

Editor's Comment

In our last issue we asked readers if there were any areas which they would like to see covered in future issues of Get Real Estate – we have had requests for an examination of licences to assign and underlet ie: the question of what a tenant should do when it wishes to sell its lease or sub-let – does it need the landlord's permission, and if so how should it apply for this? This issue contains the first of a 2 part article covering this important area.

We also take a look at the topical issue of hose pipe bans, and as more and more land owners are being faced with the choice of signing up options over land we examine what it means to enter into an option with a developer. We also take a look at the latest proposed land tax, the planning gain supplement, which will be of interest to property developers.

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Assignment and Subletting: Knowing when to ask

In our last issue we asked readers if there were any areas which they would like to see covered in future issues of Get Real – several of you have responded with a request for articles on licences to assign and underlet. Others have asked for clarification as to exactly when a tenant needs its landlord's permission when it wishes to assign its interest in the lease (ie sell a leasehold interest) or grant a sub-lease. In this two part article we will therefore focus on the question of tenants approaching the landlord for its consent to carry out various activities which are permitted by the lease, and the duties that fall upon the landlord in replying to and dealing with such requests.

Perhaps the first point to make in dealing with any Landlord and Tenant question is the fact that a lease, unlike other legal documents, does more than simply effect a "one off" transaction (such as a Deed of Transfer of Land) nor does it contain promises that are discharged as soon as a particular item is sold, such as a Contract. Instead a lease is a living document – it creates and governs the relationship between a landlord and tenant which endures throughout the term of the lease, and sometimes beyond.

In doing this the lease simply reflects

reality – a tenant who takes up a lease of premises from a landlord will want more than a simple permission to occupy the land – during his occupation the tenant may wish to sub-let some of the land (for example a floor in a building which becomes surplus to his requirements) or indeed he may wish to sub-let all the property he has received from the landlord for a shorter period of time – ie a tenant with a ten year lease may decide he does not need the premises for five years and is therefore happy to sub-let the whole for 5 years.

Alternatively a tenant may have simply outgrown his premises and may wish therefore to sell the lease to a third party, thereby relieving himself of the burden to pay rent for the rest of the term.

The tenant will require the Landlord's permission to do both of these things.

There are also other equally important occasions upon which a tenant will require permission from his landlord to do something – for example a permission from his landlord to carry out certain alterations to the premises, or a permission to charge the lease to a bank to secure borrowing. We will focus here on "alienation" ie, what happens when a tenant wishes to assign or underlet premises.

The law in this area is complex as it is based on an interaction between:

1. the words of the lease.
2. the provisions of statute.
3. a body of case law which establishes precedent as to how the interaction between statute and the words of the lease are interpreted by the courts.

Let's look at two main questions-

1. What happens if, as tenant, I want to sell my leasehold property to a third party? What must I do as regards approaching my landlord for his permission if such a permission (or licence) is required? Must I also request permission if I want to sub-let?
2. Where I am a landlord and my tenant approaches me for a request to assign the lease or to grant a sublease – do I have to consent to it?

What is the general position in law for a tenant that wishes to assign or underlet his lease?

The general position is simple – if there are no clauses in the lease covering



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Assignment and Subletting: Knowing when to ask *continued*

alienation then a tenant may freely assign or underlet his premises however he wishes. The tenant may therefore sell the lease to a third party (even if that third party is very unlikely to be able to afford to pay the rent) or he may simply grant as many underleases of various parts of the premises as he likes.

The landlord, having decided to grant a lease to a particular tenant, is of course keen to make sure that that tenant remains as his tenant throughout the term as he will have carried out the relevant checks and have obtained references in respect of just that tenant.

It is not surprising therefore that a normal commercial lease will always contain controls upon alienation. There are 2 types of control:

1. The simplest covenant against alienation is a prohibition by the landlord preventing the tenant from assigning or underletting (or parting with possession or charging) the whole of the premises or any part of the premises. This is known as an absolute covenant.
2. A more common alienation provision is a covenant that partially restricts alienation – such a covenant is known as a qualified covenant.

The most common qualified covenant is a covenant in which alienation is prohibited unless the tenant first obtains the landlord's consent.

It is important to note in the case of alienation covenants where reference is made to the landlords consent, that even if the lease does not say that consent is not to be unreasonably withheld those words are implied by law.

This applies only in the case of alienation – covenants dealing with other matters in the lease (for example not to change the use without the landlord's consent) will not automatically have the words "such consent not to be unreasonably withheld" incorporated by law.

A landlord therefore has two options when granting a lease to the tenant. He may:

- (1) insist on an absolute prohibition on any alienation. This may make the lease unattractive to tenants and when the rent is

reviewed the tenant may be able to argue that he is burdened by a difficult lease (ie: one where alienation is not permitted) and this will therefore have an effect on reducing the rent that would otherwise be achieved on rent review.

Alternatively

- (2) the landlord may make his lease more attractive to tenants by imposing a qualified restriction; ie: an obligation not to assign or underlet without the landlord's consent. In doing so the landlord will accept that he will be affected by statute so that his consent must not be unreasonably withheld.

This is the normal form of covenant found in most commercial leases. A tenant will know therefore that if he wishes to assign his lease he must apply to the landlord for consent, and the landlord must be reasonable in refusing its consent or imposing any conditions upon giving his consent. The question of conditions upon a landlord's consent is a very large topic, and one which is best saved for another article – here however we will look just at the question of reasonableness.

What is reasonable?

The famous case of *International Drilling Fluids Limited – v – Louisville Investments (Uxbridge) Limited* summarised the various principles dealing with reasonableness. It established that:

- the whole purpose of a landlord being able to control the tenant's ability to assign the lease is to protect the landlord from ending up with an undesirable tenant or from having his premises used in an undesirable way
- the landlord cannot therefore refuse consent based on grounds which have nothing to do with the lease
- where a landlord refuses its consent it does not have to prove that it was right to refuse – the landlord simply has to show that a reasonable person would have reached such a conclusion in those circumstances
- the landlord may refuse when it learns of the use to which the assignee would like to put the premises even if that use was not specifically forbidden

Assignment and Subletting: Knowing when to ask *continued*

- the principle of 'balance of detriment' was set out in this case – this means that the court must see who is harmed most if consent is refused – will the tenant be harmed (more than the landlord) because he is prevented from selling the lease, or will the landlord be harmed (more than the tenant) because he will end up with an undesirable tenant?

The law provides that the onus of proof rests with the landlord ie: responsibility rests with the landlord in showing that he was reasonable in refusing consent.

A great deal of weight is of course placed on the financial standing of the proposed assignee – a landlord is entitled to be provided with full information as regards the financial standing of the new tenant. Unsatisfactory references are therefore a reasonable ground for the landlord refusing its consent and when the landlord receives a qualified reference (typically from a bank) stating that the "assignee is a responsible and trustworthy but this reference is given without responsibility" he does not need to give much weight to it.

Contrary to popular belief, there is no hard and fast rule that the assignee must be able to show

that its pre-tax profits are equal to three times the rent payable under the lease. Such a test is often used but it is not to be slavishly followed. The landlord is, above all, entitled to protect the value of its interest. The value of the landlords interest in his premises is affected by the reputation of the tenant. A tenant who is "a good covenant" (for example a leading high street brand name) is more desirable than an unknown tenant. This is because the landlord would be able to sell his freehold interest to a third party (with a sitting tenant) secure in the knowledge that the tenant will pay the rent on time to the new landlord.

There is extensive guidance in case law as to when a landlord has deemed to be reasonable in refusing his consent and when he is deemed to be unreasonable.

We will look at some of these guidelines, the actual mechanics of applying for consent, and the duties of the landlord in the second part of this article.

Ash Jilani

Water Water Everywhere?

After a second extremely dry winter and despite the deluge of rain in May, ground water levels and reservoir levels across the south east of England are extremely low. Concern has grown for public water supplies in Kent, Sussex and London. For some time now there have been hosepipe bans across many parts of south east England. There are daily reports about water shortages and drought orders on our news programmes and in the news papers. Drought can have a significant impact on the environment, on wildlife and also will inevitably have an impact on businesses.

The water companies together with the Environment Agency need to ensure the security of the public water supply when there are water shortages. There are a number of mechanisms that the water companies can use to try to reduce water consumption. One of these

is the Non-essential Use Drought Order. You no doubt will have seen in recent press reports that three water companies have now obtained Non-essential Use Drought Orders. These water companies are Sutton and East Surrey Water, Mid Kent Water and Southern Water.

The Non-essential Use Drought Order is used to ensure that necessary measures can be introduced to safeguard essential use of water for daily household needs.

The Non-essential Use Drought Order affects both domestic and commercial use and includes the following restrictions:

- The watering by hosepipe, sprinkler or similar apparatus of gardens (except market gardens), including lawns, verges and other landscaped areas, allotments and parks.



Sarah Webster

Water Water Everywhere? *continued*

- The watering by hosepipe, sprinkler or similar apparatus of any natural or artificial surfaces used for sport or recreation, whether publicly or privately owned.
- Refilling (whether wholly or partially) of privately owned swimming pools, other than pools designed to be used for medical purposes or, where necessary, in the course of their construction. Swimming pools open to the public (including those in hotels and health clubs) are considered exempt.
- The filling (whether wholly or partially) of ornamental ponds other than fish ponds and wildlife garden ponds.
- The washing by hosepipe, sprinkler or similar apparatus of road vehicles, boats, railway rolling stock or aircraft for any other reason other than safety or hygiene.
- The cleaning of the exterior of buildings other than windows.
- The cleaning of windows by hosepipe, sprinkler or other similar apparatus that is connected directly to a mains water supply.
- The operation of mechanical car washes.
- The operation of ornamental fountains or cascades, including those where water is recycled.
- The operation in relation to any building or other premises of any system which flushes automatically during any period when those premises are wholly or substantially unoccupied.

Exemption permits can be obtained where necessary. Examples include the exemption to allow watering of sports or recreation surfaces for short periods of time each week or an exemption for mechanical car washes where water is

recycled and the amount used is less than 23 litres per wash.

If an exemption is required an application with supporting evidence should be made to the relevant water authority. Whether or not an exemption is granted will be considered on a case by case basis.

Whilst drought orders have been granted to water companies they may not yet have been implemented. If a water company with a drought order decides to implement the drought order they will display relevant publicity to ensure that their customers are aware of implementation of the drought order.

If a drought order is implemented then there are a number of actions which would constitute an offence under the drought order, for example, (although this is not a definitive list):

- Taking or using water in contravention of a prohibition or limitation imposed by or under a drought order.
- Taking or using water otherwise than in accordance with any condition or restriction imposed by or under a drought order.
- Failing to construct or maintain apparatus for measuring the flow of water required to be constructed or maintained by a drought order.

The penalties for offences under a drought order are, on a summary conviction, by fine up to the statutory maximum and on indictment, by an unlimited fine.

It is important that necessary steps are taken to conserve water to safeguard our environment and businesses. Hopefully, if we can conserve water now, we will not have to endure the dreaded standpipes later!

Sarah Webster



What are my Options?

If a land owner, whether of a green field site (such as agricultural land) or of a brown field site (such as derelict industrial land) wants to sell it to a developer, then the land owner and the developer may sign an option. An option is a legal agreement between the land owner and the developer. Typically, it will give the developer a “window” of time in which to decide whether or not to buy the land.

Land owners may be approached directly by developers, sometimes completely out of the blue, asking them to sign options. The developer may promise them large amounts of money. It may tell them that all their neighbours have agreed to sign options. However, there are various pitfalls for the unwary land owner. All land owners should be aware of what an option is and the potential risks as well as the potential benefits.

What is an option?

The most common form of option allows the developer to require the land owner to sell their land to the developer within an agreed period. Often, the option can only be exercised if the developer gets planning permission. However, the developer always has the final say over whether to buy the land, even if it has got planning permission. The developer can always say no. Usually, a large premium will be paid to the land owner at the outset. The developer then has an agreed period (which cannot be more than 21 years but is usually much less) to get planning permission and then decide whether to buy the land. If the developer gets planning permission and does want to buy the land, the purchase price is usually the market value at that time. Usually, the market value is discounted since the developer will have spent a lot of money getting planning permission.

Why are options so popular with developers?

Options are popular with developers because they enable them effectively to reserve land for an agreed period of time. They can then get on and plan their development and buy the land if, and only if, there are no problems. They may need to apply for planning permission to develop the land. They may need to negotiate with other land owners if more than one person’s land is required for their development. They may need to negotiate with adjoining land owners, for example, to get them to give up rights which would otherwise get in the way of the development. If the developer

cannot get planning permission, or cannot secure all the land it needs, or is unsuccessful in its negotiations with adjoining land owners, then it can simply decide not to buy the land after all and walk away. Developers can also choose when to buy the land and buy it when it suits them. Since they offer so much flexibility, yet put the developer in the driving seat, options are often developers’ preferred vehicle for buying land.

If they’re so popular with developers, what’s the hidden catch for land owners?

Their land is effectively “off the market” for the duration of the option. (Developers may enter into options solely with this in mind – for instance, if they want to “take out” a site which will compete with one of theirs when it comes to getting planning permission, or if they want to accumulate a land bank). They may have to wait a long time for their land to be sold. There is no guarantee that the developer will ever buy it. Also, market value and tax rates can go up and down over time, so there is no guarantee what price they will receive or what tax they will have to pay if they sell. New development taxes, such as planning gain supplement (currently under consideration), can always come in. There are also alternatives to options, such as a conditional contract or selling the land subject to overage, which may be a better bet for land owners.

What’s in it for land owners, then?

Options can be very attractive to land owners. They will normally receive a large premium up front and then the purchase price when the land is sold. (The premium is usually non-refundable whatever happens but if the developer buys the land it is usually deductible from the purchase price). The time and trouble of getting planning permission is taken by the developer. The cost of a failed planning application is met by the developer. Perhaps most importantly, no one may be prepared to take the risk of buying the land outright and an option may be the best chance of realising the land’s value for the foreseeable future. The alternatives, such as conditional contracts and overage, are not free of problems either. If the option is well negotiated and drafted, many of the risks can be minimised. For instance, a developer can be required actively to go out and get planning permission and not to promote competing sites, and there can be an indexed linked minimum price to ensure the land owner gets as fair a deal



Bill Butler

What are my Options? *continued*

as possible. However, it is normally the developer who wants an option.

What happens if land owners want to keep part of their land?

Land owners need to be very careful if they will be retaining land once the developer exercises the option. As a minimum, they need to ensure that they have all appropriate rights over the land they are selling, such as a right of way or drainage rights. If selling off part of their land leaves the remainder of their land “landlocked” (e.g. cut off from the public highway and mains drainage) then they should seriously consider requiring the developer to put in a road and sewer connecting up to their retained land. These kind of issues should be covered in the option.

What happens if more than one land owner is involved?

If the developer wants an option over more than one land owner’s land, for example over fields owned by three or four neighbouring farmers, then it is usually in the best interests of the land owners to work together as a consortium. If they do not act together, but all negotiate separate options with the developer, then various problems and injustices may arise. Some land owners may have

to wait much longer than others before their land is sold. For example, one field could be bought after one year, but another field could be bought after twenty years. Some land owners’ land may be needed for infrastructure, others for residential or commercial development. In other words, some parts of the development land may be more valuable than others although it is all needed for the development to go ahead. Arguably, therefore, everybody should receive the same price per acre, but some land owners may negotiate better deals than others. The land owners may find it easier to stand up to the developer together but it may be a case of “divide and rule” by the developer if they are not united. To overcome these problems, the land owners can enter into a “land pooling” arrangement. These are complicated to draft but are more likely to result in fairness between the land owners than if the land owners each go it alone.

Options offer opportunities to both land owner and developer alike. There are risks on both sides but careful drafting from lawyers can help to minimise these risks. Valuation advice and tax advice should always be sought by land owners and developers in addition to legal advice.

Bill Butler



Planning Gain Supplement - Sink or Swim?

The drive for new housing to be provided as soon as possible has hit a snag; lack of infrastructure. To get round this, the government has thought up the idea of taxing the gains resulting from a grant of planning permission, the planning gain supplement, or PGS. The money raised from PGS is intended to be ploughed back into the provision of infrastructure, such as roads and drains.

In the hands of the government, the concept of PGS has grown like Topsy and is now intended to apply to virtually all forms of development except "minor" householder development. Although as it is not proposed to implement PGS before 2008, there is time for further changes to be made. At present, it is intended that PGS will be collected in a self-assessment system overseen by HM Revenue and Customs at a rate described as "modest" and based on a percentage on the increase in land value resulting from the grant of planning permission. Although no definite figure has been set, the government is currently suggesting 20% on the principle that "the developer pays", although it is considering a two-tier system with a lower rate for previously developed or "brownfield" sites, which will effectively be taxed each time permission is granted. It is envisaged that the current system of planning obligations will continue but will only be applied to issues which relate specifically to a particular development, such as provision of play equipment, with all infrastructure requirements being met through PGS. It is difficult, however, to see at this stage how the infrastructure needed to support a particular development can be certain of being funded from a pot which has to cater for competing projects.

The formula which the government has devised for calculating PGS, whilst deceptively simple, is designed to maximise the amount of revenue collected. Basically, the value of a particular site without the benefit of planning permission

and with no allowance for "hope value" is deducted from the value of the site with planning permission and without taking into account any encumbrances that may exist. The developer may therefore find that he has paid for "hope value" in his initial purchase only to have this discounted for the purposes of calculating PGS; he may also find that his profit margin is reduced still further by encumbrances which reduce the actual value of the site but which are ignored when assessing its new value for PGS. This formula may maximise the amount of revenue collected but it is questionable whether it will encourage the provision of high quality development which the system should be seeking; and finally, there is the prospect of the developers' self-assessment being revisited by the Revenue and further financial losses being incurred after development has already commenced.

It is difficult to see how the unwieldy concept of PGS is going to work in practice. The government has indicated that the "majority" of funds collected will be returned for the provision of infrastructure but this is only an indication and one can only speculate as to the proportion of the money collected which will be swallowed up by the administrative requirements of the system. The Chancellor in his last budget speech indicated that PGS would be applied on a more local basis than first envisaged but this inevitably means tying the PGS to the particular site which generates it rather than having a regional pot with competing demands on resources; perhaps a move back to the section 106 agreement is indicated!

At the moment, the future under PGS looks full of uncertainty and it is difficult to see how a system which is clearly intended to reduce the profit to the developer can at the same time deliver high quality development which is adequately supported by infrastructure.

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