Real estate

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Development: Tactics for vacant possession

Welcome to the first 2016 edition of the Real Estate Bulletin.

In this issue, we provide an update on a number of topics covered in previous editions of the Bulletin following recent decisions of the Supreme Court and Court of Appeal which clarify the existing case law:

- The Technology and Construction Court has provided a useful judgement offering some guidance on the approach valuers should take in dilapidations claims
- Bad news for tenants, following the Supreme Court's much anticipated decision in *Marks & Spencer v BNP Paribas*
- The Supreme Court revisited the law on penalties in *Cavendish Square Holding BV v Makdessi*
- Good news for valuers, the Court of Appeal overturns the High Court's decision in *Titan v Colliers*
- 2015 saw many tax changes affecting the sale and purchase of UK residential property, we bring you a summary of those changes
- Developers will welcome the Government's decision to make the right to convert office space to residential permanent
- Finally, an invitation to our Development Seminar on 25 February 2016

Upcoming events

Development seminar

The Clyde & Co Real estate litigation team are hosting an upcoming seminar on tactics for vacant possession on 25 February 2016, for more information see page 12.

MIPIM

A number of our Real estate team will be at MIPIM this year and look forward to seeing you in Cannes. If you'd like to meet us, please email **seminars@clydeco.com**.

Consortium Commercial Developments Ltd v ABB Ltd

Previous Real Estate Bulletin articles have considered terminal dilapidations and the considerable importance of both landlords and tenants making their cases on liability and quantum clear at an early stage of any dispute in order to comply with the Dilapidations Protocol. The recent case of *Consortium Commercial Developments Ltd v ABB Ltd* [2015] EWHC 2128 (TCC) is an example of the court's flexible approach to analysing the expert valuation evidence should a dispute ultimately proceed to a trial and of the effect this may have on any eventual liability of the former tenant for terminal dilapidations.

Facts of the case

In 1996 Consortium Commercial Developments ("Consortium") granted a lease to ABB which came to an end in June 2011. The premises were a B1 hybrid unit located on a business park in Milton Keynes. Four years later, the disrepair existing at the expiry of the lease and failure to re-instate the premises had not been remedied. Consortium's position was that it did not want to fund the costs of the works without first recovering those costs from ABB. Consortium also wished to await an improvement in market conditions, before incurring the costs of the works and re-letting the unit. Therefore Consortium made a claim for dilapidations against ABB. Consortium's claim was limited by s.18 of the Landlord and Tenant Act 1927 to damages amounting to the diminution in value of the premises caused by the disrepair at the end of the lease.

The claims

By the time the case came to trial, surveyors instructed by the parties had agreed that the costs of reinstatement and remedying the disrepair under the lease totalled GBP 315,258.77 and that the necessary works would take 12 weeks. Consortium also claimed for loss of rent and rates over this 12 week period. This claim was based on the previous passing rent of GBP 160,000 pa and rates of GBP 728.60 pw, resulting in a further claim for GBP 45,666.24.

ABB had previously sublet the property in 2003 and, upon vacation, the sub-tenant had paid GBP 160,000 to ABB in respect of its terminal dilapidations liabilities. ABB had then made attempts to re-let the premises in its unrepaired condition with no success. ABB had refused to pay any amount to Consortium for dilapidations (not even the GBP 160,000) and Consortium therefore claimed 6% pa interest (a higher interest rate than the norm), as a means of penalising ABB for not accounting for this recovery, or any dilapidations, to Consortium.

Expert evidence

Consortium's expert valuer valued the premises in repair at GBP 1.15 million and in disrepair at GBP 600,000. ABB's expert valuer disagreed with these figures and contended for GBP 775,000 in repair and GBP 700,000 in disrepair. Therefore Consortium's case was that the diminution in value was GBP 550,000, compared to ABB's case that the diminution amounted to only GBP 75,000.

Consortium's valuer considered that the premises had a rental value in repair of GBP 77.12 psf whereas ABB's valuer's consideration of the relevant comparables produced a rental valuation in repair just above GBP 52.00 psf.

Decision

The judge was critical of both expert valuers' approaches. Judge Bartlett QC found that Consortium's expert valuer had not carried out a proper analysis of the relative relevance of the comparables used and his evidence lacked a proper explanation in relation to the in-repair valuation of GBP 1.15 million. The judge placed greater reliance on ABB's expert's valuation but found that ABB's expert valuer had not factored in appropriate adjustments to the comparables to reflect a true rental value in repair.

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Using what he considered to be the most appropriate comparable, a property with a rental value of GBP 54.44psf, the judge made an upwards adjustment for the subject premises' advantages to reach a value of GBP 60.00psf (the comparable had been sold in administration, was an older building, lacked suspended ceilings and full air-conditioning and had less capacity to be converted to office use). Accordingly, this produced an in-repair value of GBP 900,000.

Most significantly, in deciding the out-of-repair value, the judge did not consider it appropriate to then use a pound-for-pound deduction ie to simply deduct the cost of repairs from the GBP 900,000 in-repair value. This was because the judge considered that a hypothetical purchaser of the premises would not bid on this basis. The judge considered the likely reduction that a purchaser of the premises would require in order to carry out the works would be only GBP 15.00 psf in the light of the comparable evidence. The result was a reduction in value of GBP 225,000 and therefore the judge concluded that the diminution in value was limited to this figure.

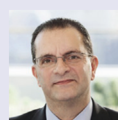
The judge then went on to consider a second issue: Consortium's claim for reinstatement items and statutory items yet to be carried out totalling just over GBP 16,000. The judge considered that all the reinstatement works were reasonable and recoverable in the circumstances as the items were small and all necessary to re-let the premises in good condition.

Dealing with the third issue and claim for loss of rent and rates for the 12 weeks required to undertake the works, the judge found that, due to the difficult market conditions in 2011 and the over-supply of similar properties, Consortium could not prove, on the balance of probabilities, that this loss was the result of ABB's breaches of covenant nor that it would not have been incurred if the premises had been left in good condition at the expiry of the term.

The judge also went on to reject Consortium's penal interest claim of 6% pa and instead awarded interest at 2.5% pa above the base rate, which he considered was the correct commercial rate.

Comments

Consortium recovered less than half of its original claim, whereas ABB was found liable for an amount over three times as much as it had contended itself liable. The case shows how the judge was free to use and adapt the expert evidence of both parties to form his own judgment of the appropriate damages due to the landlord. Furthermore the judge did not consider it significant that the tenant had recovered dilapidations monies from its subtenant and had still failed to carry out the required works. It is very likely that the legal costs incurred by both the landlord and tenant were substantial and this once again emphasises the importance of meaningful and realistic without prejudice negotiations.



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No change here!

On 2 December 2015, the Supreme Court delivered its much anticipated judgment in *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd and another* [2015] UKSC 72. Following on from our discussions in two previous editions of the Bulletin, the Supreme Court upheld the Court of Appeal's decision that it was not appropriate to imply a term into the lease entitling the tenant to a refund of the rents it had paid in advance in respect of the period after the break date.

Prior to the High Court decision in this case, it was well established law that if the break date was in the middle of a rental period, a tenant would not be entitled to recover any rent paid in advance in respect of the period after the break date unless the lease made express provision for this.

However, the tenant successfully argued before the High Court that there should be an implied term in its lease giving rise to a right to recover rents paid in advance following the exercise of a break clause in respect of the period between the break date and the end of the relevant quarter. The judge was influenced by the fact that the tenant was required to pay a substantial premium as a condition of it exercising the break option. He felt this was a clear indication that the parties had not intended for the landlord to also reap the benefit of the rents paid in respect of the period after the break date.

The landlord appealed and the Court of Appeal unanimously overturned the first instance decision, rejecting the suggestion that the right to recover the apportioned part of the quarter's rent should be implied into the lease.

Decision

The Supreme Court has also now found in favour of the landlord, dismissing the tenant's appeal of the Court of Appeal's decision. It upheld the Court of Appeal's decision that it was not appropriate to imply a term into the lease entitling the tenant to a refund of the rents it had paid in advance on the grounds that such a term was not necessary to make the contract workable.

The Supreme Court took the opportunity to clarify the law on implied terms – essentially, in order for a term to be implied into a contract, it must be either necessary for business efficacy or be so obvious that it goes without saying. The Supreme Court placed significance in this case on the fact that the terms of the lease were very full, professionally drafted and had been carefully considered between the parties. Lord Neuberger, giving the leading judgment, also confirmed that he was satisfied that the long-standing Court of Appeal decision in *Ellis v Rowbotham* [1900] that the Apportionment Act 1870 does not apply to rent payable in advance should be approved.

Conclusion

The judgment will be welcomed by landlords who will be once more reassured that, save in very exceptional circumstances (for example, where the contract could not work or would lead to an absurdity), a tenant will only be entitled to a refund of rents paid in advance in respect of a period after a break date if the lease expressly makes provision for this.

As a result of this decision, prudent tenants will continue to ensure that an express right to recover the apportioned part of the quarter's rent is included in a break clause in a new lease (although landlords in a strong bargaining position may well seek to resist this). Alternatively, tenants should try to agree a break date falling immediately before the rent payment date to avoid an overpayment. For older leases which do not include such provisions, this judgment provides some certainty for the parties and should deter tenants from raising such disputes in the future.

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Cavendish Square Holding BV v Makdessi: Penalties revisited

In the Autumn 2014 edition of the Bulletin we considered the question of whether large deposits in property transactions could be considered unenforceable penalties. That article considered the effect of the rule against penalties and bemoaned, in the context of deposits, the different legal treatment of penalties, as contrasted with forfeitures and the confusion caused by contrasting legal precedents.

At the end of last year the Supreme Court handed down its judgment in *Cavendish Square Holding BV v Makdessi* which re-stated the law on penalties, so it is worth revisiting the area to assess where the land now lies. Has *Makdessi* really changed the approach that parties should take?

Penalties and forfeitures: what are they?

For over 100 years the leading authority on the question of penalties was the decision of the House of Lords as set out by Lord Dunedin in *Dunlop Pneumatic Tyre v New Garage and Motor Company* [1914] UKHL, a decision focussed upon the difference between a liquidated damages clause and a penalty. *Dunlop* decided that, where a clause requires the payment of money upon the commission of a breach of contract then, provided the sum payable is a genuine pre-estimate of the loss that might flow from the breach, the clause is an enforceable liquidated damages clause. However, if the sum payable is not designed to compensate likely loss but rather to deter breach, then the clause is an unenforceable penalty and is automatically void.

However, there is a distinction to be drawn between an obligation to pay money upon a breach of contract (a classic penalty scenario), and a provision which envisages the loss of existing rights, such as the benefit of an existing deposit paid towards a purchase price. A contractual provision of this description is not a penalty but a forfeiture, since it operates on sums already paid prior to the breach, rather than extra sums which become payable because of the breach. Although there would seem to be little difference in the practical effect of each type of provision (the contract breaker is out of pocket either way) the legal treatment of them varies markedly.

Whereas a penalty is always void a contractual forfeiture is enforceable come what may, but the Court has jurisdiction to grant relief from forfeiture where the circumstances are such that it would be manifestly unfair to allow the forfeiture to take effect.

The law after *Makdessi*

The facts of *Makdessi* concerned the sale of 60% of the share capital of a large media business in the Middle East to the WPP Group of Companies by Mr Makdessi and his business partner Mr Ghossoub. Messrs Makdessi and Ghossoub intended to retain the remaining 40% of the shares. Payment was to be made in instalments over the years following the sale. Importantly the valuation of the business took account of the considerable goodwill that resided in Mr Makdessi in particular, since as founder of the business he had personal relationships with many key clients and employees. In order to protect that goodwill Mr Makdessi became subject to restrictive covenants which prevented him from setting up competing business or soliciting employees. In the event of his breach of those covenants the sale contract provided that as a "defaulting shareholder" Mr Makdessi would (1) lose his entitlement to any instalments of the price that were then outstanding and (2) become obliged to transfer his remaining shares to Cavendish upon valuation terms that were unfavourable to him. In due course Mr Makdessi breached his restrictive covenants, a fact he admitted shortly before the High Court trial, but sought to argue that the defaulting shareholder provisions were unenforceable as they were penal in nature. Cavendish won before the High Court but lost in the Court of Appeal and appealed to the Supreme Court.

In giving its judgment the Supreme Court swept away the existing legal test for the assessment of a penalty and restated it. The Court considered that *Dunlop* had come to achieve the status of a quasi-statutory code. The test for whether a clause is penal was restated as follows:

> "The true test is whether the clause is a secondary obligation which imposes a detriment on the contract breaker which is out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach…. but compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations."

A primary obligation is an obligation to do (or refrain from doing) something. An obligation that arises if the primary obligation is not performed is a secondary obligation. In a classic liquidated damages clause the obligation to pay liquidated damages is always a secondary obligation since it only arises if there is a breach of a different obligation of the contract.

The Court emphasised that the notion of "deterrence" did not form part of any assessment as to the penal nature of a clause as there is nothing objectionable about seeking to influence the behaviour of the other party by deterring a breach of contract (contrast the pre-*Makdessi* law which indicated that deterrence was the hallmark of a penalty). The Court did make clear, however, that if a clause strays into the territory of punishment then that is characteristic of a penalty. The question of whether a clause is intended to punish is to be determined by reference to whether it is "grossly disproportionate" or "unconscionable" when assessed against the innocent party's interest in enforcing the contract.

All very interesting but what's the difference?

It is a question of construction of the contract as to whether a particular clause is penal. That is a judgment that the Court has to make as at the time the contract was entered into, and not at any later stage, since what happens after the date of a contract is not of any assistance in the determination of its meaning. However in order to safely avoid a later finding that a particular obligation is penal the parties will have to ensure, when drafting the contract, that the consequences of that clause are not disproportionate or unconscionable compared to the legitimate interest in seeing the contract performed. In my view that can only be done by seeking to assess in advance the likely downside of a breach of contract as compared to the (potentially penal) consequences of the clause in question. As an intellectual exercise that seems to be no different to the putative genuine pre-estimate of loss that the law required before *Makdessi*. It would seem, therefore, that while the legal approach has changed the commercial approach need not.

The future

Makdessi is an interesting case but it is unlikely to be the last word in this area. *Dunlop* was the leading authority for 100 years and we doubt the *Makdessi* test will have such longevity in unrefined form as there is already academic debate about the questions that are left unanswered by the judgment. One area for potential development is the question of the different treatment of penalties and forfeitures. Back in 2014 we focussed upon the difference between the two concepts as the law as it then stood recognised a dichotomy between them. In *Makdessi* two law lords took the view that there is no reason in principle why a provision cannot be both a penalty and a forfeiture. While future litigation will be required to crystallise the thinking formally it would appear that the approach in future might well be as follows:

1. Consider if the clause is penal (applying the new *Makdessi* test). If it is penal then it is automatically unenforceable.
2. If the clause is not penal then consider whether it operates as a forfeiture and, if it does, whether it is appropriate to grant relief against forfeiture

Coming back to the issue of deposits in contracts for the sale of land, it was previously thought that provisions relating to the loss of deposits upon a failure to complete could not be a penalty. It is now clear that this is no longer the case. While it might be thought to be good news for buyers, provided sellers are sensible and go no further than is necessary to protect their position in the contract, the right to retain a deposit will still prove a powerful deterrent against default.

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Court of Appeal finds for defendant valuers in *Titan v Colliers*

In November 2015, the Court of Appeal overturned in *Titan Europe 2006-3 plc v Colliers International UK plc* (In liquidation) [2015] EWCA Civ 1083 the High Court's finding that Colliers was negligent (see our Real Estate Bulletin, Spring 2015).

The case concerned Colliers' valuation in December 2005 of a large (242,195m²) commercial property ("the Property") in Nuremberg, Germany, occupied by Quelle – at the time, Germany's biggest mail-order company, which occupied the Property on a 15-year lease, expiring in 2016. Colliers valued the Property at EUR 135 million. In reliance on the valuation, Credit Suisse made a loan of EUR 110 million to Quelle's landlord, Valbonne. In 2006, the loan was securitised with numerous other loans and was purchased by Titan, a newly incorporated special purpose vehicle, which issued around EUR 1 billion of floating-rate loan notes to investors. Quelle and Valbonne subsequently became insolvent and Valbonne defaulted on the loan in around 2009. The Property was eventually resold for only EUR 22.5 million.

Titan pursued a claim against Colliers, in which it alleged that the true value of the Property in December 2005 had been only EUR 76.6 million. Titan sought damages equivalent to the "SAAMCo cap" (ie the difference between the reported value and the alleged true value of the property, which is the maximum for which a valuer providing information of this sort can be held liable) of EUR 58.8 million.

At first instance, Blair J. found liability to have been established, on the basis that the true value of the Property had been only EUR 103 million and the bracket of reasonable valuations had been 15% either side of this, such that the valuation of EUR 135 million fell outside the bracket. The judge's finding as to true value was a somewhat surprising inference on the evidence, which showed that, amongst other things, in the same year as Colliers' valuation, and in a rising market, there had been two other valuations and one sale of the Property all at levels above the top end of the judge's bracket. The judge also rejected Colliers' argument that, as a non-recourse issuer of the loan notes to investors, Titan had, in any event, suffered no loss. Damages of EUR 32 million were awarded to Titan.

Colliers subsequently appealed on two principal grounds: (1) that the true value of the Property had been substantially higher than EUR 103 million; and (2) that Titan did not have title to sue and, even if it did, had itself suffered no loss in any event.

Finding of breach of duty overturned

On ground (1), the Court of Appeal substituted a true value of EUR 118.3 million and, as a result, found that Colliers' valuation fell within a 15% margin of error and had not been negligent. Attributing particular importance to the fact that, only six months prior to Colliers' valuation, the Property had been sold for EUR 127.1 million, Longmore LJ held that it was "inconceivable" that the true value in December 2005 could have been as low as EUR 103 million and that the judge at first instance had wrongly proceeded without regard to evidence of an actual sale, which Phillips J (in *Banque Bruxelles Lambert v Eagle Star Insurance* (1995)) had called "the most cogent evidence" of any property's market value. Referring also to three other occasions between September 2003 and March 2005 on which the Property had been valued by others at between EUR 114.7 million and EUR 134.5 million, Longmore LJ further noted that a value of EUR 103 million would be "perilously close" to the figure of EUR 100 million which the trial judge had himself said was the "absolute minimum that would have carried any credibility in the market". He found that the evidence provided by the earlier sale and valuations justified a yield of 7.4%, lower than the trial judge's figure of 8.5%. He added that, although the Court of Appeal had reached its conclusion without taking into account the rising market that had been current in 2005, this would have been yet another factor in Colliers' favour.

The securitisation issue

The securitisation issue was rendered redundant by the exoneration of Colliers on liability grounds. Expressing obiter views on ground (2), however, the court commented that, since Titan had retained legal and beneficial ownership of both the loans and the loan notes, it would

have retained the right to sue Colliers for substantial damages. The court was also not prepared to dismiss the claim on the basis that the noteholders, not Titan, had suffered the loss. Taking a novel approach, which did not arise out of either side's submissions, the court drew an analogy with the relationship between a company and its shareholders, commenting that the fact that the investors in the loan notes had been the ultimate losers did not mean that Titan itself could not have sustained a loss. Rather, if (contrary to the court's finding on the valuation) Colliers had negligently overvalued the Property, Titan would have suffered a loss as soon as it acquired the loans and securities (including the Property) from Credit Suisse.

Comment

It is certainly positive that an appellate court felt able to overturn the trial judge's views on valuation and adopted an approach more precise than simply "splitting the difference" between the retrospective calculations of opposing experts. Equally welcome is the court's recognition that the pre-crash rising market is a relevant factor that should be taken into account. Together, these findings suggest (at least implicitly) that the Court of Appeal is keen to take full account of the reality of the sustained boom in the pre-2008 European property market and to avoid hindsight to the greatest extent possible.

Less positive, on the other hand, is the court's obiter comments on the question of whether an issuer of mortgage-backed securities had standing to pursue a claim against a valuer retained by an original lender. As was submitted by Colliers, this exposes valuers instructed in the context of securitisations to the risk of liability to both investors and the issuer of securities. The Court of Appeal's analysis of this important issue was surprisingly brief.

However, every securitisation will be factually distinct and valuers will be appointed on different terms and will accept different responsibilities in relation to each transaction. It is clear from both the Court of Appeal and first instance judgments that, in determining the scope of a valuer's duty and in deciding which of a number of entities may have suffered a recoverable loss, there remains no substitute for a close analysis of both the specific contractual documentation and the structure of the individual finance transaction in question. An issuer claimant's entitlement to sue valuers in circumstances similar to those in *Titan v Colliers* may well, therefore, be a matter of dispute in future litigation and should always be assessed carefully by reference to the specific facts in issue.

In a press release published on the same day as the Court of Appeal judgment, Titan's solicitors said that they are considering an application for permission to appeal to the Supreme Court. It will be interesting to see whether the matter proceeds any further.

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Recent tax changes to buying and selling UK residential property

Over the past few months a number of changes have been made to the tax regime for buying and selling residential property in the UK. This article summarises the latest position.

Non-residents Capital Gains Tax ("NRCGT") rules (Finance Act 2015)

These rules took effect from 6 April 2015. Subject to certain exemptions, all non-residents will be subject to UK CGT on gains arising post 5 April 2015 on the disposal of UK residential property. Broadly, the basic starting point is that residential properties are rebased, for NRCGT purposes, to their market value as at 5 April 2015.

The rates of tax that will apply are:

i. Companies: 20% (that are not exempt companies)
ii. Individuals: 18% or 28% (depending on whether the individual is a basic or higher rate tax payer)
iii. Trustees and personal representatives: 28%

The main entities which are either exempt or can claim an exemption are: charities; certain investment trusts and venture capital trusts; registered pension schemes; diversely- held companies; certain unit trusts and open-ended investment companies (or "OEICs"); certain schemes which have or include investors which are offshore funds, OEICs or authorised unit trusts; and companies that deal with life assurance. Reliefs may also be available, such as principal private residence relief for individuals or indexation relief for non-resident companies.

The government also announced certain changes to the NRCGT rules at the Autumn Statement 2015, including an amendment to prevent double taxation in certain instances.

Restriction on interest deductions on purchases of buy-to-let properties (Finance (No. 2) Act 2015)

On 8 July 2015 the government announced a new measure which restricts relief for finance costs on let residential properties. It is being introduced gradually from 6 April 2017. The new rules operate by requiring, in the first instance, that profits are computed without regard to the relevant interest payments. A separate relief, a "tax reduction", is then calculated by reference to basic rate tax on an amount equal to the interest payments, for which relief has now been denied.

"Finance Costs" include: mortgage interest, sums which are equivalent to interest and the incidental costs of obtaining finance by means of the loan, for example, the fees incurred when taking out or repaying mortgages or loans. The current deduction for higher rate tax relief on finance costs will be restricted in the following way:

i. In the tax year for 2017 to 2018 the deduction from property income (as was previously allowed) will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate reduction
ii. In the tax year for 2018 to 2019 this will be reduced to 50% of finance costs and 50% will be given as a basic rate reduction
iii. In the tax year for 2019 to 2020 this will be reduced to 25% of finance costs and 75% will be given as a basic rate reduction
iv. In the tax year for 2020 to 2021 no deduction for higher rate tax relief on finance costs will be available and all financing costs incurred by a landlord will be given as a basic rate reduction

Commercial letting of furnished holiday accommodation is excluded.

Proposed changes concerning foreign domiciled persons owning (directly or indirectly) UK real estate (Summer Budget 2015)

The Government announced on 8 July 2015 that, from April 2017, it intends to bring all UK residential property held directly or indirectly by foreign domiciled persons into charge for Inheritance Tax ("IHT") purposes, even when the property is owned through an indirect structure such as an offshore company or partnership. This could, therefore, result in foreign domiciled persons being liable to pay a 40% tax liability in respect of the market value of UK residential properties held (directly or indirectly) by them on their death.

These changes are due to be included in the 2017 Finance Bill and a consultation document will be published in due course. It is anticipated that draft legislation will be included in the Finance Bill 2017. Further announcements may be made in the 2016 Budget, on 16 March 2016.

Proposed new additional 3% Stamp Duty Land Tax ("SDLT") charge on purchases of second homes (Autumn Statement and Spending Review 2015)

The proposed new rates will be 3% above the current SDLT rates and will apply to purchases of second homes, for example, buy to let properties, from 1 April 2016. It is currently anticipated that the higher rates will not apply to: purchases below GBP 40,000, caravans, mobile homes, houseboats, or funds making significant investment in residential property, although the test for what constitutes a significant investment in residential property has not yet been finalised.

It is proposed that the higher rates will apply to all contracts entered into after 25 November 2015, where completion takes place on or after 1 April 2016.

Under proposed transitional rules the higher rates will not apply to contracts which were exchanged on or before 25 November 2015 but not completed until on or after 1 April 2016.

The Government is currently consulting on the policy detail, including the way in which joint purchasers should be treated, the impact on those who only temporarily own two properties, the scope of any exemptions and compliance issues arising from the new regime. Confirmation of the final design of the new rules will be announced at the Budget on 16 March 2016.

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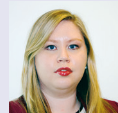

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Office to residential permitted development right to be made permanent

After much speculation, the end of 2015 brought confirmation from the Government that the permitted development right for the conversion of office to residential use will be made permanent. This is consistent with the Government's oft-stated commitment to kick start new housing delivery.

As traversed in the Spring 2013 edition of the Bulletin, the permitted development right was first introduced in early 2013. It has been popular with developers as an opportunity to create residential units without the need for a planning application and free from affordable housing obligations or other financial planning obligations. More recently, developers have been reluctant to commit to such conversions because the existing provisions require the residential use to have 'begun' by May 2016, which (amongst other practical difficulties) has given rise to concerns over its interpretation and has presented issues in obtaining funding for these projects.

Whilst the detail of the extended permitted development right is not yet available, it is fair to assume that this will be predicated on substantially the same terms as the existing right (ie subject to local authority approval of transport, contamination and flooding impacts and with a requirement to complete within three years of the approval). It is anticipated that, under the new regime, any projects which have already been approved will have until 2019 for the use to be 'begun'.

Equally of note is the Government's indication that the permitted development right will cover the demolition of office buildings and the construction of replacement residential buildings. To date, the permitted development right has only authorised the internal works which are necessary to facilitate the change of use from residential to office use; not any exterior change, which still requires planning permission (and, if applicable, listed building consent). As such, the Government's intention to incorporate demolition of office buildings and replacement residential buildings within the permitted development right demonstrates a further 'relaxing of the red tape'.

Local planning authorities which are currently exempt from the permitted development right are likely to be concerned that this remains so. This is a particular concern in those areas actively seeking to protect commercial uses (such as the Central Activities Zones in London). In response, the Government has indicated that those areas already exempt shall remain so until May 2019, after which local planning authorities will be required to make an Article 4 direction (being a direction which, in exceptional circumstances, removes permitted development rights from a specified area) if they wish to continue to restrict the use of the permitted development right.

Many (in particular, those requiring development funding) are now likely to wait for the final detail of this extended permitted development right to be published prior to committing to new projects. However, it seems inevitable that – once the detail is published – developers will be looking to invest in or review vacant commercial premises, particularly those in good proximity to existing infrastructure, as a faster means of securing residential development without the need to provide affordable housing or section 106 contributions.

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Upcoming seminar

Development: Tactics for vacant possession

On 25 February 2016, our Real Estate Litigation team will be hosting a development seminar. The talks will cover many aspects affecting developers in relation to successfully obtaining vacant possession and will include:.

- Redevelopment and the Landlord and Tenant Act 1954 – ground (f), strategies for expediting the vacant possession process and avoiding disputes
- Telecommunications Code issues – how to deal with operators and an update on the Telecommunications reforms
- Rights to light – injunction or damages? update on recent case law

The evening will be chaired by Tim Foley (Partner) with Mike Lewis (Legal Director) and Armel Elaudais (Associate) as speakers.

If you are interested in attending this event please email us at **seminars@clydeco.com** to register your interest.

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