

Real Estate Update

December 2009

Christmas: 'tis the season of the short-term shop

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Empty property, empty wallet?

Since April 2008 owners of empty commercial properties have faced the burden of paying full business rates after only a short period of vacancy. The credit crunch and resulting recession has led to a marked increase in the number of empty commercial properties, making empty property business rates a very current issue for businesses across the UK. [More...](#)

Forfeiture – does it work when a tenant is in administration?

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Round-up

Planning Act 2008

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Case note

Is it personal to want a break?

Generally, the case law surrounding break clauses deals with issues relating to the pre-conditions normally attached to a break clause, such as the requirement to give vacant possession at the break date. [More...](#)

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RPC launches new Retail Property Club. [More...](#)

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Any comments or queries?

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As part of our commitment to corporate social responsibility we are proud to support The Anthony Nolan Trust as our current Charity of the Year (www.anthonynolan.org.uk).

This is a summary of recent developments. It should not be regarded as a substitute for advice on how to act in any particular case. For further information please contact one of the authors.

Christmas: 'tis the season of the short-term shop

A recent survey by the Local Data Company found that one in ten high street shops closed in the first nine months of this year – more than 25,000 in total. However, as more and more “to let” signs appear on our streets, temporary or “pop-up” shops can, if properly managed, represent a real opportunity for both landlords and tenants.

Every year, at the first, distant sound of sleigh bells, seasonal retailers begin taking over empty units or setting up kiosks in shopping centre concourses. Some sell calendars and Christmas gifts; others are temporary outposts of all-year-round retailers wanting to increase their presence on the high street over the festive season. Increasingly, they are joined by a whole host of “pop-up” enterprises, which trade for just a few weeks, often rent-free, before disappearing again as suddenly as they came: the “Reindeer” restaurant of 2006, for example, which traded for just 23 days in an East London warehouse, complete with fake snow and real fir trees, or this year’s Marmite shop in Regent Street, selling all things Marmite-related for 10 weeks only. Earlier this year, the Government scheme for “meanwhile use” was set up to encourage community groups and arts organisations to occupy empty shops temporarily, while the search for a new commercial tenant continues.

Seasonal retailers, who might take a lease for two or three months over Christmas, have one major attraction for landlords: rental income. Suddenly, a previously vacant unit not only covers its costs, with the tenant picking up the tab for the rates, but also brings in rent. For tenants, temporary outlets can be very lucrative, allowing them to take advantage of one of the busiest times of the year without making any kind of long-term financial commitment. Although existing tenants – particularly those in shopping centres with high yearly overheads – may object to their no-strings competitors, the chances are that they will benefit from the increased footfall which these temporary rivals bring.

“Pop-up” shops are even more fleeting, often trading for just a few short weeks. Alongside these is the Government’s Empty Shops Revival Fund which has allocated £3m to be spent on the temporary transformation of empty units into community or cultural enterprises in those areas hardest hit by the recession. The idea is that this “meanwhile use” will keep high streets busy and avoid the depressing spread of boarded-up, graffiti-sprayed shops by giving empty units a useful life until such time as a commercial tenant can be found. Examples include the empty shop in Dewsbury which was turned into a police and community centre; the parade of empty shop windows in Dursley, Gloucestershire, which became a series of art galleries; and the “People’s Cinema” in Cambridge, formerly a branch of Habitat and now showing works by local art students.

As a rule, pop-up retailers and those occupying under the Government’s meanwhile use scheme do not pay rent. However, they do help landlords to cover their costs. Most importantly, they pay the rates, which can amount to a substantial saving for a landlord, especially with the cuts in empty property rating relief and the forthcoming rates increases in April 2010. Depending on the



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terms agreed, they may also make a contribution towards the cost of maintaining and insuring the property through a basic, flat-rate service charge.

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Another major advantage of temporary tenants is that they deter squatters, thereby saving landlords the costs and court hearings associated with evicting squatters, securing the property and repairing any damage done. Arguably, pop-up shops may bring wider benefits too, increasing footfall to their part of the high street or shopping centre and perhaps even boosting consumer confidence by reducing the number of empty, boarded-up units.

Temporary shops: issues for landlords

The single most important issue for landlords when taking on any kind of short-term tenant is that they must be able to get the unit back quickly if necessary – a landlord will not want to lose a longer-term commercial tenant because the temporary occupier cannot be persuaded to move out. It is therefore vital to ensure that temporary tenants are not inadvertently given security of tenure.

Landlords must ensure that all short-term leases are outside the security of tenure provisions of the Landlord and Tenant Act 1954. Tenants should not be allowed into the property until the legal documents authorising their occupation (be it a licence, a tenancy at will or a simple lease) have been completed and the relevant notices served under the 1954 Act.

To avoid arguments, the lease or licence should spell out how much notice the landlord must give the tenant to vacate the property.

Landlords will also want to minimise damage to the property. Temporary tenants should be required to keep the property clean and tidy, but it may not be realistic to require them to keep the property in good repair. Instead, landlords might ask for a damage deposit at the beginning of the term (although non-commercial tenants may struggle to pay this) or limit repairing liability by reference to a schedule of condition.

If possible, landlords will want tenants to contribute to the maintenance of the property through a basic service charge. Again, this will depend on what the parties can negotiate and what the tenant can afford.

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Temporary shops: issues for tenants

Commercial tenants wanting to take advantage of short-term opportunities will obviously need to be ready to fit out quickly, so as to get into the property and start trading as soon as possible.

Short-term tenants also need to be aware that the landlord may need the property back at short notice. Tenants should check how much the notice their landlord is required to give them and ensure that they will be able to vacate the property within that timeframe.

Another big issue for temporary tenants is planning: can they use the property for their proposed use?

Part 4 of the General Permitted Development Order 1995 which waives the requirement for planning permission for any use of land, including the provision of any "moveable structure" for the purpose of that use, provided that the use does not continue for more than 28 days in any 12 month period. For this reason, many pop-up shops deliberately only stay open for 28 days or less.

Empty property, empty wallet?

Since April 2008 owners of empty commercial properties have faced the burden of paying full business rates after only a short period of vacancy. The credit crunch and resulting recession has led to a marked increase in the number of empty commercial properties, making empty property business rates a very current issue for businesses across the UK.

The law changed on 1 April 2008, removing business rates relief for most unoccupied commercial properties. Owners of industrial properties now only have relief from business rates for the first six months of vacancy; owners of other commercial properties have relief for the first three months of vacancy. After these initial exemption periods, full business rates are payable.

The Government implemented these reforms as an incentive for owners of empty properties to bring their properties back into use and to stimulate competition within the UK. However, in the current economic climate it is not always easy to find potential purchasers or tenants willing to pay a viable rent. These changes may therefore result in huge liabilities for commercial property owners and there has been considerable backlash against the reforms.

Certain properties are exempt from the requirement to pay business rates, including listed buildings, properties with a rateable value under £15k and properties owned by companies in liquidation or administration. Owners of properties to which these exemptions do not apply may instead use the following ways to mitigate or even extinguish their rates liability.



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Ways to Mitigate

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Intermittent occupation

Commercial property owners can let their properties out on a casual basis for a period of at least six weeks. The property is then treated as having been occupied and the owner is given the benefit of another six month rate-free period. Owners could indefinitely avoid paying full business rates by letting their properties out on this six-week basis every six months. It is however important to ensure that any short-term letting is appropriately documented in order to avoid inadvertently granting the tenant security of tenure.

The Government addressed this issue in a consultation paper entitled 'Modernising Empty Property', published in 2007. It states that it wants to prevent avoidance of rates through intermittent occupation yet it does not want to restrict the ability of owners to bring premises back into use through flexible, short-term leases. The Government is consequently monitoring the situation to decide whether to extend the six-week occupancy period. It is therefore important to be aware that this legislation is subject to change.

There are companies which provide tenants willing to rent empty properties on a six-week basis every six months, enabling the landlord to avoid full business rates; however, they do impose conditions and often require some kind of financial payment. Furthermore, as this is clearly a scheme to avoid the effects of the legislation, there is no cast-iron guarantee that this type of tenancy will constitute the six-week occupancy for the purposes of the legislation.

Occupation by the owner of the property

A commercial property owner could consider occupying the property themselves for the six-week period, eg for storage purposes. If so, although the owner would be responsible for paying the business rates for the six week period, they would then have a further six months' relief upon vacating the property. This is clearly a useful way of avoiding rates; however, owners may not always have the resources to be able to fully occupy the property themselves.

Occupation by a charity or community amateur sports club

Owners could let their properties to charities and community amateur sports clubs which are only liable to pay 20% of business rates. However, it may prove difficult to find charities and clubs willing to rent commercial properties in the current climate, particularly if the property is an industrial building. Despite this, certain charities have realised that there is scope for renting empty properties at a low rent, thus enabling landlords to avoid paying rates; Healthy Planet, for example, is willing to enter into short-term leases of shops in return for a donation.

Properties in poor condition

If the property is in a poor condition and cannot be economically repaired the owner may request the local authority to remove the property from the ratings list so that rates are not payable. There is however anti-avoidance legislation in place to prevent landlords deliberately damaging their properties in order to avoid paying rates ("constructive vandalism"). If the damage is deliberate, the valuation office will disregard the change in the property's state when assessing its rateable value.

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Demolition

Owners could consider demolishing their empty properties in order to avoid paying business rates, although in the long-term this is unlikely to be a practical option.

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Unfinished properties

Unfinished properties in the course of development cannot be assessed until they are considered to be ready for rateable occupation and therefore no rates are payable until they are complete. However, this cannot be relied upon indefinitely, as local authorities have the power to serve a completion notice on the developer requiring completion of the development. This can mean that a building is treated as complete before it has been finished. It is therefore not advisable for developers to halt development of new properties solely to avoid paying rates.

Prohibition from occupation by law

Owners do not have to pay business rates if they are prohibited by law from occupying the property or allowing it to be occupied; examples of this may be if the property contains asbestos or the structure of the building is dangerous.

Appeals against rateable value

Owners could attempt to reduce their liability by appealing against the rateable value of the property in question. To do this they must lodge an appeal with the local authority; however there is no guarantee that the rate would be reduced and the company could in fact end up with a larger liability. It is worth noting that an appeal can only be lodged once against the rateable value set at a revaluation date unless the local authority alters the property's rateable value in the interim or there has been a material change to the property. Examples of a material change include alterations to the property or use of the property, a new development or redevelopment in the area, changes to the property's access or changes to the way other property is occupied in the area.

Business rates are a highly contentious issue for commercial property owners. However, as this article highlights there are innovative ways to mitigate the burden, although time will tell whether these methods will continue to withstand Government scrutiny.

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Forfeiture – does it work when a tenant is in administration?

In the last edition of Real Estate Update, we considered the position of a landlord wishing to keep the lease of premises to a company in administration ongoing and in what circumstances he will receive the full rent (ie 100 pence in the pound). If, however, the tenant is in administration and the landlord would like to bring the lease to an end, he would only be entitled to forfeit the lease if the administrator consents or the court grants an order giving him permission to do so.¹

In today's market, it would be unusual for a landlord to wish to forfeit a lease of premises where the tenant is in administration and the lease continues to generate a rental stream, since the chances of re-letting at a higher rent are generally quite remote. However, it is now common practice – especially in the field of retail administration – for the rent of premises used by an administrator to be paid monthly, rather than quarterly in advance, as provided in the lease. Such adjustments of payment are sometimes achieved with the agreement of the landlord. However, if a landlord was unhappy with this adjustment and tried instead to forfeit the lease, as the law presently stands, he is likely to fail.

The reason for this is the Court of Appeal's decision in the case of *Innovate Logistics V Sunberry Properties* [2008] EWCA Civ 1261. The facts in that case were quite complex – indeed the administrator was actually in breach of the terms of the lease. Despite this, the court decided in his favour, ie the landlord was forced to accept monthly payments and could not forfeit.

Innovate Logistics explained

In the *Innovate* case, the leased premises were used for the purposes of the administration, not by the administrator himself but by the purchaser to whom the administrator had sold the company's business under a pre-pack² arrangement. As part of the sale, the purchaser entered into a licence to occupy the premises for six months to deal with goods stored there and to perform current contacts with customers. The purchaser paid a monthly fee equivalent to the rent which the administrator passed on to the landlord. The premises themselves were not part of the business being sold. The landlord applied to court for the permission to forfeit the lease but the court refused.

Basis of the court's decision

The court applied the principles laid down in the case of *Atlantic Computers* [1992] 1 AllER 476 answering two questions:

- Would the forfeiture impede the purposes of the administration?
- If so then, balancing the different interests of the landlord and the company's unsecured creditors, should the forfeiture be allowed?

In *Innovate* the landlord was recovering the equivalent of the full rent, albeit on a monthly basis and not quarterly in advance. In the court's eyes the interests of unsecured creditors would be prejudiced to a greater degree by the forfeiture than those of the landlord would be if the forfeiture was disallowed.



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Footnotes

- 1 Paragraphs 43(4) and (6) of Schedule B1 Insolvency Act 1986.
- 2 The sale of the business of an insolvent company which is negotiated between the company (often with the assistance of an adviser who later becomes the company's administrator) and is concluded immediately following the appointment of the administrator.

The motivation of the landlord in *Innovate* was tactical rather than based on a pure desire to take back the lease. He wished, by the forfeiture application, to force the purchaser of the business to take an assignment of the lease. However, the case is also controversial because the licence was granted by the administrator in breach of the terms of the lease. The court therefore condoned the administrator's wrongful act in order to ease the sale of the business, ie applying pragmatism to support the Government's desire to implement a rescue culture for businesses in recessionary times.

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One effect of the courts taking a pragmatic approach is that decisions are more likely to depend on the facts of each individual case. Landlords should therefore be aware of this when assessing what steps they can take.

Conclusion

If landlords are considering exercising rights of forfeiture against a tenant which is in administration, the following steps are advisable: Ascertain from the administrator if the premises are either (i) being used for the purposes of the administration or (ii) will form part of the sale of the business.

If either of (i) or (ii) above is the case, forfeiture is most likely an unattractive option as the rent or its equivalent amount should be paid in full (ie 100 pence in the pound) by the administrator or the purchaser respectively.

If the premises are neither being used for the purposes of the administration nor being sold as part of the business, the landlord must consider (ideally in consultation with his advisers), the two questions in *Atlantic Computers* described above. Namely: (1) whether the forfeiture would impede the administration, and (2) if so, whose interests should prevail as a matter of fairness – the landlord's or those of the company's unsecured creditors? If the landlord has good arguments showing the answer to (1) is "no" or that under (2) his interests have priority, he should make this clear in writing (with a full explanation where necessary) to the administrator and seek his consent to forfeit.

First and foremost the landlord must find out as many facts as possible about the administration and the administrator's intentions at the earliest possible time.

FAQs for landlords

To help landlords protect their interests where a tenant is in a near insolvent state or insolvent, we are publishing a series of Q&A factsheets over the next few weeks. To receive copies of these, please register here mark.lavers@rpc.co.uk.

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Case notes

Is it personal to want a break?

Generally, the case law surrounding break clauses deals with issues relating to the pre-conditions normally attached to a break clause, such as the requirement to give vacant possession at the break date. However, the recent case of *Norwich Union Life and Pensions v Lincac Mouldings Ltd* concerned the issue of personal break clauses and highlighted how easily these rights can be lost.

Facts

Norwich Union owned a rundown industrial estate in Southend-on-Sea. Lincac Mouldings Ltd (Lincac) were assigned two leases in 1986 (the Leases). Two licences to assign were entered into, first, granting Norwich Union's consent to the assignment, and secondly, containing a personal break clause only exercisable by Lincac.

The Leases were assigned to a group company, Lincac Automotive Ltd (Automotive), who subsequently entered into administration and sought to re-assign the Leases to Lincac. Norwich Union refused consent on the grounds that Lincac would seek to terminate the Leases and thus avoid the potential loss of income. Despite this Automotive attempted to assign the Leases to Lincac without Norwich Union's consent and then purported to give notice to Norwich Union to terminate the Leases.

Decision

The court decided the following:

1. Was Lincac entitled to exercise the break clauses even though the Leases were assigned to Automotive?

The court confirmed that Lincac was not entitled to exercise the break clauses because it was not the tenant in possession. It was decided that the purpose of a break clause is to enable a tenant in possession to bring the relationship of landlord and tenant to an end. The proposition that the lease could be terminated by a party that had once been, but no longer was, the tenant in possession made no commercial sense.

2. Would Lincac's right to exercise the break clauses be revived in the event that, having once assigned the Leases, it reacquired them by further assignment?

The answer was no. It would not make commercial sense to attribute to the parties an intention that a personal break right should revive were Lincac to reacquire the lease. This would cause uncertainty, which would be unattractive to the landlord and prospective purchasers of the reversion. If Lincac wished to retain the right to break, it could have sublet the property instead of assigning it.

Comment

The case is a good warning to tenants with personal break clauses who may be thinking about assigning their lease. This case highlights what could be missed when group companies reorganise and restructure their property portfolio. If a tenant wishes to retain a personal break right they should sublet the property rather than assign the lease.



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Round-up

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Planning Act 2008

In our July update we reported on the changes to the consent regime for Nationally Significant Infrastructure Projects created by the new Planning Act 2008. One of the key changes was that there would be a new unified consent scheme for the construction or extension of energy generating facilities.

The new body created to determine the applications for planning permission, the Infrastructure Planning Commission (IPC), was launched on 1 October 2009 and will start taking applications on 1 March 2010. Draft National Policy Statements for Energy and Ports were published on 9 November and have now been put out to consultation.

Energy and Infrastructure Partner, Sarah Cassidy, says: *"The Planning Act was 10 years in the making but now we are getting to see the start of the new regime being put into place. It will be interesting to see how the IPC carries out its advisory role during this transitional phase and also to see the content of the draft National Policy Statements, especially given that applications for consent will be determined against these policy documents."*

RPC will be providing a series of Business Alerts summarising the key developments in this area; please contact Natalie Smith on natalie.smith@rpc.co.uk if you would like to receive these updates.

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Planning Consent

The consultation period on the extension of planning permissions has concluded, resulting in the introduction of a process by which planning permissions can be extended. To qualify, the permission must have been granted on or before 1 October 2009 and development must not have begun. The main change since the publication of the consultation paper is that this power will now extend to all qualifying permissions, not just those for major developments.

In practice, only one extension will be allowed per planning permission, and it should be noted that the consultation paper did specify that where an extension permission is granted all the original conditions and the description of the development must remain the same.

Development Partner, Philip Boursnell says: *"There has been much confusion amongst the planning community about these changes. It is not yet clear, for example, what impact an extension permission would have on any section 106 agreement already in place. The guidance to the application form suggests that applicants seek pre-application advice from their local planning authority. It will be interesting to see whether the advice given varies from one authority to another."*

Carbon Reduction

The timetable for implementation of the CRC Energy Efficiency Scheme has been altered so that participants will no longer be faced with the burden of buying two sets of allowances in April 2011. Originally, the Scheme provided that participants should monitor emissions between April 2010 and March 2011 and report to



Round-up continued...

the Environment Agency in a "Footprint Report". Retrospective allowances would then have to be purchased in respect of this period in April 2011, at the same time as the allowances estimated for the coming year.

These changes mean that in the first year of the Scheme participants will simply have to monitor their emissions without having to retrospectively purchase allowances.

Partner Mark Lavers comments: *"The changes to the Scheme will allow the CRC to establish itself in the first year without creating a double burden on participants in April 2011. This seems a much more sensible approach than the initial proposal and will be welcomed by potential participants."*

News

RPC launches new Retail Property Club

RPC has established a new Retail Property Club. The first meeting will be an evening seminar on CRC Energy Efficiency Scheme and BREEAM in the Retail Environment on 11 February 2010. Please contact Sarah Broughton on sarah.broughton@rpc.co.uk if you are interested in attending.

Christmas Quiz – win a bottle of champagne

To bag some bubbly simply identify these buildings and email your answers to natalie.smith@rpc.co.uk before 31 December 2009.

The winner will be announced in our March Update and, in the case of a tie break, we will pull the lucky winner's name out of a (suitably festive) hat.



A



B



C



D



E



F

And finally...

Happy Christmas from all of the Real Estate team here at RPC!

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