

REITs

At the beginning of 2007, most of the real estate companies already quoted on the main stock market converted to REIT status and all but one of the rest followed soon afterwards. Everything looked serene and set fair.

Unfortunately, despite the enthusiasm with which REITs were universally embraced, they were unable to escape the general down rating of commercial property companies as a result of the drying up of finance and loss of investor confidence in the second half of the year and the expected flow of new conversions atrophied.

The big pub companies, which had been widely tipped to be the next converters to REITs, all decided that conversion was a step too far in the current economic climate. Another notable casualty in the leisure and hospitality sector was the abandonment of the proposed Vector flotation and subsequent conversion to a REIT. This transaction involved the bundling of some top branded hotels, including Marriott, Hilton, Hotel Du Vin, and Malmaison, and when it was pulled the change of investor sentiment was plain for all to see.



For further information contact
susan.freeman@mishcon.com

The Ban on Smoking in Public Places



On 1 July 2007, England joined the rest of the United Kingdom and implemented a ban on smoking in all enclosed and semi-enclosed public spaces. As it was the last to implement the ban, the effect was entirely predictable and, for this reason, fairly manageable.

Those pub companies with a good food offering and/or an attractive seating area outside the building have survived and even thrived, while those with neither of these have struggled.



For further information contact
susan.freeman@mishcon.com

Prudential Assurance Company Limited v PRG Powerhouse Limited



At the time that this case was decided back in April there was considerable concern about the precariousness of the protection

offered to a Landlord by a lease guarantor if confronted with a company voluntary arrangement (CVA).

Although the message may have been lost in the far bigger stories that took centre stage during 2007, 2008 might well see it gaining greater notoriety.

For those of you who have forgotten, this was a case where the High Court ruled that the particular CVA proposed by the directors of Powerhouse as its preferred route out of insolvency was unfairly prejudicial to the Landlords of the electrical retail outlets where Powerhouse had ceased trading who were to suffer the loss of the parent company guarantees underpinning the Tenant's covenant. For the Landlords, this was a pyrrhic victory only.

For, although the Landlords won on the particular facts of the case, the Court made it clear that, as a matter of law, it is possible for a CVA effectively to require creditors, including Landlords, to release a parent company guarantee. Had the CVA been expressed in slightly more favourable terms to the Landlords (and the debate will focus on how much more favourable), then Powerhouse would have won and relieved its parent of all its freely negotiated obligations. Another general point made by the Court was that creditors will always be prejudiced by a CVA and that "unfair prejudice", which is what must be proved to defeat it, requires something more.

Even now, the Tenant is appealing against the Court's decision and the appeal will be heard early in 2008. Landlords will wait for the outcome with some trepidation, especially given the likely retrenchment of consumer confidence for the immediately foreseeable future and the inevitable increase in insolvencies in the retail sector as a result.



For further information contact
daniel.levy@mishcon.com

The effect of the Sub-Prime Mortgage Defaults in the US Housing Market



The chickens well and truly came home to roost on this about half way through 2007 and, after the dust had settled, perhaps the most surprising aspect was the hallowed status of the financial institutions among the first to be caught out. Northern

Rock's difficulties still make the headlines and remain an all too vivid reminder of the financial carnage that started last summer.

The reverberations of the "credit crunch" are still resounding around the world and the extent of the default and exposure of the banks and investors is not yet fully apparent. Until such time as it is and investors regain confidence, credit is likely to be both expensive and difficult to find and this has obvious implications for the commercial (and residential) real estate market in the UK.

For some, of course, the current situation is not a reason for despondency at all, but an excellent buying opportunity.

Planning Gain Supplement

Landowners and developers alike were seen punching the air in delight when the Chancellor (Gordon Brown) announced in the March 2007 budget that he was prepared to abandon his proposed Planning Gain Supplement if a credible alternative scheme could be found.

This provides a neat link between our look back at 2007 and our predictions for commercial real estate's fate in 2008...



For further information contact
oliver.goodwin@mishcon.com



For further information contact
rachael.jordan@mishcon.com

Community Infrastructure Levy

In the Autumn 2007 pre-budget report, the Chancellor (Alistair Darling) announced his intention to introduce a levy to capture an appropriate proportion of the increase in value of a piece of land generated by the grant of planning permission for its development.



Billed as a type of Roof Tax along the lines of the scheme introduced locally in Milton Keynes, landowners and developers need to remain cautious about this until flesh is put on

to the bones of the proposals thus far announced. The provisions are contained in the Planning Bill currently making its way through Parliament, but this itself will only authorise the Secretary of State to establish a Community Infrastructure Levy by making subsequent regulations. Only the general principles are actually laid out in the Bill.

The aim of the levy, says the Bill, is to ensure that costs incurred in providing infrastructure to support the development of an area are at least partly met by landowners who have benefited from it.

The proposal is that the liability will arise on the **grant** of planning permission, but that the levy will not become payable until the planning permission is **implemented**. The liability for payment will be that of the landowner and contracting parties will no doubt allow for this in negotiating the financial aspects of any development transaction.

Watch this space for more information as these proposals are developed further, in time for their anticipated launch in 2009.



For further information contact
oliver.goodwin@mishcon.com



For further information contact
rachael.jordan@mishcon.com

Supplementary Business Rates

The pre-budget report also revealed proposals to allow local authorities to levy a supplementary local business rate in certain situations.

Unlike the Business Improvement Districts, which were usually welcomed and sometimes demanded by local businesses, the supplementary business rates will be imposed, albeit with certain safeguards.

The essential elements of the proposals are:

- The maximum levy will be an additional 2p in the £1 assessed on the rateable value of the property
- It will only apply to properties with a rateable value exceeding £50,000
- It can be levied only in respect of projects that would not otherwise have happened
- If the levy is intended to raise more than one third of the total cost of the project proposed, then a referendum must be held with a simple majority in favour for the project to proceed.

Quite how widely this new power will be used remains to be seen but, with all the other financial pressures on business and the retail sector in particular, we hope and expect that a certain amount of restraint will be exercised.



For further information contact
daniel.lipman@mishcon.com

REITs – Further Disappointment



Many had hoped that the original structure of REITs had been tightly drawn by the Government so that it could assess how the sector would use the advantages that it offered, with relaxation following in fairly swift order if no perceived abuses occurred.

It was with some disappointment, therefore, that we read in the pre-budget report that there are no current proposals either to soften the onerous stock exchange listing requirements for REIT companies or to extend the REIT regime to companies and funds investing in residential property portfolios.

Without these changes, it is difficult to see where the next surge of momentum for the REIT structure will come from in the foreseeable future, as there remain enough offshore structures that can provide similar tax advantages to satisfy the needs of sophisticated investors.



For further information contact
susan.freeman@mishcon.com

Development of Brownfield Sites: Changes to Tax Incentives



Finally on issues arising out of the 2007 pre-budget report, the Treasury announced a review of the tax incentives available to developers for the

redevelopment of long term derelict and brownfield sites.

Its proposals were issued between Christmas and the New Year and are:

- To extend the existing tax relief for contaminated land to include the cost of clearing brownfield sites of previous foundations, reinforced piling and redundant services, and the eradication of Japanese knotweed infestation
- To withdraw the current exemption from Landfill Tax for waste removed from contaminated land.

Particular points to note are that there will be a time lag between expenditure on clearance costs and receipt of tax relief and that certificates for exemption from Landfill Tax will expire by 31 March 2010 at the latest and must have been applied for by 30 November 2008. Further details are expected in the 2008 Budget, so watch this space for an update...



For further information contact
belinda.bridgen@mishcon.com

Empty Property Rates Relief



Despite loud protests from everybody within the industry, and a sustained campaign in Property Week, the existing reliefs from rates on empty commercial properties are to be severely restricted from April 2008.

From then, the only available reliefs will be as follows:

- For industrial or warehouse properties, no rates for the first six months of vacancy and full rates thereafter
- For all other commercial properties (including retail), no rates for the first three months of vacancy and full rates thereafter.

Previously, landowners could render their properties uninhabitable to avoid rates liability, but this self-help remedy (or avoidance measure) will no longer be available. The relevant regulations retrospectively provide that any physical changes intentionally made to properties since the announcement of the proposed disapplication of the existing reliefs are to be ignored for the purposes of rates liability.

In future, only charities and Community Amateur Sports Clubs will be able to take advantage of full relief from rates liability in respect of their vacant properties and then only if the next proposed use of them is for their charitable or sporting purposes.

Given that the Government has refused to back down on this issue despite the vehement opposition to it, investors should prepare for its introduction in April 2008.



For further information contact
philip.freedman@mishcon.com

Energy Performance Certificates

For some time now, it has been clear that the Government will require property owners to obtain Energy Performance Certificates for both residential and commercial properties; however, it would be wrong to blame the Government for this, it is merely implementing a long standing EU Directive dating back as far as 2001.



The original plan for commercial properties was that Energy Performance Certificates would be required on the sale or letting of all commercial properties from 6 April 2008.

Owing to the delay in announcing what qualifications an inspector must obtain, and the consequential delay in there being a critical mass of available suitably qualified inspectors, the introduction of the requirement for Energy Performance Certificates is to be staggered. The dates are now as follows:-

- 6 April 2008 for a commercial property exceeding 10,000 square metres
- 1 July 2008 for a commercial property exceeding 2,500 square metres
- 1 October 2008 for all other commercial properties.

Goodbye to the Law of Distress; Hello to CRAR



The regulations for the new commercial rent arrears recovery scheme are, we are informed, nearly ready for final publication and it is now clear that, at some time during 2008, the common law right for a landlord to seize

and sell its tenant's goods to recover rent arrears will be abolished and replaced by a new modern statutory system.

We set out the details of the new scheme in our August 2007 briefing. If you missed this, it can be found on our website at www.mishcon.com/Real_Estate/CRAR.



For further information contact
daniel.levy@mishcon.com

Corporate Manslaughter Act 2007



On 6 April 2008 the Corporate Manslaughter Act 2007 will be brought into force, leaving developers and

contractors in particular open to prosecution outside of the existing health and safety legislation if somebody for whom they are responsible is killed.

Whilst we are assured that the Act is not going to run wholly in tandem with the existing health and safety legislation in the event of a fatality, it is difficult to see how this will not be the case when one takes a closer look at the published guidance.

In deciding upon its verdict, the jury is expected to analyse whether the health and safety legislation has been breached, how serious the breach was, and what was the foreseeable risk posed by the breach.

It is at least theoretically (let us hope not practically) possible for a company to be prosecuted under both

the Corporate Manslaughter Act and the existing Health and Safety legislation, leading to two fines.

In the last day or so, the Sentencing Advisory Panel has announced that fines on a guilty verdict under the Corporate Manslaughter Act will be between 2.5% and 10% of global turnover, depending on the seriousness of the breach.

The good news for directors is that prosecution of a company under the Act does not depend on the simultaneous prosecution of an individual; it does not, however, preclude it either!

Real Estate Team

Partners

Nick Doffman (Head of Real Estate)
Mark Baker
Philip Freedman, CBE
Susan Freeman
James Garton
Kevin Gillon
Deidre Hennessy
Ronald Hooberman
Daniel Levy
Daniel Lipman
Ian Paul
Alan Spiers

Assistants

Nicola Bishop
James Brownlie
Daniel Ellison
John England
Alice Galbraith
Simon Hart
Davina Hay
Rachael Jordan
Jason Kallis
Kirpaul Kaur
Caroline Ko
Mark D. Levine
Helena Liebster
Emma Macintyre
Karen Milne
Thomas Morton
Simon Noonoo
Geraldine
Phythian
Haidee Priday
Lizzy Tennant
Sukhi Walia

Head of Planning & Environment

Oliver Goodwin

Consultants and Senior Associates

Geoff Hayhurst
Ian Lipman
Michael Mitzman
Arnaud Montagna
Oliver Tarlow

Tax Principal

Belinda Bridgen

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