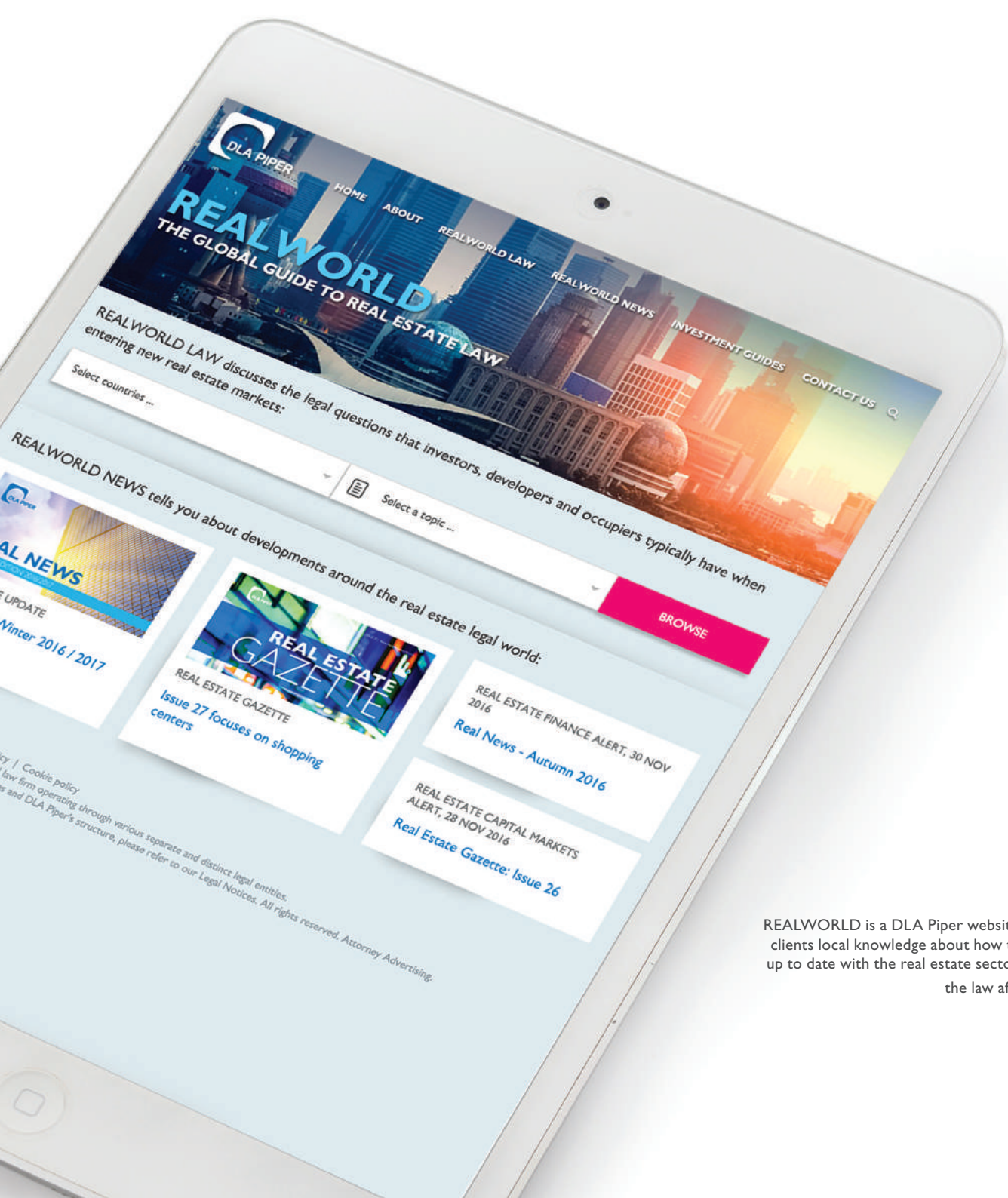
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