K&L GATES

Overriding Interest

Highlighting developments and issues in the real estate industry

Spring 2012

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Concealment and Exposure

Since the Localism Act was enacted in November 2011, a lot has been written about the provisions the Government hopes will facilitate its Big Society agenda. Many of these, such as neighbourhood plans, community right to bid to acquire, taking over local authority services and even revoking the regional strategies, are yet to come into force, await further guidance or will take time before their impact is felt. However, there are some which are already in force and may have an early impact. This article focuses on two of them.

Finance

In mid-January, provisions permitting "local finance considerations" to be material considerations in planning applications came into force. The Government included this in the Act to ensure that money secured through the New Homes Bonus (NHB) and the Community Infrastructure Levy (CIL) could be taken into consideration when a local authority decides a planning application. Some questioned the need for this addition, concerned that it might be broadened to any sums of money and that an application might be perceived to be bought. Legislation already required material considerations to be taken into account and questions were asked why "local finance considerations" needed to be elevated to the statute book, seemingly above other considerations such as environmental concerns. Uncertainty is created by the caveat that local finance considerations should be had regard to, but only "so far as material to the application". This leaves room for objectors to argue that money secured through NHB or CIL should not have regard given to it where Council's policies for the reinvestment of NHB or CIL money do not show how it is directly connected to the proposed development.

Concealment

One of the many provisions expected to come into force in April 2012 is a change to the rules on time limits when a local authority can undertake planning enforcement action. It is common for purchasers of property, when not given full planning information, to rely on the perception that a local authority cannot undertake enforcement action after a period of time: four years from a breach in relation to operational development or the construction and use of a private dwelling; or ten years from a breach in relation to change of use or breach of condition. Recent court cases relating to dwellings hidden behind bales of straw or pretending to be barns have clarified the law but did not change the rules.

The Localism Act brings in a new enforcement procedure through the magistrates court and removes any time limit if the court considers a breach, or any of the matters constituting the breach, has been deliberately concealed. A local authority can refer any alleged breach to the court if it thinks it has sufficient evidence that a breach has been concealed (and the local authority's word is final). This creates concern for any purchaser as any little act of concealment could expose the whole development to enforcement proceedings and the concealment could have been made by anyone, even a third party. A purchaser should be wary of relying on the 4 or 10 year rule and undertake enough due diligence to satisfy themselves there is nothing that could be construed as "deliberate concealment". The change was made to ensure that houses hidden in barns or straw bales could not become lawful, but there is a danger there will be "policy creep" and minor breaches will result in draconian enforcement action, despite current protestations that this is not the intention.

Events and Announcements

Real Estate Team of the Year

The K&L Gates real estate team have recently received their third nomination for "Real Estate Team of the Year". The team were shortlisted by Legal Business, which follows on the back of short listings by both the UK Lawyer Magazine and Legal Week. The "transaction" on which the nomination is based, is highlighted in this issue of OI, known as the Project Vanquish Transaction see page 6.

The Green Agenda and Sustainability Initiatives

On 29 February K&L Gates participated in a seminar hosted by CBRE on "The valuation of Sustainability in the UK commercial property market: a review of the Investment Property Databank's ISPI Monitor Q4 2011 results, and a look forward to what the future holds for the sector". Sebastian Charles, a Partner in our planning and sustainability group participated on a panel discussion covering amongst other things, ISPI's latest Q4 results. Sebastian joined speakers/panellists from the IPD (Christina Cudworth), CBRE (John Symes-Thompson), Prupim (Paul McNamara), Legal and General (Bill Hughes), RICS (Ben Eldar, Global Director of Valuation), and Aviva (Richard Jones). Watch this space for the next launch which will be held at our offices in early November.

New Offices

Milan

The firm's 41st office is in Milan, Italy. Milan is the financial and commercial centre of Italy, which in turn is the eighth largest economy in the world. Milan is our eighth office in Europe. Milan joins our existing constellation of European offices in Berlin, Brussels, Frankfurt, London, Moscow, Paris, and Warsaw.

São Paulo

Our 40th Office was opened in São Paulo, the largest city in Brazil and one of the largest in the world. It is the business hub of Brazil, and Brazil itself is the seventh largest economy in the world. The flow of trade and of investment to and from Brazil now connects this South American country with all corners of the globe. São Paulo is destined to be an important part of our firm-wide platform.

Doha

Our 39th Office opened in Doha, the capital city of Qatar, an independent sovereign state on the Qatari peninsula which juts one hundred miles into the Persian Gulf from Saudi Arabia. Doha is a one-hour flight from Dubai, where the firm has maintained an office for the past two years. Qatar has experienced rapid economic growth over the last few years. In 2010, it had the world's largest per capita Gross Domestic Product, and its economy grew by nearly 20 percent. Qatar is the world's largest producer and exporter of liquefied natural gas. Oil and gas account for more than 50 percent of Qatar's GDP, 85 percent of its exports and 70 percent of Government revenues. Qatar has become an economic powerhouse on the strength of these huge reserves of natural gas and of oil as well as its purposeful commitment to internal and external investment and diversification of its economy.

Dilapidations Protocol

Many readers of OI will be familiar with the Property Litigation Association's (PLA's) Pre-Action Protocol for Terminal Dilapidations Claims (the Protocol). The Protocol was first introduced in 2002 and has subsequently been revised a number of times. Though previously not formally adopted under the Court Civil Procedure Rules (CPR), it has for a number of years been seen as best practice; it is endorsed to that effect by the RICS in its current Guidance Note on Dilapidations.

After much hard work and lobbying by the PLA, the Protocol has finally been formally adopted under the CPR and came into force on 1 January 2012.

Changes had been made to the Protocol. The adopted version does not have many of the definitions that appear in the versions that preceded it, and the drafting has been made more concise. Essentially, though, the structure of the Protocol remains the same. As before, under the Protocol, landlords are expected to serve terminal schedules on tenants within a reasonable time, which is stated generally to be within 56 days after the termination of the tenancy, and the schedule should be endorsed, either by the landlord or by the landlord's surveyor. The endorsement should be to the effect that:

- the works in the schedule are reasonably required to remedy the breaches;
- full account has been taken of the landlord's intentions for the property; and
- the costings, if any, are reasonable.

The biggest change to the Protocol is the inclusion of a tenant's endorsement. This is to mirror the landlord's endorsement and, similarly, confirmation is required in respect of the tenant's response to the schedule that:

- the tenant (or its surveyor) is of the opinion that the works detailed in the tenant's response are all that will reasonably be required for the tenant to remedy the breaches;
- the tenant's costings are reasonable; and
- account has been taken of what the tenant (or its surveyor) reasonably believes to be the landlord's intentions for the property.

Failure by parties to comply with the Protocol may lead to cost sanctions or other sanctions as follow non-compliance with the other CPR protocols. The Protocol does emphasise, however, that the court will be concerned only with substantive failures to comply rather than minor or technical shortcomings.

Readers should note that the RICS is in the process of producing a new, sixth edition, of its Guidance Note on Dilapidations which will no doubt reflect the formal adoption of the Protocol.

K&L Gates Global Real Estate Team MIPIM 2012

Members of the Real Estate, Construction, Tax, and Finance teams look forward to seeing you at MIPIM 2012.

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Transaction Focus — Project Vanquish

Introduction

In this issue of OI, we profile the acquisition by Henderson Global Investors in June last year of one of London's largest development sites at Leadenhall Triangle, for £188m. Our multidisciplinary property team demonstrated that even in this economic climate, a combination of the right client, right deal and the right team can yield excellent results, meeting the objectives of all involved.

Deal Snapshot/Background

The purchase of the Leadenhall site was not only highly complex, but was also both commercially and legally sensitive, and involved multiple parties in several jurisdictions.

The transaction comprised the purchase of distressed assets from administrators PwC after the maturity of debt secured against five buildings in the City put the real estate assets into insolvency. Hatfield Philips acted as special servicer of the loan.

Andrew Petersen, a real estate finance member of our property team in this transaction, has a background in the very specialised CMBS market/distressed real estate, and has acted for Hatfield Philips (the special servicer of the loan). So, with his background and facilitation of the deal, and with the team's existing track record in acting for Henderson, we were well placed to guide our client through the financing/legal complexities, a process coordinated and managed by Stuart Borrie, a corporate real estate partner who works with Henderson.

The final sale followed a marketing process including over 60 information memoranda being issued to interested parties, resulting in 11 initial bids being submitted to all lenders.

Legal Experience and Innovation/Team Working

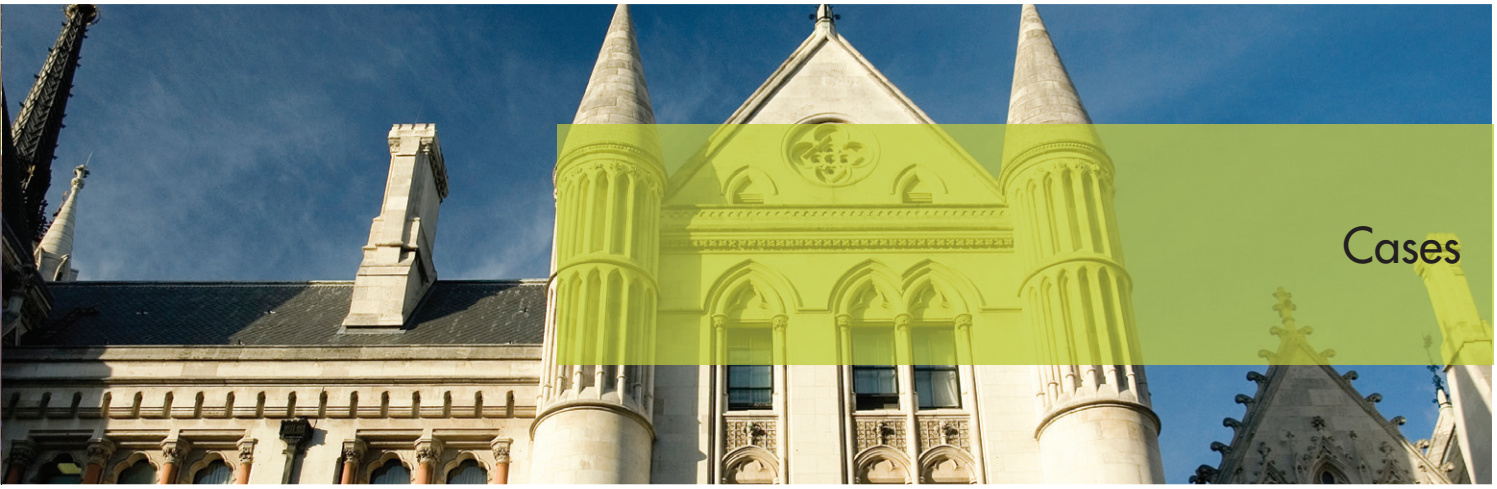
This transaction was complex legally on many levels. It was a sale by administrators and therefore various procedures needed to be followed which are unique to this type of sale. In addition, the involvement of the special loan servicer, Hatfield Philips, and nature of the loans added an additional legal dimension.

Project Management Skills

The transaction involved advising on complex structuring and involved multiple jurisdictions and parties. As such, excellent communication skills and project management within the team and of the external parties was essential. In London this was achieved by ensuring that the team were situated physically within close proximity to each other. In addition the fact that the firm has a global platform of 41 Offices meant that Stuart Borrie, who led and project managed the team, was able to call on other firm resources around the clock and in different time zones.

Client Satisfaction

Nick Deacon, our client, and fund manager at Henderson has stated, "This transaction was legally complex and highly sensitive and it was essential that confidentiality was maintained. It was critical that the team understood the sensitivities involved, and that we maintained the confidence of the administrators throughout the process. Strong project management skills were crucial given the many disciplines, people and different jurisdictions involved. The K&L Gates property team were proactive, commercial and innovative".



Cases

Competition Act

In proceedings for the grant of a new lease of an oil terminal, a tenant oil company sought to use principles of competition law to reduce the rent. The tenant claimed that, by seeking excessive rents in negotiations, the landlord port owner was abusing its dominant position in the provision of port facilities contrary to the Competition Act 1998. The Court of Appeal struck out the tenant's claim as the competition allegations were inadequate: the allegation that the rent proposed by the landlord in negotiations was abusive was irrelevant as the negotiations would be overtaken by the duty of the court to settle the terms of the lease in accordance with the Landlord and Tenant Act 1954. A tenant could not have any legitimate concern that the court would fix a rent that was abusive in competition terms.

Comment: Whilst found to be irrelevant to the tenant's claim, as a matter of law, competition claims would not always be irrelevant to proceedings for the grant of a new lease under the 1954 Act.

Humber Oil Terminals – v – Associated British Ports, CA

Easements

The freehold owner of a property comprising a number of flats sought to construct a lightwell in the garden which was opposed by the lessees of the flats. The lessees had served notice on the freeholder seeking a right to collective enfranchisement and had also sought a right to acquire the freehold to the garden. On commencement of the lightwell construction (which included the excavation of a trench), the lessees sought an injunction on the basis of an easement granted to the lessees to use the garden, and they also argued that the freeholder was under a duty not undertake material work prior to enfranchisement.

It was held that the creation of the lightwell did not amount to a substantial interference with the easement to use the garden. As for the excavation of the trench, though the construction process was significant, the interference (of six months) was temporary. An injunction was not appropriate to a temporary or trivial interference and accordingly, only nominal damages were awarded.

Comment: The court said that the extent of the duty proposed by the lessees would have a very broad impact on enfranchisement claims and there was no need for a duty of this nature.

Barrie House Freehold – v – Merie Bin Mahfouz Company, ChD

Trustees' Sale

The trustees of a property had been granted consent to sell a trust property by an earlier court order. Prior to the sale, conditions for obtaining planning permission became more favourable and, accordingly, the trustees were concerned that the order may no longer apply. A surveyor had recommended that the sale should proceed without planning permission in light of the application time required, the poor economic climate and the continued lack of certainty of success. A further court order was therefore sought by the trustees for consent to sell the property without planning permission, which was opposed by the defendant on the basis that the best market price would not be achieved.

Consent was granted. It was held that, at the time of the earlier court order, there was a prospect of obtaining planning permission. Consequently, circumstances had not changed significantly so as to impact the effectiveness of the order. Where there was no certain prospect of increase in market value, it was unreasonable to expect the trustees to engage in an expensive and speculative planning application. Finally, even if planning permission had been obtained, it would have only marginally increased the amount that would be available to the trust beneficiaries.

Comment: The defendant did not take the opportunity to provide additional valuation evidence and therefore his submissions were based on speculations and inference.

Page – v – West, ChD

Business Tenancy

A business operator had entered into an arrangement with a local authority to run a caravan site under three agreements: an employment contract to work as a security guard, an agreement to occupy a bungalow, and an operator agreement for the site. The local authority wished to terminate the arrangement and, in response, the operator sought the grant of a new business tenancy under the Landlord and Tenant Act 1954. In doing so, he submitted that only the operator agreement was genuine, with the employment and bungalow contracts being a sham.

The court said that the central issue was whether or not the operator was running the business as agent for the local authority. If he was, that would preclude exclusive possession. Being part of the same transaction, the three agreements were intended to be read together. Whilst the operator was carrying on the business at his own financial risk, there were a number of factors which suggested an agency relationship, including local authority control and provision of free services. The court concluded that the cumulative effect of these factors was inconsistent with the suggestion the operator was running the site as his own business.

Comment: The fact that the parties entered into the agreements in order to prevent legislation applying (here, the acquisition rights under the Housing Act 1985), did not demonstrate that the documents were not intended to take effect in accordance with their terms.

Brumwell – v – Powys County Council, CA

Break Notice

It was a condition of a lease break that, at the break date, all payments due under the lease be paid else the break would be of no effect. The tenant served a break notice together with a letter stating that it was not aware of any breach of the lease. The day before the break date, the tenant delivered to the landlord a cheque for six months' rent (but not for the default interest that had accrued) and stated again that it was not aware of any breach of the lease. The landlord claimed that the break was of no effect, and the court had to consider, amongst other things, the meaning of "paid" in the lease, whether the delivery of the cheque constituted "payment" prior to the break date, and whether principles of estoppel precluded the landlord from claiming default interest without demand after the break date.

The court said that the parties' conduct in the use of cheques as payment created an implied term which displaced the common law rule that a debtor must pay a debt with legal currency. Accordingly, the landlord could not reject the cheque. There was, however, nothing in the course of dealings which showed a requirement for prior demands for default interest. Further, estoppel did not arise as, on the balance of probabilities, the landlord did not know that the tenant was mistaken in stating that it did not owe any sums under the lease.

Comment: The fact that time was of the essence under the lease was not considered to require payment of cleared funds.

Avocet Industrial Estates – v – Merol, ChD

Service charges

The landlord of a residential block who was proposing to carry out major works to the block consulted with the lessees to a limited extent but failed to comply fully with the statutory consultation requirements under s.20 of the Landlord and Tenant Act 1985. The lessees contended that, as a consequence, the landlord could only recover £250 per flat pursuant to the consultation regulations. The landlord, in response, sought dispensation from the consultation requirements under s.20ZA of the 1985 Act. At first instance, the Leasehold Valuation Tribunal refused dispensation and the landlord appealed to the Upper Tribunal (Lands Chamber). The landlord contended that its application for dispensation should only be refused if the failure to consult had caused some major prejudice to the lessees and the LVT had failed to consider whether any prejudice had been caused.

The Upper Tribunal held that, where non-compliance with the regulations was substantial, it would be reasonable to assume that the loss of opportunity to make representations amounted to significant prejudice. It said that the LVT had considered the issue of prejudice and that it could be inferred that they had concluded that the breach was so substantial that prejudice could have been taken to have flowed from it. The landlord's appeal was dismissed.

Comment: K&L Gates is acting in the leading case in this area, Daejan Investments - v - Benson, which was relied upon by the Upper Tribunal and which is due to be heard by the Supreme Court in December.

Stenau Properties - v - Leek, UT (Lands)

New Team Members

We are pleased to welcome Diego Shin, Jim Mottram, and Julian Goodman in London.

James Mottram

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Jim Mottram is a partner in the Corporate Tax department of the London office. Jim joined K&L Gates in 2011 having qualified as a solicitor in the Tax Department of an international law firm in 1995. He was employed as a fund tax specialist by a big four accountancy firm, before becoming a partner in a leading London law firm in 2001.

He has wide experience in a range of corporate tax issues with a particular focus on funds taxation and international structuring. He has advised on a number of European structures for investment in real estate, both for taxpayers and tax exempt investors.

Jim was at the forefront of the introduction of the UK-REIT legislation speaking at conferences both in the UK and in the US on the development of the draft legislation. He advised 3 of the initial 9 listed companies on the tax aspects of their conversions when the legislation was enacted. He also advised on the formation and listing of the first new UK-REIT to be launched.

Diego Shin

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Diego is a senior associate in the Finance Group of K&L Gates' London office. Diego's practice focuses on the financing, syndication, acquisition, restructuring, discounted pay-off and securitisation of real estate debt.

The UK Legal 500 2009 edition has described Diego as a "highly capable rising star" and as "recommended."

Julian Goodman

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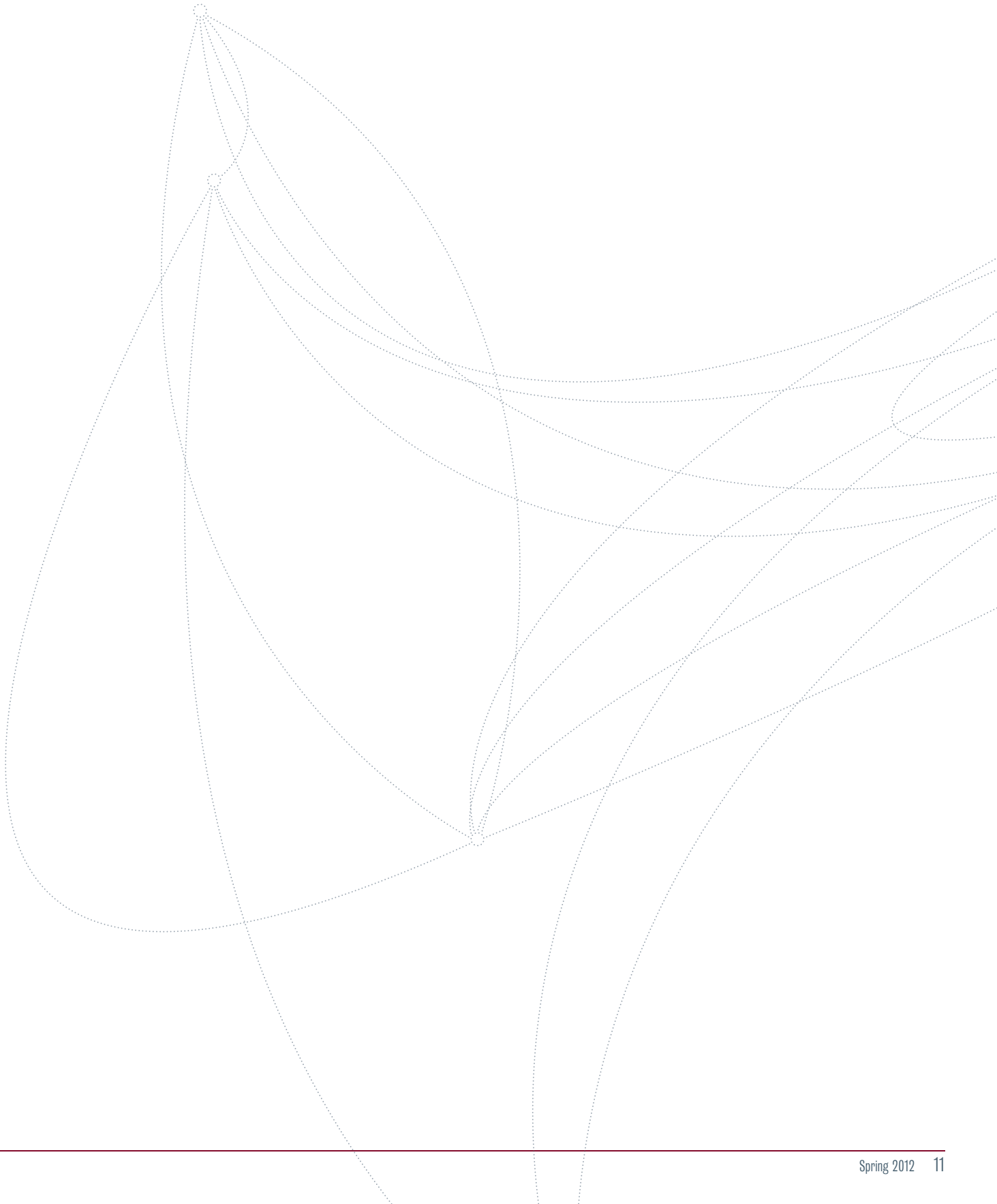
Julian is a consultant and member of the finance and real estate groups in the firm's London office and has a wide ranging background in relation to real estate finance and pure real estate matters. His experience in relation to real estate based finance matters includes property finance loan origination; CMBS and RMBS transactions; structured real estate transactions; real estate acquisition and development finance.

In addition to advising investment banks in relation to such matters, and in particular real estate aspects, he has also advised a rating agency and monoline insurers in relation to the real estate aspects of structured and securitised transactions. In addition to finance based matters Julian also has a wide range of experience in relation to pure real estate matters including property acquisitions, disposals and leases both for investment and occupational clients as well as in the context of the structuring of property interests for structured real estate transactions.



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