

commercial property

Financial Services Authority to regulate “Sale and Rent Back” sector

“Sale and Rent Back” (SRB) companies buy homes from individuals, usually at a significant discount, and then rent them back to the previous owners. This is one of the few sectors that are currently flourishing and one of the secrets of its success is the sub-prime mortgage bubble. In a climate where the Council of Mortgage Lenders puts the number of mortgage borrowers in arrears last September at 168,000 and is expecting 75,000 repossessions this year, the market has grown quickly.

SRB may be flourishing but its reputation is struggling under bad publicity generated by unregulated poor behaviour. New landlords have evicted tenants and some SRB companies have defaulted on their own mortgage repayments. Stories of tenants being forced out by overlooked short-term tenancy clauses and rent hikes have abounded.

Up until now, the Consumer Protection from Unfair Trading Regulations were all that regulated the sector. The Office of Fair Trading (OFT) may only apply for enforcement orders in order to prevent infringements of consumer protection laws. In some cases where companies flout consumer protection laws it may use criminal sanctions but it is often too late by then.

This time last year, Adam Sampson of housing charity Shelter voiced widespread concerns that companies operating in the sector were “rip-off merchants” and called for regulation. With unprecedented alacrity the government is responding.

The Financial Services Authority (FSA) will implement new regulation. However, the OFT has considered that the situation is so volatile that the FSA intends to bring an emergency regime into play. The interim regime will commence on 1 July 2009.

Activities which will be regulated are:

- Entering into an SRB agreement as an agreement provider
- Administering an SRB agreement
- Arranging an SRB agreement
- Advising on entering an SRB agreement

Firms will need to apply for interim permission from the FSA in order to trade. Many bodies will be exempt from the need for authorisation. These bodies include registered social landlords, local authorities, the Homes and Communities Agency and the Tenants Advisory Service.

Those firms which are not covered by this exemption will need to submit completed applications for interim permission within one month of the commencement date. So, assuming that 1 July is the commencement date, an application must be made by 1 August 2009 and the FSA warns that late submissions will not be considered.

Information about the application process is available on the FSA website in the “Doing business with the FSA” section (under “How do I get authorised?”). Draft application packs will indicate the information that the FSA will require.

If this affects you, our advice is to start thinking now about making your

application as the requirements are rigorous and you will need to assemble and submit a substantial package of information and documentation about your business. Please contact us if you require advice or assistance with the application process.

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Law Firm of the Year
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Welcome

Welcome to Hill Dickinson's commercial property newsletter summer 2009. You will notice that this issue has a different look from past editions. This is an example of Hill Dickinson's new corporate brand identity and we have pleasure in introducing it to you by means of our publication.

Why have we changed our look? The past three years have seen the firm grow 50% by merger and organic growth, with key milestones including the merger with Hill Taylor Dickinson in November 2006 and the forthcoming merger with long established London City practice, Middleton Potts, in July 2009. A stronger, more distinctive look was therefore needed to reflect the firm's improved status and its prominence in a highly competitive market.

We are delighted to announce a major win for the firm at the annual North West Business Insider Property Awards. Having been shortlisted for the Property Law Firm of the Year award, Hill Dickinson was announced as overall winner at the awards ceremony on 4 June.

Insider magazine reported that, "the judges gave Hill Dickinson the edge, recognising the work the firm did over the past year for blue-chip names that have kept coming back to its resourceful and respected team for years." So a big thank you goes out to all those involved in this year's nomination!

We are also pleased to announce the arrival since the last edition of Jonathan Dover. Jonathan joins our expanding commercial property team in Manchester as a partner, bringing with him a wealth of experience and an impressive client base.

In this quarter's edition, we explore a range of topical issues affecting our commercial property clients.

If you have any queries about matters raised, please get in touch with our editorial contact Bill Chandler at bill.chandler@hilldickinson.com

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Rent to Buy

An absence of credit, house prices spiralling downwards and hesitant buyers who are faced with an uncertain job market all means that selling newly built or redeveloped residential property is an increasingly difficult task for developers and private landlords. Imaginative solutions are needed so **Julia Stansfield** considers one such solution - "Rent to Buy" schemes.

In 2008 a government initiative was announced aimed at assisting first time buyers. The scheme is for households earning up to £60,000 per annum whereby the prospective buyer will be able to rent at 80% (or less) of the going rate for two to three years. This enables them to save up for the deposit and fees involved in a house purchase. They would also be given an option to buy 25% or more of the property under the scheme (the balance would be shared ownership with affordable rent). The government intends that this will, alongside other schemes, help 75,000 first time buyers on to the property ladder.

Whilst the government prepares to put this in place, developers and private landlords are stepping in with their own solutions to tackle the problems that they face in selling their houses and apartments.

In the US, the practice of offering rent to buy was commonplace before the recent financial crisis but their models were generally based on a rising market and not suited to the current tough economic climate. Such schemes therefore need to be drafted from scratch to match the current specific needs of UK developers – and their purchasers. A discussion of four possible approaches follows.

Firstly, a private property owner who is struggling to sell could rent out their property on a fixed term assured shorthold tenancy of six months or more. The rent of, for example, £600 pcm, totalling £3,600 over the six months, would then be deducted from the asking price at the end of the fixed term. An

informed tenant would no doubt ask for an option agreement to be entered into at the same time to protect their payments. If the purchasers choose not to proceed at the end of the term, the money they paid over the term of the lease remains as rent and the landlord has at least had an income from the property in the short term, whilst waiting for the market to pick up.

The second mirrors the private landlord scheme but on a much larger scale. A developer with a newly completed apartment block available for occupation may now be facing difficulties in finding new buyers with the necessary mortgage approvals. Dropping the price may be one option, but a rent to buy scheme could assist in maintaining the purchase price whilst giving the prospective buyer longer to save for a deposit and obtain their mortgage approval.

Consider a purchase price of £135,000. The prospective buyer enters into an assured shorthold tenancy for a period of 18 months, paying a rent of £600 pcm. At the same time as signing up to the AST they enter into an option agreement whereby all of their rent is deducted from the fixed purchase price of £135,000 should they decide to exercise the option at the end of the term.

The rent paid amounts to a total of £10,800 over 18 months, which in turn amounts to 8% of the purchase price. The buyer will then need to ensure that they have also saved sufficient additional funds over the 18 month period to meet at least a 10% deposit requirement. 100% mortgages appear to now be consigned

to the past and even the number of 90% mortgages available has fallen sharply in recent months.

The third rent to buy method differs by charging an option fee at the outset of perhaps 2% of the price. At the end of the 18 months this option fee is added to the rent amount and it is anticipated that the buyer then has the total 10% deposit required to satisfy their lender's needs. This fee is also likely to concentrate the buyers' minds on purchasing the property - ultimately it has to be remembered that the developer wants to sell the property and not simply rent it out.

A fourth method is a stepped scheme. The same principle applies as with the other three schemes - the rent you pay is refunded as a deposit - however the full amount is only refunded in the first six months and thereafter the amount will drop for each further six month period that the tenant rents the property. This means that at 12 months the purchaser would only receive perhaps 75% back and after 2 years, perhaps only 25%.

For any of these schemes, the purchase price could either be fixed at the start or valued at the time that the tenant decides to proceed to purchase and this would need particular consideration at the outset.

Once a developer or private landlord has decided to proceed with a rent to buy scheme, caution is needed in drafting the documentation. Practical issues such as how the assured shorthold tenancy and the option link in to each other, service charge provision and car parking requirements must all be carefully contemplated. The individual requirements of each developer are paramount and what is suited to one developer may be inappropriate for another.

One final note of caution relates to the tax implications, in particular in respect of Value Added Tax.

When a residential developer sells the properties - either the freehold or on a long leasehold of over 21 years - they are making a zero-rated supply. A zero rated supply is a taxable supply and the developer will normally recover all of the related input VAT i.e. any VAT paid out on the purchase price of the land, professional costs and also on any of the

development costs.

If they instead choose to grant an assured shorthold tenancy, they are then making an exempt supply - which is not a taxable supply - and they will then become partially exempt (if they are not already). Consequently, at this point, the developer may need to make a clawback adjustment and repay some of the VAT it has recovered on the VAT returns it has already submitted. The change in intention can also affect how VAT is to be recovered on their current and future VAT returns. HMRC have issued guidance which will assist many developers to avoid or at least reduce clawback .

This is only a brief summary of the VAT position and specialist tax advice should be sought to ensure that the developer is not caught out unexpectedly. Specialist advice will also allow the developer to investigate ways of avoiding this situation.

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Case study

Downtown Living are a residential development company. In September 2008 their new block of 85 apartments known as "the Room" in Preston reached practical completion. Contracts had already been exchanged prior to this on the majority of the apartments and it was anticipated that the remainder would sell quickly. However, due to the sudden and unexpected downturn in the property market, the sales did not occur as anticipated.

Faced with the prospect of a proportion of the apartments remaining empty, managing director Stuart Whittle realised that they would need to find an alternative solution that would create an income stream and also protect the value of the development. Accordingly, working with Julia Stansfield of Hill Dickinson, together they produced a rent to buy scheme based on an option agreement with an assured shorthold tenancy of 18 months. It has now been signed up to on several of the apartments. The success of this scheme has prompted them to use a similar scheme for their new build apartments at Haigh Park View in Wigan (developed by their company Construction Partnership UK Limited).



Stop press

The article 'Goodbye distress, hello CRAR' in the Spring 2009 newsletter mentioned that no date had been set for the introduction of the Commercial Rent Arrears Recovery regime. We now understand that implementation is unlikely before April 2012 at the earliest.



The human face of the property downturn

In these troubled times much has been written about the impact of falling house prices on house builders. **Paula Milburn**, a partner in Hill Dickinson's specialist family team, discusses the impact of the downturn on divorcing couples.

Estate agents and property developers have always been able to rely on separating and divorcing couples selling and buying property. However given the depth of the recession, separating couples are finding it increasingly difficult to agree property values and achieve sales. Furthermore, those leaving family homes are now tending to rent given falling house values and rental figures combined with the difficulties in securing mortgage finance pending the sale of the main family home.

Usually when a couple decides to separate they are advised to consider a transfer of property, normally into the wife's name to provide for continuity for the children. 12 months ago most couples were able to agree a property value, sometimes assisted by a formal valuation. This is no longer the case, as all too often one partner will struggle to accept the extent of the property downturn and the impact on property values. Even if a couple is agreed on the value of the property, it is now far more difficult to raise finance to remortgage to buy a joint owner out or persuade a mortgage company to transfer a mortgage into one person's name based on an income combination of salary and child support payments.

For couples with children in the difficult situation of waiting for homes to sell, the position is dire. The children know that their parents are separating but the

day-to-day reality is different with some families having to remain together for up to two years before they are able to find a purchaser, let alone achieve a sale.

The falling house prices and turbulent markets not only make it difficult for separating couples but also for professional advisers including accountants, lawyers and surveyors because:

- Couples are nowadays far more sceptical about property valuations – either not accepting significant falls in value or maintaining that valuations are out of date within a month of completion and hence requesting second desk top valuations.
- Property valuations are subject to increasing challenge as a result of disappointment, on the part of one party, as a result of commercial valuations taking into account falls in rental yield when valuing commercial premises or significantly discounting 'hope' value for change of use.
- Some couples are deferring decisions to separate because of concerns about employment, availability of mortgages and falling house prices and investments. Concerns are highlighted because the majority of families 'downsize' on divorce and so are worse affected by the property slump.

- In less turbulent times, the husband would traditionally retain his company shareholding and pension assets and the wife would get the house. Increasingly, husbands are not willing to offer the wife the house and the savings as property is still perceived to be the 'copper bottomed asset' in comparison to company shares and non-final salary pension schemes.
- Many couples have committed to investing in buy to let properties to bolster pensions and have invested in commercial property SIPPs. Accordingly, instead of requiring one family home valuation, a number of professional valuations are required and couples approaching retirement can be left in the position of trying to agree pension sharing in respect of commercial property SIPPs and transfers of buy to let properties with falling rental yields and lack of mortgage finance.
- Prior to the housing market slump, some husbands and wives agreed to split property assets with one receiving a fixed lump sum from property proceeds. This is all well and good in a stagnant housing market but with falling house prices one party is inevitably a loser unless a percentage split of the proceeds of sale is agreed.
- Notwithstanding the publicity about the housing market, some do not accept that their estranged husband or wife is doing all that they can to achieve a sale. Accordingly courts are seeing an increase in applications for the court to adjudicate on the sale price for a property and to determine choice of agent and method of sale, with auctions being increasingly popular for those desperate to move on.

So is it all doom and gloom for couples thinking about separating or divorcing? Definitely not – it has never been easier for divorce lawyers to persuade courts that shares in companies have significantly reduced in value and that company accounts are not a true reflection, in these very difficult times, of share value.

However in the vast majority of divorces there are no winners or losers – both the husband and wife will gain or lose out from the property slump when re-housing in a falling property market and increasingly family financial settlements are being structured in ways that share the assets to share the market risks.

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Disclaimer: good news or bad news?

When a tenant becomes insolvent, their trustee in bankruptcy or liquidator has the power to disclaim the lease. A previous tenant or guarantor may initially be relieved to hear that the lease has been terminated but, as **Bill Chandler** advises, a recent case has confirmed that is not necessarily the end of their liability. Disclaimer can also affect the insolvent tenant's subtenants and mortgagees.

Section 178 of the Insolvency Act 1986 entitles a liquidator to disclaim onerous property, which is defined as unprofitable contracts and any other property which is unsaleable or which may give rise to liability. Property leases often fall into this category. Section 315 gives a similar power to a trustee in bankruptcy. The power does not however extend to administrators. Disclaimer operates "so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company/bankrupt in or in respect of the property disclaimed".

Where the insolvent tenant is the original tenant under the lease and has no guarantor, sub-tenant or mortgagee, the disclaimer of the lease by the tenant's trustee in bankruptcy or liquidator effectively brings the lease to end. But often there are other parties with an actual or potential liability or interest under the lease:

- Previous tenants of pre-1996 leases who are liable for the remainder of the term
- Previous tenants of post-1996 'new tenancies' who have guaranteed the current tenant by way of Authorised Guarantee Agreement (AGA) given on the assignment of the lease
- Guarantors of the current tenant and, in some cases, of previous tenants
- Subtenants
- The insolvent tenant's mortgagee

So, what happens to those parties when the lease is disclaimed on behalf of the current tenant? Well, the relevant sections of the Insolvency Act go on to provide that the disclaimer "does not affect the rights or liabilities of any other person".

Previous tenants and guarantors

The disclaimer of the lease does not absolve previous tenants and guarantors from their liability to the landlord. The leading authority is the House of Lords' decision in Hindcastle Ltd -v- Barbara Attenborough Associates Ltd (1997), which confirmed that the disclaimer did not affect a guarantor's liability to the landlord, which continued as if the lease had continued to exist.

On 1 April 2009, the Court of Appeal confirmed in the case of Shaw -v- Doleman that the same principle will apply to a former tenant liable under an AGA, even though the former tenant's guarantee was, as is usual, limited to "the period during which the assignee is bound by the tenant covenants of the lease". The former tenant argued that, since the current tenant was no longer bound by the lease, the guarantee should fall away too. However, the Court of Appeal upheld the High Court's decision that for the purposes of the AGA the current tenant was to be treated as still being bound by the lease. This is all the more unfortunate for the former tenant because the result is that she can be pursued for the entire remainder of the term, whereas, had the lease not been disclaimed, there was always the hope that the lease might be assigned again, which would have ended her liability under the AGA.

Of course, most guarantees and many AGAs contain a specific obligation on the guarantor to enter into a new lease with the landlord in the event that the lease is disclaimed.

The landlord may however lose the ability to pursue previous tenants and guarantors if it does anything inconsistent with the continued existence of the lease such as, for example, taking possession of the property.

Subtenants and mortgagees

Section 179 of the Insolvency Act 1986 (in respect of liquidators) and section 317 (in respect of trustees in bankruptcy) requires notice of the disclaimer to be given to subtenants and also to mortgagees, who then have 14 days to apply to court for a vesting order. The disclaimer does not take effect unless no application is made within that period or the court subsequently confirms the disclaimer. Any order vesting the headlease in a subtenant will however impose the rent and other terms of the headlease on the subtenant, which may not be desirable, particularly where the headlease is at a higher rent than the sublease.

If the subtenant chooses not to take a vesting order, he may remain in occupation for the residue of the term, even though the sublease has effectively gone, but again he is required to pay the headlease rent and observe the tenant covenants in the headlease.

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“I want my money back!”

Jill McKenna asks whether the recession is an “exceptional circumstance” entitling the buyer to recoup its deposit if it is no longer in a position to complete the purchase by the completion date?

As discussed in the article ‘Credit Crunch: Weathering the Storm’ in the Winter 2008 newsletter, we are moving through uncertain and turbulent times. With a continued downturn in the property market, more buyers find themselves in a position where they have paid a deposit and are then unable to complete the purchase, perhaps for example due to a falling property market or not being able to fund the purchase as lenders withdraw their offers.

It is widely known that if a buyer does not complete it will not be able to recoup its deposit. It is lesser known that section 49(2) of the Law of Property Act 1925 allows the court to use its discretion to order the return of deposits.

There is no statutory guidance as to how the courts should apply this discretion but the recent case of [Midill \(97PL\) Limited -v- \(1\) Park Lane Estates Limited \(2\) Gomba International Investments Ltd \[2008\] EWCA Civ 1227](#) sets out some clear guidelines.

This article considers the relevant law and the [Midill](#) case to ascertain whether

the current financial climate will have any bearing on the return of deposits.

What are deposits?

Deposits, although not required by law, are usually paid by the buyer to the seller on exchange of contracts. Customarily, a buyer will pay to the seller a deposit of 10% of the purchase price and this is reflected in the standard conditions of sale. However, it is becoming more common for a lower sum to be acceptable. A deposit acts as part payment of the purchase price and indicates the buyer’s intention to complete the contract. It is common knowledge that if the buyer does not complete, the seller will usually forfeit the deposit.

Section 49(2) Law of Property Act 1925

Section 49 provides that the buyer or the seller may apply to the court in respect of any question arising out of or connected with the contract (not being a question affecting the existence or validity of the contract) and the court may make such

order as it considers to be just.

Section 49(2) provides:

“where the court refuses to grant specific performance of a contract or in any action for the return of a deposit the court may, if it thinks fit, order the repayment of any deposit”.

Section 49(2) applies to contracts for the sale or exchange of any interest in land and was introduced to correct the apparent injustice of a series of 19th century cases. The injustice arose because even when the court refused to force a buyer to complete because the seller's title was defective, the buyer was still unable to rescind due to the terms of the contract and consequently the buyer was not entitled to the return of its deposit.

Section 49(2) is very wide and it has been left to the courts to use at their discretion. No clarity has been provided in the case law and indeed the first reported case was Schindler -v- Pigault in 1975 in which the court thought it unnecessary to provide a view of the section. Between 1975 and 1985 there were cases that expressed different views but none yielded a binding authority.

The majority of academics favour a wide view of section 49(2) and some courts have preferred the ‘generous’ approach as in Universal Corporation -v- Five Ways Properties Limited [1979] 1 EGLR 163 (“Universal”) in which the court's discretion was viewed to be a wide one and to be exercised “in any circumstances which make this the fairest course between the two parties”. Others have taken the ‘stricter view’ as in Omar -v- El Wakil [2001] EWCA Civ 1090 (“Omar”). In Omar, certain principles were laid down to assist in dealing with the complex details of that case. However, there was no citation of authority or any assistance from Counsel.

In Midill the Court of Appeal reviewed the authorities and commented that the first instance decisions in Universal and other similar cases are useful as illustrations of how section 49(2) has been applied in certain circumstances. However, the Court of Appeal in Midill applied the guidance from Omar. The following points arise from Omar:

- Although the courts have power to determine the organising principles of section 49(2), the starting point should be that the deposit “is an earnest for performance”

- It is “common knowledge that if a purchaser pays a deposit he is likely to forfeit it if he does not fulfil the contract”
- There needs to be certainty attaching to the consequences of paying a deposit

It was concluded that for the court to exercise its discretion under section 49(2) and order the return of the deposit, the circumstances must be “exceptional”.

The facts of Midill

Briefly, the Court of Appeal refused to allow the buyer's appeal for the return of its deposit under a sale contract. The buyer unsuccessfully claimed that the seller was not ready, able and willing to complete and that consequently the notice to complete was invalid. As the buyer did not comply with the notice to complete, the seller rescinded the contract and forfeited the deposit. The seller then sold the property to another unrelated party for a higher price.

The buyer claimed that the Court of Appeal should exercise its discretion under section 49(2) and return the deposit, arguing that the resale of the property for a higher price amounted to a special circumstance, but the Court of Appeal did not exercise its discretion and the following points arise from the case:

- The guidance of the Court of Appeal is clear that the court will not ordinarily order the repayment of the deposit and that applies even if the seller makes a profit on the subsequent sale. In this case the subsequent higher sale price was not considered exceptional in light of the then current property market.
- If the liability to repay the deposit depended on some future sale price there would be considerable uncertainty and delay and this is exactly what a deposit is intended to avoid.
- There needs to be “something more or special or exceptional” to justify departing from the normal approach. There was no special factor in this case.
- The seller bears the risk and cost in between exchange and completion and there is no reason why the buyer should have the benefit of the increased sale price.
- The buyer was a “sophisticated investor” and was well aware of the risks involved in failing to complete the contract.

Conclusion

Midill reinforces the purpose of the deposit and makes it clear that the seller can keep the deposit if the buyer defaults and that the burden of proof is on the buyer to show that this presumption should be overridden.

A seller should always endeavour to ensure that it is ready, able and willing to complete a transaction, even if it suspects that a buyer will default, thereby reducing the risk of a challenge by the buyer.

A buyer may consider making amendments to a contract that could for example incorporate a right to rescind the contract if after exchange of contracts the buyer is no longer able to fund the purchase.

A buyer who is aware of the risks of failing to complete cannot rely on the court exercising its discretion under section 49(2) and generally if a buyer defaults the court will not order the return of the deposit.

It therefore appears unlikely that a buyer could rely on the current financial crisis as an exceptional circumstance whereby the court would order the return of a deposit. After all, a buyer defaulting on completion is precisely the type of risk that a deposit is intended to protect against.

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Ripon yarns

A recent case involving an accident at Ripon Cathedral serves as a useful reminder of occupiers' liability to visitors under the Occupiers' Liability Act 1957. As **Bill Chandler** explains, whilst the outcome will bring relief to owners and occupiers of historic buildings, this does not mean that health and safety considerations can be entirely ignored.

The facts are simple enough. Ripon Cathedral, like many old buildings, does not comply to modern ideas of health and safety. Floors and stairs are uneven and worn, and there are no handrails on staircases. So, when tourist Jennifer Hunt fell and injured her ankle whilst descending the stone stairs to the cathedral crypt in June 2006, was it 'an accident waiting to happen' for which the cathedral should be held liable?

When Mrs Hunt's personal injury claim was heard by Middlesbrough County Court in October 2008, District Judge Cuthbertson thought not and Mrs Hunt lost her case. Despite the modern preoccupation with health and safety, the duty imposed by the Occupiers' Liability Act is to take such care as is reasonable to ensure that the visitor is reasonably safe in using the premises for the purposes for which the visitor is permitted to be there. This does not mean that visitors must be kept absolutely safe (if indeed this is ever possible) and the standard required

will depend on the nature and age of the building. So an uneven floor which may be acceptable in Ripon Cathedral would not be acceptable in the local supermarket.

In the Ripon Cathedral case the judge considered that it would be obvious to any visitor that modern standards would not apply and that visitors should adjust their expectations and behaviour accordingly, taking care in particular where to place their feet. The risk of uneven stairs was so obvious that signage was not required but not so dangerous as to require intervention by way of repair.

But owners and occupiers of heritage buildings must not fall into the trap of believing themselves exempt from health and safety considerations. The test of what is reasonable may be different for a heritage property than for a modern property but the test does still apply and visitors must be kept reasonably safe. So, for example, a missing step would be a very different matter from a slightly uneven one. The judge may have been less sympathetic had Ripon Cathedral not previously carried out a health and safety risk assessment and initiated a one way system.

The decision does not make new law but is a useful reminder to the owners and occupiers of all types of property of the basic legal duty and that different standards will apply in different circumstances. And whilst most people will agree that Ripon Cathedral should not have to adapt the oldest surviving crypt in the country to meet 21st century safety standards, in return we all need to watch our step when visiting historic properties.

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