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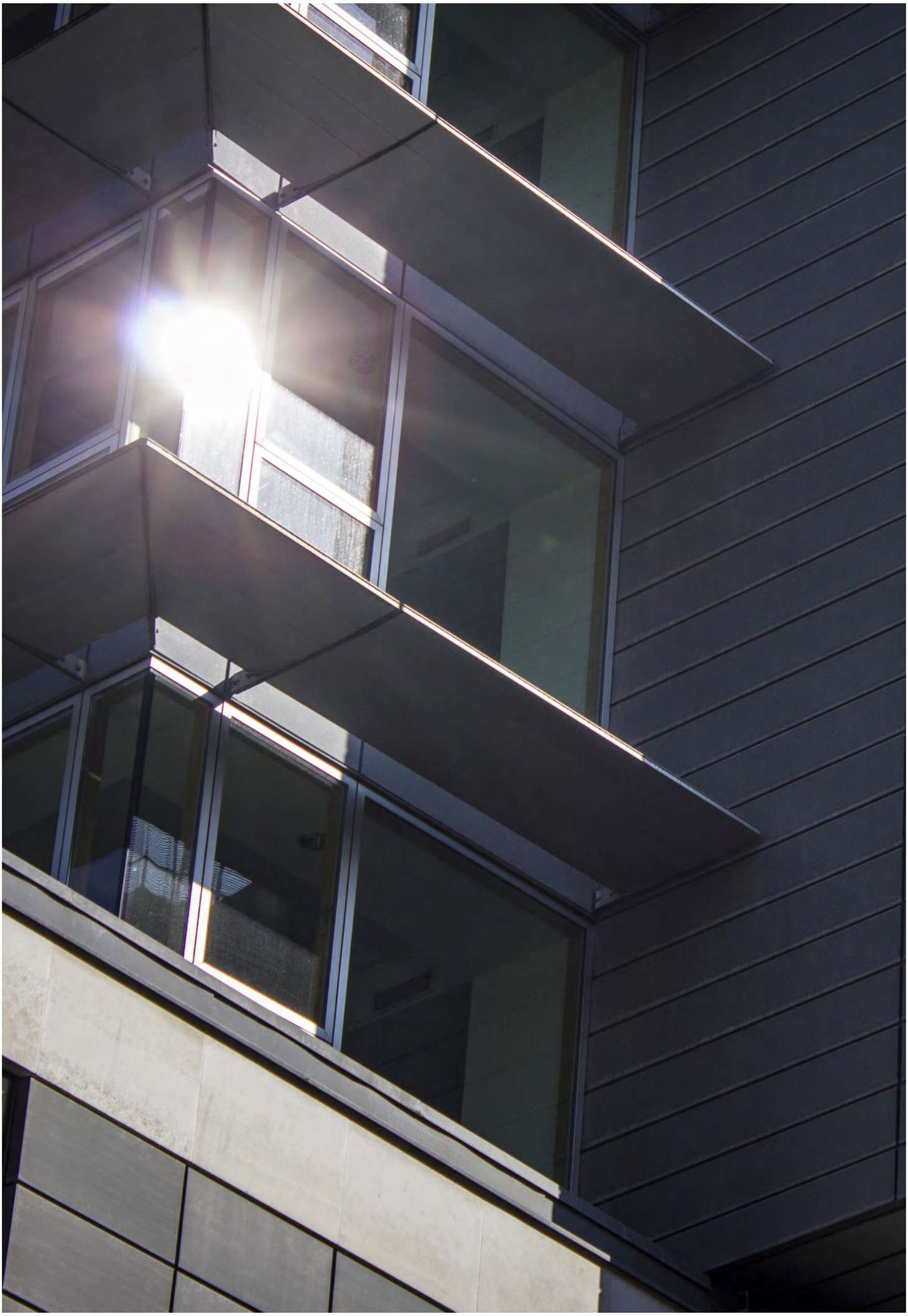

Solving the surplus: Leasehold liability transactions

Nicholas Cheffings and Laura Oliver offer an answer to the problem of surplus leasehold liabilities.

Leasehold properties become surplus to requirements for any number of reasons: individual stores become unprofitable; changes in working practices mean less office space is needed; or a takeover means rationalisation.

Deciding that a leasehold property is not needed is rarely the end of the story. If the end of the lease term is not imminent, the business may have to carry on paying rent and other outgoings for years. The problem is that surplus real estate tends to receive little attention at board level – but it is a real cost to the business.

The solution

With active management, it may be possible to negotiate piecemeal surrenders with landlords. Third parties may be interested in taking on all or parts of the properties. There may also be rates saving schemes available which could reduce some of the overhead cost.

It is, though, very rare that the business itself will be best placed to secure these deals once the easy wins have been taken. In addition to the management time required, the necessary expertise does not usually exist in house. So what is the solution? It may be a leasehold liability transaction (LLT), where the business outsources the problem to a specialist manager. By carefully structuring the outsourcing, a third party is incentivised to reduce the liabilities swiftly and with maximum long-term benefit for the business.

From an accounting perspective, the effective disposal of lease liabilities at one hit (as opposed to over a protracted period by way of single surrenders and assignments in difficult markets) provides increased certainty, the removal of market risk and possible tax efficiencies.

How it's done

The business makes a capital payment or series of payments to the manager which, in turn, takes responsibility for all of the business's obligations under the leases. The parties enter into a management agreement under which the manager contracts to fulfil those obligations and is given a power of attorney to enable it to do so. As a matter of law, the business remains the tenant under the lease and so the landlord is unaffected. In practice, it is the manager that deals with the landlord in relation to all aspects of the lease and the property.

The capital payment is often paid by instalments reflecting the decreasing liability over time. Essentially, the transfer price is assessed by reference to a best estimate of the cost to settle the various leasehold obligations. The gross liability is the cost of rent and other outgoings under the leases plus a sum for the inevitable dilapidations liability. Against that, one sets off estimated rental income from subletting, making allowances for void periods, rent-frees, anticipated rental changes and the like. The resulting net liability is based on accounting provisioning.

The primary risk to the business is that the actual liability under the leases proves to be higher than the payment made to the manager. This can be covered off by careful staging of payments and the use of charged accounts and restrictions on the manager making distributions to shareholders. In effect, the manager is backing itself to beat the provision. It works like this: if the gross liability is £40m, the business might pay £27m to the manager and the manager might be able to pay down the liabilities for £25m. So, the business saves money, as well as the hassle, and the manager makes £2m profit.

Who's doing it?

The precise requirements of the business dictate the terms of the transaction, but the starting position will always be a reasonable number of surplus leases which have proved, or may prove, difficult to eliminate. For this reason, the businesses involved tend to be large household names, including Whitbread, B&Q and Santander.

According to Charles McKendrick, Morrisons' Director, Estates and Asset Management, its key driver was "risk mitigation in a cost-controlled way" which allowed the company to refocus its in-house resources on high-value-add areas. McKendrick added: "The portfolio was diverse with a range of short- and long-leasehold tenures, tenants and locations. Surplus Property Solutions (SPS) has dealt with the portfolio much quicker than we would have achieved ourselves with eight of the 12 long-leasehold properties dealt with in the first year, and the gross liability for the long-lease element reduced by 87.5%."

These transactions have also proven popular with public and quasi-public bodies which need to reduce their overheads, including the Department for Business, Innovation and Skills (BIS) and Royal Mail.

Roger Taylor of UK Shared Business Services structured an LLT for BIS in 2014 as part of its major estate rationalisation programme. This was a first for government. He said: "It has proved to be a successful innovation that has delivered in excess of what the business plan projected. There were a number of reasons for taking this approach, including time, available resource, and some challenging interests, which expert asset managers such as Greenhills had the skill and knowledge to resolve in ways which we did not."

Tellingly, he added: "As we look at further estate rationalisation, this is certainly an approach that I would consider once again where it is appropriate." He is not alone in thinking this way.

The market has developed over the years and there is now a specialist pool of managers with dedicated resource, experience and track record: notably SPS, Greenhills and Legacy Portfolio. A key ingredient for success is a relationship of trust between the manager and the business. Reputations must be protected. The fact that LLTs have been quietly growing in popularity and have been successfully used across a range of sectors and asset classes is a testament to their value as a viable solution to a very real problem. Expect to see more of them.

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A game of drones

The use of drones in the UK is increasing rapidly. Real estate already benefits from the technology but as their use becomes more prevalent it's important to understand what they are, how they are used and what the risks are. Graham Cutts and Dion Panambalana are on the case.

What are drones?

Drones are unmanned flying vehicles, which means that they are not piloted in the air but controlled remotely by someone on the ground. The media use drones to produce real-time footage whereas the fire services use them to provide an aerial perspective on operations and in agriculture, they are used for crop dusting. While Facebook works on an ambitious plan to use drones to provide wireless internet access in remote areas, Amazon is proposing to revolutionise its service through delivery by drone.

Drone technology presents many opportunities for the real estate sector. Already, construction companies use drones to survey sites and local authorities use them to assist with planning applications. A recent report[1] by The Future Laboratory even suggests that drone visits will replace property viewings by 2025.

However, drone operators must be wary when flying drones over land they don't own. Equally, landowners should be aware of their rights when drones pass through their airspace.

Drone use can:

- breach aviation regulations;
- be a trespass and/or a nuisance;
- cause property damage; and
- infringe privacy and data protection laws when drones are equipped with photographic equipment.

What's the law on this?

Regulations differentiate drones by weight. Drones over 150kg are within the remit of the European Aviation Safety Agency[2]. Drones below 150kg are regulated by national aviation authorities which, in the UK, is the Civil Aviation Authority.

The primary UK legislation is the *Aviation Navigation Order 2009*[3]. The Civil Aviation Authority has usefully explained how this legislation applies to drones in its publication: *Unmanned Aircraft System Operations in UK Airspace*[4].

Under the legislation[5] small drones weighing not more than 20kg are the operator's responsibility. The operator must maintain direct, unaided visual contact with the drone. The Civil Aviation Authority explains that this usually means 500m horizontally or 400ft vertically unless an approved anti-collision system is fitted.

You need air traffic control permission to fly a drone weighing more than 7kg in controlled airspace. A useful website called *www.noflydrones.co.uk* has an interactive map feature showing UK no fly zones, which shows that most of London is a no-fly zone.

The operator doesn't need a licence. However, the operator does need CAA permission to fly a drone for "aerial work" which broadly means flying a drone commercially. If flying for the purposes of surveillance or data gathering you'll also need permission to fly:

- over or within 150m of a "congested area" which is widely defined as an area substantially used for residential, industrial, commercial or recreational purposes;
- over or within 150 metres of an organised open-air assembly of more than 1,000 persons;
- within 50 metres of any vessel, vehicle or structure not under your control; or
- within 50 metres of any person.

[1] 8 March 2016

[2] Regulation 216/2008

[3] SI 2009/3015

[4] CAP 772: Unmanned Aircraft System Operations in UK Airspace

[5] Articles 166 and 167, Aviation Navigation Order 2009

More onerous regulations apply to drones over 20kg up to 150kg. Airworthiness approval and registration with the CAA are required.

Violation of the legislation incurs criminal liability. The CAA has successfully brought prosecutions. For example, an individual was prosecuted last year for nine offences having flown his drone over iconic London sites and live football matches.

It's crucial that drone operators understand these regulations before flying a drone.

Drones in your airspace? Trespass and nuisance

The case of *Bernstein of Leigh v Skyviews & General Ltd*[6] established that a landowner's airspace extends to such height as is necessary for the ordinary use and enjoyment of the land. Skyviews took a photograph of Bernstein's house using an aeroplane then tried to sell it to him. The court decided that Skyviews had not infringed Bernstein's airspace and therefore there was no trespass.

However, in *Anchor Brewhouse Developments Ltd v Berkley House (Docklands Developments) Ltd*,[7] Berkley's cranes invaded Anchor's airspace by swinging over Anchor's land and that invasion had amounted to a trespass given the regularity and permanence of the infringement.

[6] [1978] Q.B. 479

[7] 38 B.L.R. 82

So, to establish aerial trespass you need to establish some permanence of the infringement, otherwise temporary airspace invasion may at worst only be a nuisance. Based on *Bernstein*, someone flying a drone over your land to take a photograph is probably not committing aerial trespass. But flying over your airspace on a daily basis and remaining in that airspace for a length of time disproportionate to the need to do so may amount to a trespass and making a continuous video recording may amount to a legal nuisance (bearing in mind that nuisance can arise from a single incident). The law is currently untested and each case will turn on its facts. However, bringing an action for trespass is not easily done without significant evidence to demonstrate the infringement and degree of permanence.

Privacy and data protection

Drones equipped with cameras run the risk of breaching rights to privacy and data protection laws. Article 8 of the European Convention on Human Rights establishes the right to respect for private and family life. Additionally, images of identifiable persons could fall within the definition of "personal data" for the purposes of the *Data Protection Act 1998*.

The Information Commissioners Office has explained that drones are highly likely to invade privacy due to their ability to operate at significant height and their unique vantage point. The ICO has provided some useful guidance on avoiding infringement which includes:

- only activating the drone's recording equipment when necessary;
- secure storage of any images and destroying these when no longer needed;
- restricting the drone camera's vision so it can only focus on one place; and
- notifying individuals that they are likely to be recorded, for example, by erecting signs.[8]

Property damage

Drones can cause property damage if flown negligently, or if the drone itself becomes defective or an item is dropped from it. A claim can be brought under the Civil Aviation Act 1982[9], where aircraft owners are liable for damage caused to any person or property by a person in, or an article falling from, an aircraft unless the injured party have themselves been negligent. Equally, there may be scope to claim under an owner's buildings insurance given that damage caused from planes or things dropped from them is often an insurable risk. It remains to be seen (and tested by the courts) whether drone damage would be insurable on the terms we're all used to.

What future legal developments can we expect?

In March 2015, the government explained that its objective is to integrate drones fully into the aviation system. It acknowledged that the public need reassurance regarding security, privacy and data protection, but also that overregulation risks killing off the industry.

We can therefore expect legal and regulatory development as the drone market expands. Brexit creates an added complication as much of the existing regulatory framework is European. How will the Civil Aviation Authority take on the European Aviation Safety Agency's responsibilities? The Data Protection Act implemented a European Directive[10] into UK law so how will leaving the EU impact data protection? Questions such as these will need to be answered in a post-Brexit world.

Clearly, the technology and the law are in flux. Nevertheless, as an industry that is open to change, the real estate sector should embrace these developments to harness the unique opportunities drones can provide.

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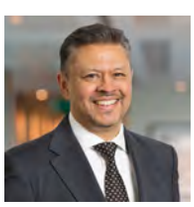

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[8]For more ICO guidance see https://ico.org.uk/for-the-public/drones/ and https://ico.org.uk/media/for-organisations/documents/1542/cctv-code-of-practice.pdf.

[9]s.76(2) Civil Aviation Act 1982

[10]Data Protection Directive (95/46/EEC)

Drones: the key facts

- we're likely to see more drones in our skies in the foreseeable future;
- drone operators should be aware of the legal framework around fly zones together with the risk of infringement of a land owner's rights;
- for landowners and occupiers, successfully establishing aerial trespass may be difficult although nuisance may be an easier win;
- drone use can breach aviation regulations which differentiate drones by weight.

Great expectations or hard times?

As the most powerful player in the London planning regime, all eyes are on Sadiq Khan as the new Mayor settles into City Hall. But what the Dickens can we expect to see? Kathryn Hampton takes a look at the Mayor's top planning priorities and reviews what he has done so far.

Bleak House

Housing is a top priority for the new Mayor. He pledged to ensure that 50% of new builds in London are affordable and has already increased provision in schemes such as Barking Riverside (where the target increased from 28% to 35%) and Old Oak Common, where Khan imposed a 40% requirement.

The new Mayor is looking to deliver a higher rate of affordable housing on public land schemes and is reportedly willing to see lower returns on TfL land to secure increased housing. However, with recent figures showing that social housing construction is at an all-time low, Khan is going to have to work hard to ensure that the bricks are laid, if he is to achieve his target.

Khan wants to ensure that more housing is "*genuinely affordable*" and a revised definition of "*affordable*" is expected in new planning guidance this Autumn. Deputy Mayor for Housing, James Murray has said that the definition will include "*social rent, London Living Rent and shared ownership*".

The Mayor has also committed to "*getting a better deal for renters*" and it is thought that his office will be fighting for a build to rent exemption from the starter homes requirement.

The Mystery of Viability Assessments

Sadiq Khan has also switched his attention to viability assessments submitted with planning applications, which have been blamed for restricting affordable housing provision and over-complicating the planning process. The Mayor has called for greater transparency and is currently considering the introduction of a fixed tariff to replace affordable housing contributions.

A 35% tariff has been mooted as a possible solution and the intention is that the fixed rate will be set at a level which incentivises developers to choose the tariff system over the viability assessment route. It will not necessarily mean an end to viability assessments, but James Murray hopes that the tariff system will be popular due to the certainty and speed that it will offer.

Our Mutual Friend works on public sector land

The Mayor's office is already working on changes to the London Plan and we can expect to see revised policies to push public sector building and increase affordable housing. The Mayor has committed to "*building new homes on land owned by the Mayor, including Transport for London land, and bidding to develop other public sector land*". He has already released a piece of TfL land for development in Kidbrooke, and is expected to insist that half of all homes built will be affordable.

In an effort to increase public land development, Khan has pledged to find new sources of investment and there have been calls for relaxed lending for local authorities and housebuilders. We may also see the new Mayor fighting for the retention of central taxation receipts, such as SDLT from London homes, to fund new housing.

The Battle of Life: Making London "Liveable"

Described as one his key aims, we expect that in addition to housing, this will involve increased local employment initiatives and a focus on public spaces and air quality.

The Mayor's public consultation in July included new proposals to combat air pollution and his amendments to the London Plan will introduce stronger policies on: tall buildings, the green belt, public spaces and empty homes.

The Long Voyage made shorter: Improving Infrastructure

Khan is committed to improving infrastructure, which he cited as one of his "*foremost priorities*". The Mayor pledged to plan for new transport infrastructure, including Crossrail 2 and extensions to the DLR and Bakerloo lines. He said that he will "*involve business in decision making on key issues of policy and planning, from skills and housing costs, to transport infrastructure*".

Conclusion

The new Mayor has already started to shake up the planning system in the Capital. He has *Great Expectations* for housing and is keen to see the end to *Hard Times* for Londoners. We wait with *Old Curiosity* to see how he puts his plans into action.

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Case round up

Lien Tran and Paul Tonkin summarise recent case law

Ottercroft Ltd v Scandia Care Ltd and another [2016] EWCA CIV 867

Court upholds rights of light injunction against "high-handed" developer

Scandia had given undertakings not to develop their property so as to cause interference with their neighbour Ottercroft's rights to light. In breach of these undertakings, Scandia built a metal staircase which caused a relatively minor loss of light (valued at less than £1,000) to Ottercroft's restaurant.

The trial judge found that, although the infringement was relatively minor, Scandia had acted in a 'high-handed' and unneighbourly manner by deliberately misleading Ottercroft. Despite being fully aware that their actions would affect Ottercroft's rights, Scandia proceeded to build the staircase in deliberate breach of their undertakings. Taking into account all the circumstances, the judge ordered a mandatory injunction requiring Scandia to alter, remove or replace the staircase so that it no longer infringed Ottercroft's rights.

Scandia appealed, arguing that the judge had failed to carry out a fair and objective balancing exercise in deciding to award an injunction rather than a payment of damages. They claimed that the award of an injunction was oppressive given the minor nature of the infringement.

The Court of Appeal dismissed the appeal. The trial judge had a broad discretion and should not be overturned by an appeal court unless he had clearly made the wrong decision. Although the criteria set out in the leading case of *Shelfer v City of London*[11] "open the door" for a judge to exercise his discretion to award damages instead of an injunction, they do not compel him to do so. The Supreme Court in *Coventry v Lawrence*[12] stated that an injunction may be necessary to do justice and warn others, especially if the defendant has acted in a high-handed manner. In this case, the Court of Appeal made clear that there had been no error in the judge's exercise of discretion.

[11] [1895] 1 CH.287.

[12] [2014] UKSC 13.

Pineport Ltd v Grangeglen Ltd [2016] [EWHC] 1318

Relief from forfeiture granted 14 months after landlord exercised right to forfeit

The High Court granted relief from forfeiture to a tenant 14 months after a landlord exercised his right to forfeit by peaceable re-entry. Whilst delay may ultimately be a decisive factor against granting relief, the court has a wide discretion in reaching that decision. In this instance, the court considered it wrong to base its decision on delay in isolation, without having regard to all of the circumstances.

The case concerned a lease of industrial premises granted for 125 years at a premium of £90,000 and which had a value of £275,000. In April 2014, the landlord forfeited the lease for non-payment of service charge amounting to £24,000. At the time of forfeiture, the tenant company's sole director was suffering from depression. Over a year later, in June 2015, the tenant applied for relief from forfeiture.

Where a lease is forfeited for non-payment by court proceedings, a tenant needs to apply for relief from forfeiture within six months. However, where forfeiture is by peaceable re-entry, the High Court can still grant relief after the six month period, which is used as a guide rather than a strict time limit.

The court took into account the high premium paid for the lease and the fact that the arrears amounted to less than 1% of its value, meaning the landlord would gain a disproportionate windfall if relief was not granted. The court also found that granting relief would not prejudice the landlord, who had not taken any steps to market or re-let the property. The tenant's ill-health meant that he did not appreciate the risk and associated consequences of forfeiture and he had not sought legal advice at the time of forfeiture. The tenant had also taken steps to satisfy the arrears and the landlord's costs, including by a family member selling his home.

As such, the court considered that the tenant's application was made with "reasonable promptitude", which was an "elastic concept which is capable of taking into account human factors", albeit that this was clearly an extreme and unusual case. The tenant was granted relief and the lease was reinstated subject to a condition that the arrears, interest and the landlord's costs were paid.

McDonald v McDonald [2016] UKSC 28

Article 8 ECHR will not affect possession orders against private tenants

The Supreme Court has clarified that Article 8 of the European Convention on Human Rights (ECHR), an individual's right to respect for private family life and their home, has no bearing on the court's decision to grant a possession order against a private sector tenant.

Fiona McDonald occupied her home under an Assured Shorthold Tenancy (AST) granted by her parents, who owned the property subject to a mortgage. The mortgage lender appointed a receiver when the parents fell into arrears. Ms McDonald failed to pay the rent under the terms of the AST, causing the receiver to issue possession proceedings against her.

The court made a mandatory possession order under section 21 of the Housing Act 1988 which was upheld by the Court of Appeal.

By the time the case reached the Supreme Court, there were two main issues for consideration:

1. Was the court, as a public authority, required by the Human Rights Act 1998 to act in a way compatible with the ECHR, such that it had to consider the proportionality of the possession order and the interference with Ms McDonald's rights under Article 8? Ms McDonald argued that it was and the fact that she suffered with a personality disorder was a relevant consideration that should have been taken into account.
2. If so, could section 21 of the 1988 Act be construed in a way which was compatible with the ECHR?

On the first point, the Supreme Court ruled against Ms McDonald. Treating the courts as a public authority for this purpose would effectively mean that the ECHR was directly enforceable between private citizens in contract disputes. The 1988 Act already reflects parliament's efforts to balance the competing interests of private landlords in the residential sector and their tenants. The Supreme Court went on to say that if it had agreed with Ms McDonald, it would have had to make a declaration of incompatibility on the second issue.

Vanquish Properties (UK) Limited Partnership v Brook Street (UK) Limited [2016] EWHC 1508 (Ch)

Break notice invalid where landlord incorrectly named

The case concerned premises on Fenchurch Street, which were originally let by the City Corporation to Brook Street. The lease contained a landlord's right to end the lease on 27 September 2016 on six months' notice. The premises were to be redeveloped and the City Corporation granted an overriding lease to the developer, Vanquish, meaning that they would become Brook Street's direct landlord. The overriding lease described the lessee as "Vanquish Properties (UK) Limited Partnership". As soon as the overriding lease was granted, the solicitors acting for Vanquish purported to serve the break notice on Brook Street. In the notice, they stated that they were instructed by and were serving notice on behalf of "Vanquish Properties (UK) Limited Partnership, the landlord of the property."

Despite what the overriding lease purported to say, it was legally impossible for Vanquish Properties (UK) Limited Partnership to be the tenant under the overriding lease (and, by extension, Brook Street's landlord). A limited partnership is shorthand for a collection of individual partners. It is not a legal entity in its own right and cannot hold a lease. As such, Brook Street's landlord was not Vanquish Properties (UK) Limited Partnership, rather it was Vanquish Properties GP Limited, which was the general partner of the Limited Partnership and was (as a limited company) capable of holding the lease.

The tenant challenged the validity of the break notice. It argued that the entity on whose behalf the break notice was purported to have been served was not an entity at all. It was not its landlord and in those circumstances the break notice could not be valid. The court agreed. The landlord could only be Vanquish Properties GP Limited and the notice did not say that it was being served on behalf of that entity. Vanquish's argument that the defect in the notice could be cured because a "reasonable recipient" would have understood what was intended was also rejected – the court found on the contrary that a reasonable recipient would have been confused on receipt of the notice. Vanquish had accordingly lost the right to break the lease.

Britel Fund Trustees v B&Q PLC [2016] unreported

Early break clause and rent-free period significantly impacts rent assessment

In these unopposed lease renewal proceedings, the parties had agreed on all the terms of the lease apart from rent and interim rent. Under section 34 of the Landlord and Tenant Act 1954, the court must assess the rent for the renewal lease based on what the property might reasonably be expected to be let for in the open market by a willing lessor to a willing lessee. The property was a retail warehouse, occupied by the tenant for its DIY business.

The parties had agreed a mutual rolling break clause in the renewal lease, which was exercisable at any time after 30 June 2018 on six months' notice. Both parties' valuation experts arrived at their rental valuations for the premises by assessing the open market rent which a DIY retailer would pay for the premises for the full term of the lease and then applying a discount in respect of the break provision. However, both experts later accepted that the break clause was such that no DIY retailer would accept the lease as they would not be willing to incur the substantial fit out costs where the lease could be ended two years later. The experts agreed that the only type of tenant who would be willing to take the premises subject to the break would be a discount retailer. Whilst a DIY retailer would have paid £600,000 per year for the premises without the break option, the court found that a discount retailer taking the lease with the break option would only be prepared to pay £373,000 and that this was the appropriate rent for the new lease.

The court also held that a three-month fitting out period should be taken into account when assessing the rent. Section 34(1)(a) of the Landlord and Tenant Act 1954 states that the tenant's current occupation should be disregarded in the rent valuation. Therefore any tenant taking a new lease would need to out the premises. The court found that this rent-free period should be rentalised over the whole lease term (in this case, 10 years), further discounting the rental level.

Riverside Park Ltd v NHS Property Services Ltd [2016] EWHC 1313

Break notice invalid where demountable partitioning prevented vacant possession

The tenant had carried out works in the property, including installing demountable partitioning. The tenant later served a break notice to terminate the lease. Under the lease, the break notice would only be valid if the tenant gave up vacant possession on the break date. The tenant failed to remove the demountable partitioning by the break date. The landlord argued that this amounted to a failure to give vacant possession. The break had therefore not been validly exercised and the lease would continue. The tenant argued that the partitioning was a fixture which now formed part of the premises and so did not have to be removed to give vacant possession. Alternatively, the presence of the partitioning did not impede the landlord's ability to re-let and so should not be treated as preventing vacant possession.

The court found, with the benefit of expert evidence, that the partitioning was a chattel (moveable asset) rather than a fixture. It was not attached into the structure of the premises and could be removed with relative ease. The partitioning had been installed for the benefit of the tenant and to its preferred layout. That layout was unlikely to suit a new tenant and therefore the presence of the partitioning did impede the landlord's ability to re-let. Vacant possession had not been given and therefore the break was ineffective.

Edwards v Kumarasamy [2016] UKSC 40

Landlord not held liable for disrepair outside the building

A landlord appealed to the Supreme Court following the Court of Appeal's decision that he was liable for an injury suffered by his tenant outside the rented property. The tenant claimed damages for personal injury after he tripped on the uneven path outside his block of flats.

Section 11(1)(a) of the Landlord and Tenant Act 1985 implies a landlord's covenant to keep the structure and exterior of a dwelling house in repair, including any part of the building in which the landlord has an interest. The Court of Appeal held that the implied covenant applied to the path, as it could be described as the exterior of the front hall and therefore part of the building in which the landlord had an interest. Even though the tenant had not informed the landlord of any disrepair, the landlord was still liable for the tenant's injury.

The Supreme Court overturned the decision and allowed the landlord's appeal. As the path on which the tenant tripped led from the building's entrance to the car park, it was not part of the actual exterior of the property. The paving was outside the building and could not be properly described as part of the front hall. As such, the implied covenant under section 11(1)(a) of the Landlord and Tenant Act 1985 did not apply and the landlord was not under a duty to keep the path in repair.

Birdlip Ltd v Hunter and another [2016] EWCA Civ 603

Building scheme must be determined from the conveyance itself rather than external evidence

Birdlip Limited obtained planning permission to build two new houses on its land. Birdlip's land was one of several plots of land which had been sold by the same vendor back in 1910, subject to a restrictive covenant on each plot not to build more than one dwelling in favour of the retained land. The adjoining owners, the Hunters, objected to the plans. They could not directly enforce the restrictive covenant in isolation because in 1910 their property had been sold-off before Birlip's land and therefore did not benefit from the covenant. However, they argued that the restrictive covenant was enforceable as part of a building scheme (or "scheme of development") for the benefit of all the other properties in the scheme regardless of the order in which they were sold-off.

The High Court held that a building scheme existed and that the Hunters could enforce the restrictive covenant against Birdlip. The judge observed that the estate had many classic building scheme characteristics and that the restrictive covenants were for the common benefit of all the owners on the estate.

The Court of Appeal overturned the decision and allowed Birdlip's appeal. Although it accepted that a building scheme could sometimes be inferred, it was insufficient to merely show that a series of conveyances contained similar restrictive covenants. The existence and extent of a scheme of development should primarily be determined from the conveyance itself or related transaction documents. Wider sources may be considered as additional evidence, but they will rarely be sufficient to establish a building scheme on their own. In this case, the evidence was insufficient to show that a building scheme had been intended in 1910.

MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2016] EWCA Civ 553

Parties can vary lease by oral agreement despite boilerplate requirement for variations to be in writing

Rock occupied office space under a licence from MWB. After entering into a written agreement to expand its premises at a higher licence fee, Rock failed to keep up with the payments and fell into arrears. MWB proceeded to exclude Rock from the property, terminated the licence and claimed for the arrears.

However, Rock argued that it had been wrongfully excluded from the property. It claimed that the parties had varied the licence by entering into an oral agreement to reschedule the licence fee payments, giving Rock a longer period in which to pay. The first payment under the revised schedule was paid by Rock and accepted by MWB. However, MWB argued that the original written licence agreement contained the express provision that "all variations to this licence must be agreed, set out in writing and signed on behalf of both parties before they take effect". In addition, there was no consideration for the oral agreement.

The trial judge held that, despite the parties having entered into an oral agreement, the express provision in the licence prevented it from being effective. However, had the oral amendment taken effect, then there would have been adequate consideration in the form of Rock's agreement to comply with the terms of the revised schedule and subsequent first payment.

However, the Court of Appeal held that the oral variation to the licence *was* effective. Even though the licence had an express provision requiring all variations to be in writing, the court considered the parties' autonomy to be paramount. Where the parties had previously agreed to only vary the contract in writing, they were still free to amend those terms in the future.

The Court of Appeal agreed with the trial judge that there was good consideration to bind the parties under the oral agreement. Although part payment of a sum has long been established as not being adequate consideration, MWB gained a further commercial benefit from keeping Rock in occupation instead of having a vacant property. As such, MWB had not been entitled to terminate the licence for non-payment.

Leaseholders of Foundling Court and O'Donnell Court v The Mayor and Burgesses of the London Borough of Camden and others [2016] UKUT 366 (LC)

Superior landlord has duty to consult under section 20 LTA 1985

The leaseholders of Foundling Court and O'Donnell Court were residential tenants in a mixed use block in London called the Brunswick Centre. The council owned the headlease of various parts of the complex, including the residential blocks in question.

In 2004, the freeholder of the Brunswick Centre served notice on its immediate tenant, the council, under section 20 of the Landlord and Tenant Act 1985 informing them that it intended to carry out major works to the property. The freehold owner did not, however, serve similar notices on its subtenants, the residential leaseholders. However, the council forwarded the freeholder's notice to each of its own tenants.

The residents argued that the consultation requirements under section 20 had not been properly complied with and they were therefore not obliged to pay for the works under their service charge. The Upper Tribunal (Lands Chamber) held that the landlord's duty to consult under section 20 applied to the person who intended to carry out the works, in this case the freeholder, rather than the council. Where a superior landlord of a residential property intends to carry out qualifying works or enter into a qualifying long term agreement, they have an obligation to consult with subtenants as well as their immediate tenants. This obligation is imposed on the superior landlord rather than the intermediate landlord, in spite of the fact that the subtenants have no direct landlord and tenant relationship with the superior landlord. The freeholder had failed to consult with the residential sub-tenants and therefore it could not recover the cost of the works by way of service charge from the council.

Roundlistic Ltd v (1) Nathan Russell Jones (2) Aideen Mary Seymour [2016] UKUT 325 (LC)

Landlord who offered lease variation was not estopped from relying on tenant's breach of restrictive covenant

Jones and Seymour were tenants of a maisonette under a lease, which contained a restrictive covenant that tenants were not to use the premises other than as a single private dwelling house occupied by the current tenant and the family. However, the tenants sub-let the lower maisonette to a third party and notified the landlord, Roundlistic, of their intentions. The landlord argued that the restrictive covenant prevented the tenants from sub-letting the property.

The First-Tier Tribunal agreed with the landlord in that the terms of the lease prohibited the sub-letting. However, the landlord was estopped from relying on the lease's wording because it had offered the tenant a variation of the lease to prevent the sub-letting. The tribunal also considered that the covenant was an unfair term and therefore did not bind the parties.

The Upper Tribunal agreed that the clause did prevent the tenants from sub-letting. However, contrary to the First-Tier Tribunal, the Upper Tribunal found that the landlord was not estopped from relying on this term. Immediately prior to the grant of the sub-lease, the landlord had clarified its position and restated that it regarded the covenant as enforceable. Throughout its dealings with the tenant, the landlord had made clear that it considered the tenant to be in breach of the covenant. Therefore no estoppel arose to prevent it from relying upon the clause. The Upper Tribunal also found that no relevant "contract" had been made for the purposes of the Unfair Terms in Consumer Contracts Regulations 1999. As the landlord had been statutorily obliged to grant the new lease to the tenant, the regulations did not apply. Therefore, the term could not be rendered void for those purposes.

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Q&A

Tom Eyre-Brook looks at a recent change in TOGC policy whilst Jane Dockeray deals with a proposed change to SDLT filing and payment times.

Q: I am selling a freehold subject to a headlease and occupational underlease. The buyer and the tenant of the headlease are group companies and in the same VAT group. Does this affect whether the sale will be a TOGC (transfer of a going concern)?

A: You are lucky as HMRC has now clarified the position and accepted that this will be a TOGC. Put more technically, and following a recent Upper Tribunal case on the subject , there can be a transfer of a business as a going concern if a transferor transfers (part of) a business to a transferee in a VAT group with the business' customers and both the following apply:

1. the transferee intends to continue to use the transferred assets to operate the same kind of business in providing services to other group members; and
2. those other group members use the services to make supplies outside of the VAT group.

In a real estate context, this now means, for example, that where a freeholder sells its interest in a property, which is subject to a headlease and an occupational underlease, the transaction can qualify as a TOGC even if the buyer and the headlessor are part of the same VAT group (provided that the occupational tenant is not part of that VAT group). Previously, such a transaction could not qualify because HMRC considered that the buyer was not continuing the sellers' property letting business as the only supplies it would make would be to a member of its VAT group.

Perhaps surprisingly, HMRC has also now conceded that if a business that exists within one VAT group, is transferred out of that group, the normal TOGC rules will also apply.

Again, in a real estate context, this now means for example that where a freeholder sells property which is let to a member of its VAT group, the transaction can still qualify as a TOGC. Previously, such a transaction would not have qualified because HMRC's view was that the seller was not carrying on a property letting business prior to the sale (as the only supplies being made were to a member of its VAT group).

HMRC has invited businesses that may have overpaid SDLT because of its previous treatment of intra-group businesses to claim relief and confirms that the "generally-prevailing practice" exclusion will not apply to such claims. Any such claim must be made within 4 years of the date of the transaction.

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Q: I have heard that HMRC intends to reduce the filing and payment time for SDLT from 30 days to 14 days. Is that correct?

A: HMRC has issued a consultation on various proposed changes to the filing and payment process and one of the questions concerns this reduction in the filing and payment window. However, the introductory blurb suggests that the government have already decided to make this reduction, having announced it in the Autumn Statement 2015. Their main concern is to seek views on whether and what issues might arise as a result of the reduction.

In our opinion, the process of preparing the forms to report complex commercial transactions is complicated and can be extremely time-consuming. In time-pressured transactions, it is often not possible during the course of the transaction to engage with the approval of the significant amount of information which needs to be included on the returns. It is not unusual for transactions to be completed where required information about a property (for example, details of leases/subleases) is simply not known and has to be ascertained following completion.

We also believe that the decision to reduce the filing and payment window to 14 days might exacerbate the number of returns submitted with incomplete information and the significant processing costs incurred by HMRC will be further heightened. Whilst we file our returns electronically, currently over 40% of paper returns are submitted with "errors". We feel that substantial simplification of the forms and of the amount of information required should be undertaken in order to mitigate this risk and we hope that the government will take this on board when the result of the consultation is announced.

The full title of the consultation is: "Stamp duty land tax: changes to the filing and payment process". The consultation closes on 7 October and can be found on the www.gov.uk website.

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This newsletter is written in general terms and its application in specific circumstances will depend on the particular facts.

If you would like to receive this newsletter by email please pass on your email address to one of the editors listed below.

If you would like to follow up any of the issues, please speak to one of the contacts listed below, or to any real estate partner at our London office on +44 20 7296 2000, or to any real estate partner in our worldwide office network as listed at the back of this newsletter:

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