

Winter 2008

# HILL DICKINSON

Commercial Property Newsletter

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## Welcome

Welcome to the winter edition of Hill Dickinson's commercial property newsletter.

As 2008 draws to a close, we can start to reflect on what a dramatic year this has been for the economy, with the property market being hit especially hard. In light of this, we are hosting a timely seminar for clients called 'How to survive the credit crunch' in our Manchester and Liverpool offices (on 18 November and 4 December respectively).

It was good to see so many of you at our recent environmental seminars hosted with Place North West. We're now already planning the 2009 events schedule, so watch this space for news on this.

We hope you find the newsletter informative. If you have a specific query about a topic covered in an article, please contact the relevant author. We also encourage you to provide us with general feedback on the newsletter itself, so please do get in touch.

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# Project Monitoring

Guest contributor Michael Griffiths of Edward Symmons LLP, a lead author of the RICS Project Monitoring Guidance Note, considers the increasingly important role of the Project Monitor.

Since the mid 1990's, a great deal of success has been derived from property development excepting, of course, the last year or two. At times of rising markets any mistakes, oversights, and underestimations could be remedied simply by having a part developed site re-valued. However, in a stagnant or shrinking market such remedial measures are not possible and so for some time to come greater certainty will be required by lending institutions prior to agreeing to finance a scheme. An experienced Project Monitor is central to achieving this aim.

The role of Project Monitor has been largely undefined, the extent of service provided being decided on a practice by practice, case by case or client by client basis. In April 2007, the Royal Institution of Chartered Surveyors published the first comprehensive guidance on the role and services that can be provided entitled 'RICS Guidance Note – Project Monitoring'. For Project Monitor also read Development Monitor, Monitoring Surveyor, Bank's Quantity Surveyor, as they are all one and the same.

The Guidance Note defines the role of the Project Monitor as:

"Protecting the Client's interests by identifying and advising on the risks associated with acquiring an interest in a development that is not under the Client's direct control."

So, consider the situation where a bank is asked to lend the majority of finance for a development. It has no way of knowing the project specific risks associated with the scheme and no direct contractual relationship with the acquisition of land or how it is developed but it has a very real interest in the outcome. The same situation can apply to funds, a prospective tenant or purchaser which is to enter into a commitment to lease or purchase a property upon completion, grant funders and even government departments.

It is essential to understand that a Project Monitor does not simply confirm or question a developer's cost plan. Everyone knows the average construction costs of housing, apartments, warehousing etc.. The questions to be asked are 'Why will this particular scheme cost more or less than the average?' and 'What are the inherent risks that could affect the client?'



Once the particular circumstances of the development are understood, risks and uncertainties can be identified and so can either be removed, mitigated or have contingencies put in place. Only then can the actual exposure of the client and cost of the scheme be predicted with any certainty.

In identifying project risks it is essential that the Project Monitor works in close tandem with the client's lawyer. When acting for the third party, the lawyer is often in the position of checking the draft contracts, warranties and other documents provided by the developer. He or she will then advise the client of the risks associated with the scheme, as presented. However, there are always risks that cannot be ascertained from legal documentation and if not identified, then the lawyer cannot seek to have additional clauses included or existing clauses amended. The Project Monitor is required to identify risks and report them by way of an 'Initial Report' to the client. These risks can then be made known to the lawyer whereupon the legal consequences can be fully considered and appropriate action taken to mitigate or eliminate them prior to the client fully committing.

Of course once 'issues' are identified, conditions can be applied to various agreements but they must then be checked as the development progresses to ensure compliance. Again, this 'monitoring' is a central function of the Project Monitor.

Typically a Project Monitor, with appropriate involvement of the client's lawyer, will advise upon the specific requirements of a scheme in relation to:

- land and property acquisition matters;
- statutory consents;
- competency of the Developer, its team and insurances and any proposed project management systems;
- financial appraisals;
- development, finance, consultancy and construction agreements;
- construction costs and programmes; and
- design and construction quality.

In many ways, the skills required of a Project Monitor are the same as those of an experienced Project Manager. These encompass not simply cost control, but considerable knowledge of all property and development issues, be they related to planning or environmental matters, statutory requirements, construction and resourcing or lease terms and end user needs.

It is because of these skill sets that experienced Monitoring Surveyors are now being employed by banks and funds - together with valuers, commercial surveyors and lawyers - to become directly involved in schemes and assist the developer in realising a site's full potential and minimise losses. This involvement not only encapsulates construction issues and costs, but also extends to providing alternate development proposals, financing arrangements and realistic phasing, all having regard to market conditions.

Developers often view a Project Monitor as an unnecessary additional cost and a meddler. In reality, they should be viewed as a relatively economic health check of the scheme by an experienced development professional. To the third party client, their knowledge and experience is essential both in the advice they can give directly to the client and also in assisting its other due diligence consultants.

The RICS Guidance Note provides valuable advice on identifying risks associated with development schemes and should be considered essential reading by all parties involved either directly or indirectly in the process.

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# Credit crunch: weathering the storm

Hill Dickinson's Restructuring and Insolvency Team has recently been strengthened by the appointment of Partner, Jeremy Reilly. Jeremy has over ten years experience in restructuring and insolvency and is also a Licensed Insolvency Practitioner. Jeremy's appointment bolsters the existing nine-strong team and is a welcome addition in the current climate.

In recent weeks, we have seen turbulent times as the effects of the credit crunch have led to a global finance crisis, which appears to have plunged most of the world's leading economies into recession. In this article, Jeremy takes a closer look at what this all means, in particular for those involved in the property industry.

This Autumn, we have seen unprecedented events in the money markets, with the markets seemingly in melt-down until massive Government intervention across the globe and the quasi-nationalisation of many of the leading banks. It is hoped that this extraordinary intervention will finally bring some stability to the markets and eventually unlock inter-bank lending and therefore encourage liquidity to flow again through the markets, something which has sadly been lacking in recent months. However, it still remains to be seen whether we have now reached, as it has been put, "the beginning of the end" or "the end of the beginning".

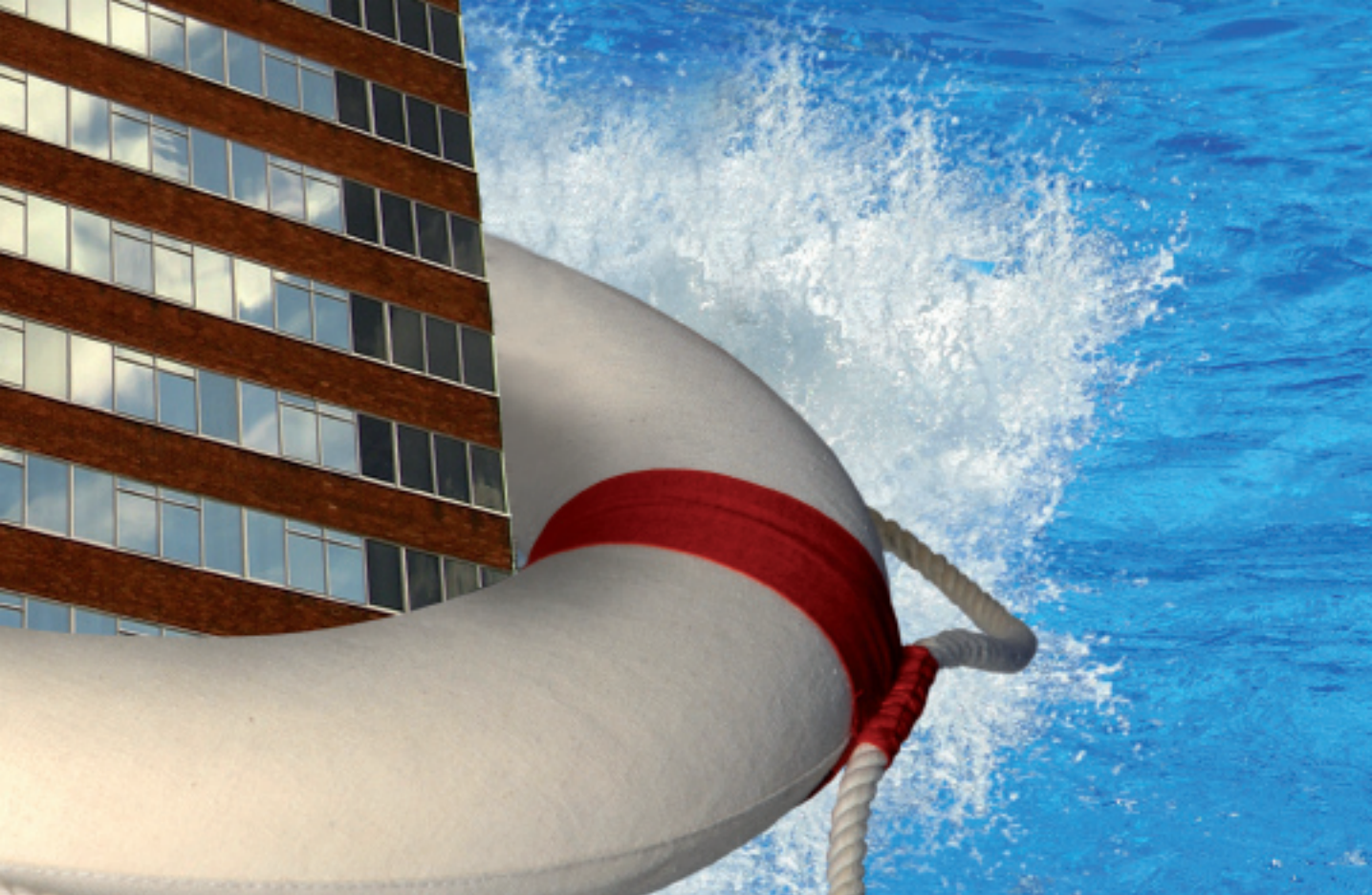
What is clear is that in the real economy, the UK is unlikely now to avoid recession. Consumer spending is weakening as a result of modest real income disposal growth, increased unemployment, tighter credit conditions, the poor housing market and depressed confidence levels. The services section, which has been a key engine of growth for many years, has been severely affected by the effects of the credit crunch. Manufacturing output has also fallen recently, despite the weaker pound.

Other global economies have been hit making exports increasingly difficult. Recession now seems unavoidable, despite the likelihood of a drop in fuel and food prices over the coming weeks and the resulting reduction in the inflation rate.

It is fairly clear that the property industry, with a dramatic fall in property prices over the last twelve months or so, has already entered into recession. Likewise, retail with falling consumer demand this year has already entered a difficult period. It is expected that in January 2009 and afterwards many banks/lenders will have no alternative but to call in loans for those retailers struggling in the current market. January will be a crucial time because after the Christmas period, much of the retail stock will have been turned to cash, which should reduce the amounts owed to the banks and therefore will be the optimum time for the banks to end funding.

In the circumstances, landlords, who will have likely already seen an increase in tenant default, will need to be increasingly proactive, acting quickly to protect their position. They will have to maintain a proactive approach in rent collection to ensure that payment of rent is at the top of any tenant's priorities going forward. However, in the current climate where replacement tenants are likely to be hard to find, landlords will also need a flexible approach. Open dialogue with tenants should be encouraged. At times, concessions might have to be granted with regard to the timing of rent payments or even moving from quarterly to monthly payments.

In the event that the tenant does go bust, a landlord, in most cases, is likely to be dealing with an Administrator. The immediate effect of an administration is that a moratorium comes into being which means that any creditor cannot take action against a company except with permission of the administrators or the Court, and this would apply to a landlord in respect of his right to forfeit or distrain.



Notwithstanding this, the landlord should act proactively finding out as soon as possible what the Administrator's plans are for the property. The landlord also needs to consider his priorities i.e. whether he wants the property back or whether he wants the tenant to remain in occupation. The landlord also needs to check what his security position might be with regard to any rental deposits. The landlord should also be insistent that any on-going rent from the date of the Administrator's appointment is to be paid as an expense of the administration. If an Administrator does not appear amenable to any dialogue or negotiation, the landlord will have to consider at least the threat of an application to Court to force the Administrator's hand.

In the current climate, everyone, not only landlords, should take simple and practical measures to protect themselves as much as possible. The directors of any company need to be aware, that if their companies are struggling or potentially insolvent, then their overriding duty is to their creditors. This does not necessarily mean that they should cease trading, but they should take every step to minimise any potential loss to the creditors. The following practical steps should always be considered:

- A continual review of the business and also preparation of cash flows based on a number of scenarios (including the worst case!).
- Wherever possible, the implementation of a constructive programme to reduce expenditure to ensure adequate cash flow going forward.
- The consideration of the disposal of unprofitable or marginal parts of the business and dismissal of staff surplus to present needs.
- The holding of regular directors meetings, at least once a week, to review the situation.
- Ensuring accounts are properly kept and are up to date.
- Professional advice to be sought where appropriate.
- Major creditors to be kept informed and on-side.

In the current climate all parties should keep an open dialogue with their banks/lenders. As we are fully aware, lenders themselves have been through a difficult period.

It is not necessarily in the lender's best interest to pull the plug where a company is struggling, particularly looking at the current values of property. The key point is to open a dialogue with the lender sooner rather than later, keeping the lender fully aware and well informed of the current situation. Hopefully, with the increased Government intervention and its stake in many of our banks, it might be that you will find a more sympathetic hearing than you expected.

All parties should be careful to what extent they themselves provide credit. All debts need to be regularly reviewed. Due diligence must be taken out on any new clients/customers and tenants. A cautious approach is likely to be the safest in the long run, as the banks themselves are finding out.

In the long run, the way of financing property deals is likely to change significantly. In the medium term there are likely to be fewer lenders in the market and higher stakes of equity will be required from borrowers in the future.

Although this will be a challenging time, there will also be opportunities in terms of consolidation and acquisitions for those who have the cash to spend. Bargains are likely to be had, particularly in the property world.

The message is that all concerned should take appropriate steps to protect themselves during the forthcoming storm, but on a positive note the storm will end and there are likely to be real opportunities in the future.

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# Housing and Regeneration Act 2008

Property Partner Graham Archibald reviews this important new Act, which promises a radical shake-up in the provision of new housing and the regulation of social housing.

After receiving Royal Assent on 22 July 2008, the first provisions of the Housing and Regeneration Act 2008 ("the Act") have come into force. The Act abolishes the Housing Corporation in England and separates its investment and regulatory functions into two new agencies that will be responsible for increasing the supply of social and affordable housing and providing better services for social housing tenants. Both agencies are intended to begin operating in early December 2008.

## The Homes and Communities Agency ("HCA")

The HCA will bring together English Partnerships, the Housing Corporation's investment arm and the Academy for Sustainable Communities. By bringing the investment and regeneration experience of these organisations into one new 'super-agency' the Government hopes to be better able to achieve national targets for growth, renewal and provision of affordable housing.

The objectives of the HCA are:

- to increase the supply and quality of housing in England
- to secure the regeneration and development of land or infrastructure in England
- to support in other ways the creation and regeneration or development of communities in England or their continued well-being and
- to contribute to the achievement of sustainable development and good design in England

The HCA will have extremely wide powers which enable it to do many things in the pursuit of these objectives including the power to:

- acquire property by agreement or compulsory purchase
- hold, manage and dispose of property
- act as the planning authority for any area designated by the Secretary of State either for all purposes or with a limited remit
- give financial assistance to any person and in any form, such as grants or loans, and on such terms as the HCA considers appropriate
- establish or acquire an interest in a company with the consent of the Secretary of State

The HCA will take on existing programmes run by the Housing Corporation, such as the National Affordable Housing Programme.

## The Tenant Services Authority ("TSA")

The TSA will regulate social housing landlords, taking on the regulatory functions previously carried out by the Housing Corporation. The aim is to ensure a high standard of management across housing associations and, at a later date, local authority social homes. The current target for the inclusion of local authority housing in the new regulatory system is Spring 2010.

The Act provides for the TSA to maintain a list of all 'registered providers' of social housing removing the concept of a Registered Social Landlord.

Unlike the criteria for registration under the Housing Act 1996 there is no requirement that a registered provider is a non-profit organisation. Instead registered providers will be divided into profit and non-profit providers, with the latter being subject to more stringent regulation. Existing Registered Social Landlords will automatically be registered as non-profit registered providers. Registration is not compulsory and only registered providers will be subject to the TSA's regulation.

The TSA will:

- set regulatory standards for registered providers relating to issues such as rent, allocation criteria and complaints
- monitor compliance with standards
- authorise surveys and inspections of sub-standard housing
- hold inquiries into the financial affairs of registered providers
- direct constitutional changes of non-profit registered providers

Regulation is to be carried out on a more 'risk-assessed' basis. High-performing registered providers will be rewarded with a cut in red tape while those with a high level of tenant dissatisfaction will be targeted using increased investigatory and enforcement powers. In particular regulation will focus more on the financial viability of providers.

The increased enforcement powers of the TSA include the ability to:

- issue enforcement notices requiring registered providers to take certain actions
- impose fines
- reward compensation to victims of failing registered providers
- require a failing registered provider to tender out or transfer some or all of its management of social housing
- appoint a manager of a failing registered provider
- in the case of non-profit registered providers to transfer land out of the control of the registered provider and to appoint and remove officers
- direct the HCA not to give financial assistance to certain registered providers

## Section 9 Consent – Property Transactions

Under section 9 of the Housing Act 1996 the consent of the Housing Corporation is currently required before a Registered Social Landlord can dispose of any property. A disposal made without this consent is void. This requirement for consent is replicated in section 172 of the Act, although the disposal of a dwelling by a registered provider will only require consent if the dwelling is social housing. No consent will be needed for the disposal of commercial or undeveloped land. Section 172 of the Act is not yet in force, however, and no commencement date has been appointed. The section 9 regime therefore continues to apply to current Registered Social Landlords.

It is too early to say whether the Act will succeed in its commendable goals, but it will be interesting to see what impact it will have on the troubled housing market.

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# Unregistered land, your time is up!!

With nearly two thirds of all land in England & Wales now registered at the Land Registry, Bill Chandler recommends that you consider registering any unregistered land you may own.

Just three years ago, less than half of England & Wales was registered land. Now it is nearly two thirds and the Land Registry is keen to increase that figure further. If you own unregistered land, there are several advantages in registering your land. These include the so-called "state guarantee" and asset management advantages, but the two biggest benefits are:

1. it will make any subsequent dealing with the land easier, since you can show the prospective buyer or tenant the Land Registry title rather than a collection of title deeds. The more extensive and complicated the property, the greater the advantage of registering in advance of a dealing.

2. since 2003 it is much harder for anyone to deprive you of your property if it is registered land. If your land is unregistered and someone else occupies part (or all) of it for 12 years they may be able to claim your land by "adverse possession" (commonly known as "squatters rights"). However, if your land is registered you will be notified of their claim and will have the opportunity to object and to take action to recover possession of your land.

Many organisations with significant land holdings (including many local authorities, landed estates and utility companies) are currently in the process of voluntarily registering their portfolios of unregistered land, but the benefits apply equally if you own a single unregistered property.

Voluntary registration is not free, but by way of inducement the Land Registry charges a reduced fee. On large portfolios they will also appoint a project manager and commit to a service level agreement.

If you wish to consider voluntary registration further, please feel free to discuss the issue with your usual Hill Dickinson property contact.

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## At last, some good news for landlords

This time last year Matthew Forrest reported on the serious implications for landlords of the Court of Appeal decision in the case of Scottish & Newcastle plc -v- Raguz. Last year the Court of Appeal held that for the purposes of the Landlord & Tenant (Covenants) Act 1995 the increased rent payable following rent review is "due" from the review date itself (even if the new rent is not ascertained until later), rather than once the new rent actually becomes payable under the lease following determination.

This decision required landlords to serve section 17 notices on previous tenants and guarantors whenever a rent review had not been determined by the review date, even where the current tenant continued to pay the passing rent and was not actually in default. Failure to serve notices could prevent the landlord from pursuing the former tenant/guarantor for the uplift if the current tenant failed to make the balancing payment once the rent review was concluded.

On 29 October 2008 the House of Lords issued its eagerly awaited judgment and we are pleased to announce that common sense has been restored. The position on late rent reviews is now that:

- the uplift only becomes "due" once it actually becomes payable under the lease following determination of the reviewed rent;
- no section 17 notices need to be served whilst the current tenant continues to pay the passing rent pending determination of the reviewed rent;
- the landlord has 6 months from the date the balancing payment becomes payable (following determination of the reviewed rent) to serve a section 17 notice on previous tenants/guarantors if the current tenant fails to pay.

The decision will come as a welcome relief to landlords, particularly in an economic climate where tenant default is on the rise. It is no longer necessary for landlords to serve precautionary section 17 notices where nobody is actually in default.

The decision also highlights the unpredictability of the legal process. The House of Lords has reversed the decision not only of a High Court judge but also the Court of Appeal, while two of the five Law Lords disagreed with certain aspects of the majority decision. Even the majority acknowledged that they were taking a decision based on fairness and justice in the face of ambiguous drafting of the legislation.

If you require any advice or assistance on tenant default, please contact your usual Hill Dickinson contact or one of our specialist property litigation team.

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## About Hill Dickinson

Hill Dickinson offers a comprehensive range of legal services from offices in Liverpool, Manchester, London and Chester, and its associated firm Hill Dickinson International has offices in London and Greece. Collectively the firms have over 150 partners and a complement of more than 1000 staff.

Hill Dickinson is a major force in insurance and is well respected in the company and commercial arena. The firm's marine expertise is internationally renowned and it has one of the largest marine practices in the UK following a merger with Hill Taylor Dickinson on 1 November 2006. The firm has an award winning property practice and is widely regarded as a leader in the fields of commercial litigation, employment, intellectual property, NHS clinical/health related litigation and private client.

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